ALANCO TECHNOLOGIES INC
Form 10KSB/A
December 21, 2006

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

FORM 10-KSB/A

Amendment #2

Annual Report Pursuant to Section 13 or 15 (d) of
The Securities Exchange Act of 1934
For the fiscal year ended June 30, 2006
Commission file number 0-9347

ALANCO TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Arizona	86-0220694
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)

15575 North 83rd Way, Suite 3, Scottsdale, AZ 85260
(Address of principal executive offices) (Zip Code)

Registrant's Telephone Number: (480) 607-1010

Securities registered pursuant to Section 12(b) of the Act: None
Securities registered pursuant to Section 12(g) of the Act

COMMON STOCK
(Title of Class)

Check whether the issuer (1) filed all reports required to be filed by Section 13 of 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

Yes X No

The Registrant's revenues for the fiscal year ended June 30, 2006 were

$6,659,600.

State the aggregate market value, based upon the closing bid price of the Common Stock as quoted on NASDAQ, of the voting stock held by non-affiliates of the registrant: $18,006,500 as of September 22, 2006.

Indicate the number of shares outstanding of each of the registrant's classes of common stock: 38,163,700 shares of Class A Common Stock (net of treasury shares) and no shares of Class B Common Stock as of September 22, 2006.

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

Except for historical information, the statements contained herein are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts. From time to time, the Company may publish or otherwise make available forward-looking statements of this nature. All such forward-looking statements are based on the expectations of management when made and are subject to, and are qualified by, risks and uncertainties that could cause actual results to differ materially from those expressed or implied by those statements. These risks and uncertainties include, but are not limited to, the following factors, among others, that could affect the outcome of the Company's forward-looking statements: general economic and market conditions; reduced demand for information technology equipment; competitive pricing and difficulty managing product costs; development of new technologies which make the Company's products obsolete; rapid industry changes; failure by the Company's suppliers to meet quality or delivery requirements; the inability to attract, hire and retain key personnel; failure of an acquired business to further the Company's strategies; the difficulty of integrating an acquired business; undetected problems in the Company's products; the failure of the Company's intellectual property to be adequately protected; unforeseen litigation; unfavorable result of current pending litigation; the ability to maintain sufficient liquidity in order to support operations; the ability to maintain satisfactory relationships with lenders and to remain in compliance with financial loan covenants and other requirements under current banking agreements; the ability to maintain satisfactory relationships with suppliers; federal and/or state regulatory and legislative actions; customer preferences and spending patterns; the ability to implement or adjust to new technologies and the ability to secure and maintain key contracts and relationships.

EXPLANATORY NOTE

This amendment No. 2 to Form 10-KSB for the fiscal year ended June 30, 2006 is being filed for the purpose of modifying Part 1, Item 6 - Management's Discussion and Analysis of Financial Condition and Results of Operations and Part II, Item 8A - Controls and Procedures, and redating the certifications in Exhibits 31.1 and 32.1. This amendment has no effect on reported net loss or net loss per share.

Except for the items described above, none of the information contained in our original filing on Form 10-KSB has been updated, modified or revised. The remainder of our original report on Form 10-KSB is included herein for the convenience of the reader.

PART I

ITEM 1. BUSINESS

GENERAL DEVELOPMENT OF BUSINESS

Alanco Technologies, Inc. was incorporated in 1969 under the laws of the State of Arizona. Unless otherwise noted, the "Company" or "Alanco" refers to Alanco Technologies, Inc. and its wholly owned subsidiaries. Alanco (Nasdaq: ALAN) is a provider of advanced information technology solutions with the Company's operations for fiscal years ended June 30, 2006 and 2005 diversified into two reporting business segments including: (i) design, production, marketing and distribution of RFID (Radio Frequency Identification) tracking technology, and (ii) manufacturing, marketing and distribution of data storage products.

The Company acquired its RFID (Radio Frequency Identification) tracking technology known as the TSI PRISM system in May 2002 through the acquisition of the operations of Technology Systems International, Inc., a Nevada corporation ("TSIN"). The Company continues to participate in the data storage market through two wholly-owned subsidiaries: Arraid, Inc., a manufacturer of proprietary storage products to upgrade older "legacy" computer systems; and Excel/Meridian Data, Inc., a manufacturer of Network Attached Storage ("NAS") systems and other storage related products for mid-range organizations.

The acquisition, effective June 30, 2006, of StarTrak Systems, LLC ("StarTrak"), located in Morris Plains, New Jersey, added Wireless Asset Management, a third reporting business segment described as a provider of wireless GPS tracking and monitoring services, which are offered on a monthly subscription basis to various industry segments. The company's primary focus is currently the refrigerated or "Reefer" segment of the transport industry, providing the dominant share of all wireless tracking, monitoring and control services to this market segment.

2

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

RECENT BUSINESS DEVELOPMENTS

New Product Announcement - On September 7, 2006, the Company announced that StarTrak Systems, LLC, its wholly owned subsidiary, had commenced the initial commercial deployment of the new ReeferTrak(R) Scout RFID product line designed specifically for localized food distribution fleets, including fast food, dairy and grocery operations. Two Los Angeles-area food distributors have recently purchased and deployed the new ReeferTrak Scout units and base stations at their distribution centers.

ReeferTrak Scout is an RFID wireless communications system that gives users full two-way command and control capability of their refrigerated truck and trailer fleets when the units are within a several mile range of a base station-equipped distribution center. When the "reefers" are operating out of range of the distribution center, the Scout unit logs GPS, trip and refrigeration unit performance data and automatically downloads the information to StarTrak's central data center via the local base station upon return to the center. Customers use the data to immediately confirm temperature compliance of the shipment from origin to destination. The base stations' several mile RFID range provides excellent coverage of distribution facilities, allowing customers to achieve significant savings in yard operations, fuel usage and product quality.

Material Definitive Agreement - On August 28, 2006, the Company completed agreements whereby the Company raised $1.3 million in debt financing from certain officers and members of the Company's Board of Directors. The funds

were used for working capital requirements related primarily to the acquisition of StarTrak Systems, LLC, an acquisition that was effective on June 30, 2006.

Contract for Wireless Tracking and Monitoring of Refrigerated Containers - The Company announced on August 24, 2006 that its subsidiary, StarTrak Systems, LLC ("StarTrak"), had begun delivery on a single contract valued at greater than $10 million for its GenTrak wireless tracking system and related monitoring services. The StarTrak contract represents one of the largest single industrial deployments of wireless tracking and monitoring systems on refrigerated assets anywhere.

GenTrak is a GPS-based, wireless monitoring and control system, initially deployed on marine gensets to monitor the location, operating condition, fuel levels, etc. of both the gensets and any connected refrigerated container. A marine genset is a portable generator temporarily connected to a refrigerated container to provide power during the land-based portion of the transport cycle. The GenTrak system provides significant operational savings and quality improvements to global shipping companies in their refrigerated container operations.

Nasdaq Listing Notification - In August of 2006, Alanco announced that it had received a staff determination letter from Nasdaq indicating that the Company failed to comply with the minimum bid price requirements for continued listing as set forth in Nasdaq Marketplace Rule 4310(c)(4), and that its securities may be subject to delisting from the Nasdaq Capital Market. The Company has appealed the Staff determination and requested a hearing before the Nasdaq Listing Qualifications Panel ("Panel"). Under Nasdaq Marketplace rules, a request for a hearing stays the delisting action pending the issuance of a written determination by the Panel. The hearing was held on September 14, 2006 in Washington, D.C. with representatives of the Company present. There can be no assurance that the Panel will grant the Company's request for continued listing. Pending a decision by the Panel, the Company's common stock will remain listed on the Nasdaq Capital Market.

Sale of Unregistered Securities - On July 14, 2006, the Company completed the sale, in a private offering to several private and institutional investors, of 240,000 Units consisting of one share of its Series A Convertible Preferred Stock together with a 5-year warrant to purchase three shares of the Company's Class A Common Stock at a price of $.60 per share ("Unit") for a Unit price of $1.71. The Company received $410,400 from the offering. Twenty five percent of the Units, or 60,000 Units, were purchased by an institutional investor with the balance purchased by members of the Company's Board of Directors. Due to the structure of the offering and the Nasdaq stock market requirements, warrants issued in this offering to members of the Board of Directors are restricted from being exercised without shareholders' approval, which shall be requested at the next annual meeting of the Company's Shareholders.

DESCRIPTION OF BUSINESS

RFID TECHNOLOGY SEGMENT

The Company acquired, in May 2002, the operations of Technology Systems International, Inc., a Nevada Corporation ("TSIN"). The technology consisted of the proprietary TSI PRISM(TM) wireless RFID tracking capabilities utilized primarily in correctional facilities, security management and personnel monitoring. The acquisition was effected through a wholly owned subsidiary, Technology Systems International, Inc., an Arizona corporation, by the issuance

of Alanco Class A Common Stock to purchase TSIN's assets and assumption of specific liabilities of TSIN. During the fiscal year 2005, the Company changed the name of Technology Systems International, Inc. to Alanco/TSI PRISM, Inc. ("ATSI").

Marketing - ATSI markets its TSI PRISM(TM) RFID tracking system primarily in the United States, through the Company's direct sales representatives and a network of lobbyists. The primary focus of the marketing effort has been directed at the domestic state and federal correctional facilities and county jail markets. In addition, ATSI is providing transmitter technology for a project in the corrections market in Europe.

Raw Materials - The RFID Technology segment utilizes various domestic subcontractors for materials and parts used to manufacture its products. One domestic supplier represented approximately 34% of those purchases for fiscal year ended June 30, 2005. During fiscal year ended June 30, 2006, no subcontractor accounted for 10% or more of the business segment's purchases.

The Company anticipates continued concentration of vendor purchases; however, additional suppliers are readily available at competitive pricing levels. The Company does not foresee any future significant shortages or substantial price increases that cannot be recovered from its customers. See Competitive Conditions below for a discussion related to a new licensing agreement to provide new technology that may increase concentration of purchases in future years.

Competitive Conditions - The TSI PRISM(TM) system is the only known wireless RFID continuous real-time tracking technology currently available to the correctional facilities market. There are other companies attempting to introduce area location and monitoring technologies in the correctional facilities market, offering an area or zone detection system. However, at this time these technologies are not capable of providing continuous real-time tracking.

During fiscal year 2005, Alanco entered into a technology license agreement ("License") with a developer of RFID real-time location services technology utilizing 2.4 GHz wireless networking standards. The License grants to Alanco an exclusive five-year worldwide license for the corrections market, to acquire, modify or combine the 2.4 GHz technology with Alanco's 900 MHz TSI PRISM technology. The Company believes the 2.4 GHz technology has certain application advantages over the 900 MHz technology in international markets and in some segments of the U.S. corrections market. The License requires royalty payments on product sold and stipulates minimum annual purchase requirements starting in the second year of the License. As consideration for the License, Alanco agreed to make certain prepayments for future product purchases and granted a warrant to purchase 500,000 shares of Class A Common Stock at a price of $1.00 per share.

Employees - The Company's RFID tracking segment employed eighteen full-time employees as of June 30, 2006 and 2005, respectively.

Seasonality of Business - Location and tracking products have minimal seasonality. However, many of the products in this segment are marketed to state and federal government customers that are affected by annual budget schedules and economic conditions.

Dependence Upon Key Customers - The RFID Technology segment is in an early stage of commercial market development. Targeted customers operate the majority of the prison facilities in the United States and include the 50 state governments, numerous county governments and the federal government. During the twelve months ended June 30, 2006, substantially all revenue was generated from four state governments. In fiscal year 2005, a substantial portion of revenues

recognized were generated from two Midwestern state governments. The Company anticipates that as market penetration of its TSI PRISM(TM) technology accelerates, the Company will have numerous customers. However, due to the type of product sold by the RFID Technology segment, the size of each contract may continue to be significant.

Backlog Orders - The Company operates using system order contracts that it considers to be firm and non-cancelable and extended maintenance contracts not longer than twelve months. Under this method, the Company had an order backlog as of June 30, 2006 of approximately $560,100, compared to $76,200 at fiscal year end 2005.

Research & Development - The Company estimated that the ATSI operation spent approximately $200,000 and $360,000 in research and development expenditures, recorded as selling, general and administrative expense, during fiscal years 2006 and 2005, respectively.

WIRELESS ASSET MANAGEMENT

The Company's Wireless Asset Management business segment was created by the acquisition, effective June 30, 2006, of StarTrak Systems, LLC ("StarTrak"), a privately held company located in Morris Plains, New Jersey. StarTrak is a leading provider of wireless GPS tracking and monitoring services which are offered on a monthly subscription basis to various industry segments. The company's primary focus is currently the refrigerated or "Reefer" segment of the transport industry. StarTrak provides the dominant share of all wireless tracking, monitoring and control services to this market segment.

Marketing - StarTrak markets its wireless tracking and wireless subscription data services in the United States, both through dealers and the company's direct sales representatives. The primary focus of the marketing effort has been directed at the domestic refrigerated transport market and the reefer equipment providers. The company also has limited international sales (Australia, Europe) and expects that segment to grow as well.

Raw Materials - The Company anticipates the Wireless Asset Management segment will utilize various domestic subcontractors for materials and parts used to manufacture its products; however certain vendors may represent more than 10% of total purchases for fiscal year 2007. Additional suppliers are available at competitive pricing levels and we anticipate concentration of purchases will decrease as new products are introduced and volumes increase. The Company does not foresee any future significant shortages or substantial price increases that cannot be recovered from its customers.

Competitive Conditions - StarTrak is the only known provider of wireless GPS tracking and monitoring services that offers a subscription program to the refrigerated or "Reefer" segment of the transport industry. There are other companies marketing GPS tracking services to the general transport industry; however, to our knowledge, none have the capability of providing integration with the major manufacturers' "Reefer" electronic systems that allows for the monitoring of various sensor data on a real time basis.

Employees - The Company's Wireless Asset Management segment employed thirty-three full-time employees and two part-time employees as of June 30, 2006.

Seasonality of Business - Location and tracking products have minimal seasonality. However, many of the products in this segment are marketed to commercial customers that are affected by annual budget schedules and economic conditions. Further, high asset utilization during the summer months can cause some seasonal effects on deployment of units.

Dependence Upon Key Customers - The company has numerous end customers, many of which chose to purchase StarTrak products from two primary OEM refrigerator equipment suppliers. StarTrak is the only vendor currently providing the two OEMs with tracking and monitoring products for the refrigerated or Reefer segment of the transport industry. Additionally, the company is currently delivering product and providing subscription services under a contract with a major customer that is expected to exceed 10% of fiscal year 2007 segment revenue.

Backlog Orders - The Company operates using order contracts that it considers to be firm and non-cancelable. Under this method, the Company had unfulfilled contracts as of June 30, 2006 of approximately $11 million.

COMPUTER DATA STORAGE SEGMENT

The Company's Computer Data Storage segment consists of two separate units, Arraid, Inc. ("Arraid") and Excel/Meridian Data, Inc. ("Excel"). Arraid is a Phoenix, Arizona-based manufacturer of legacy computer data storage products, and Excel is a Dallas, Texas-based provider of data storage networking products and services.

Arraid designs and manufactures proprietary data storage subsystems called "emulators" that serve as translators between older "legacy" computers and state-of-the-art storage devices and provides unique, cost-effective storage system solutions. Arraid's unique products are targeted at users of special application legacy computers, such as airplane flight simulators, nuclear power control systems, missile tracking computer systems, etc.

Excel is a manufacturer and marketer of data storage networking products and is recognized as a leading provider of optical storage devices, such as CD/DVD-ROM servers. Excel also markets a Network Attached Storage ("NAS") product line and other storage products incorporating state-of-the-art software technology.

Marketing - Arraid markets legacy storage products nationally and internationally through Company sales representatives and independent sales representatives and distributors. Excel markets optical storage and NAS products, primarily in the United States, through national advertising, telemarketing and Company sales representatives.

Raw Materials - The computer data storage operations have numerous domestic sources for materials and parts used to manufacture their products. For fiscal year 2006 and 2005, no supplier provided 10% or more of the Company's data storage material and parts purchases. The Company believes that it has an adequate supply of materials and parts and does not foresee any significant shortages or substantial price increases that cannot be passed on to the customers.

Competitive Conditions - There are numerous competitors in the computer data storage market, with no company dominating the market. Arraid principally provides unique storage products to a limited market with minimal direct competitors. Excel competes with many established companies in the general

storage market and many of these companies may have substantially greater financial, marketing and technological resources, larger distribution capabilities, earlier access to customers and more opportunities to address customers' various information storage requirements than the Company. The Company also competes with many smaller, less established companies in specific storage product segments. Some of these companies may have earlier access to new technologies or products than the Company. The announcement or introduction of new products and/or implementation of effective marketing strategies by its competitors may have a materially adverse affect on the Company's business.

Employees - As of June 30, 2006 the Company's computer data storage business employed twenty-seven full-time employees, compared to twenty-four full-time employees as of June 30, 2005.

Seasonality of Business - Computer data storage products have minimal seasonality. However, many of the products in this segment are marketed to business customers, which in some cases can be significantly affected by budget restraints and economic conditions.

Dependence Upon Key Customers - During fiscal year ended June 30, 2006, no customer accounted for more than 10% of the reported Data Storage revenues. During fiscal year 2005, one customer accounted for 10.2% of revenues.

Backlog Orders - The Company operates using customer purchase orders that in some cases may not be considered firm and non-cancelable. Methods of defining a firm "Backlog Order" are being evaluated, and if the Company utilizes that information in evaluating sales activity, the information will be reported.

Research & Development - The Company estimates it spent approximately $150,000 in research and development expenditures, recorded as selling, general and administrative expense, for both fiscal years 2006 and 2005.

NET ASSETS HELD FOR SALE

The Company's reporting business segments for both fiscal years 2006 and 2005 are limited to the RFID Technology segment and Computer Data Storage segment discussed above. Assets classified on the Company's balance sheet at June 30, 2006 and 2005 as "net assets held for sale" consist of remaining Restaurant Equipment segment assets, which are being liquidated and are valued at the lower of cost or net realizable value. Income of the Restaurant Equipment liquidation activities are reported as "other income" for both the current and prior fiscal years.

ITEM 2. PROPERTIES

The Company's corporate office and the ATSI operation are located in an approximate 9,300 square foot leased facility in Scottsdale, Arizona. The current lease expires on July 31, 2007.

In August 2003, Arraid entered into a three-year 5,200 square foot office/manufacturing space lease and moved to a new Phoenix, Arizona location. The three-year lease, scheduled to expire on August 31, 2006, was extended through August 2008.

Excel/Meridian Data, Inc. entered into an office/manufacturing space lease during fiscal year 2001 for 11,328 square feet in Carrollton, Texas. The five-year lease, scheduled to expire on March 15, 2006 was extended through April 2009.

StarTrak Systems, LLC, is currently occupying an approximately 5,000 square foot office/manufacturing facility in Morris Plains, New Jersey under a lease scheduled to expire on September 30, 2007. Management is currently working with its landlord to obtain significant additional office/manufacturing space required due to business expansion.

ITEM 3. LEGAL PROCEEDINGS

The Company is a party to litigation that relates to the acquisition, in May of 2002, of substantially all the assets of Technology Systems International, Inc., a Nevada Corporation ("TSIN"), to litigation arising out of Carolina Casualty Insurance Company's failure to pay a claim (relating to the TSIN litigation) pursuant to a Directors and Officers insurance policy, and to litigation arising from an expired property lease between the Company's subsidiary, Arraid, Inc., and Arraid Property L.L.C., an Arizona limited liability company. The actions are more fully described below:

On January 30, 2003, a shareholder of TSIN filed a derivative suit naming as defendants the Company and its wholly owned subsidiary, ATSI. The venue for this action is the Arizona Superior Court in and for Maricopa County, Arizona, as case number CV2003-001937. The complaint sets forth various allegations and seeks damages arising out of the Company's acquisition of substantially all of the assets of TSIN. This derivative suit was terminated and the action converted into a direct action by TSIN by stipulation and court order in July 2003.

TSIN is currently in Chapter 7 bankruptcy. The Chapter 7 Trustee failed to prosecute the action timely and the state court dismissed the action for lack of prosecution, but allowed the Trustee to restart the action, which the Trustee has done as case number CV2006-007398. The Company is seeking its attorney's fees with respect to the dismissed action, and will appeal the court's order allowing the Trustee to restart the action. The Company's management, in consultation with legal counsel, believes the plaintiff's claims are without merit and the Company will continue to aggressively defend the action. In addition, the Company will pursue reimbursement of legal expenses incurred from TSIN.

The Company is the plaintiff in a lawsuit (U.S. District Court No. CV-04-0789-PHX-DGC) arising out of Carolina Casualty Insurance Company's ("Carolina") failure to pay a claim regarding the TSIN litigation, that the Company made pursuant to its Directors and Officers Insurance Policy ("Policy") issued by Carolina. The Company seeks payment for its legal expenses in the TSIN litigation and reimbursement of legal fees incurred in the Carolina litigation. The District Court granted summary judgment in favor of Carolina and the Company has filed an appeal with the Ninth Circuit Court of Appeals.

On July 18, 2003, Arraid Property L.L.C., an Arizona Limited Liability Company ("Arraid LLC"), filed a complaint in the Arizona Superior Court in and for Maricopa County, Arizona (case number CV 2003-13999) against the Company and its wholly owned subsidiary Arraid, Inc., alleging breach of lease and seeking substantial monetary damages. The suit relates to an expired lease agreement for property previously leased by Arraid. Following a trial, the Court found in favor of Arraid LLC against the Company with respect to certain factual findings resulting in damages owed by the Company in an amount currently undecided, but anticipated to be less than $35,000. The prevailing party, which has not yet been determined by the court, will likely be awarded some attorney's fees. Based upon a determination of the amount of any final award against the Company, the Company's management, in consultation with legal counsel, will determine whether to appeal the decision of the court.

The Company may also, from time to time, be involved in litigation

arising from the normal course of business. As of June 30, 2006, there was no such litigation pending deemed material by the Company.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the Shareholders during the fourth quarter of fiscal year ended June 30, 2006.

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Alanco's common stock is traded on the Nasdaq Small Cap Market under the symbol "ALAN."

The following table sets forth high and low sale prices for each fiscal quarter for the last two fiscal years. Such quotations represent inter-dealer prices without retail mark-ups, markdowns, or commissions and, accordingly, may not represent actual transactions.

Quarter Ended	High	Low	High	Low
September 30	$0.99	$0.70	$1.72	$0.91
December 31	$0.70	$0.46	$1.19	$0.78
March 31	$0.78	$0.48	$1.20	$0.69
June 30	$0.83	$0.60	$1.37	$0.89

As of June 30, 2006, Alanco had approximately 1,300 holders of record of its Class A Common Stock. This does not include beneficial owners holding shares in street name.

During the fiscal year ended June 30, 2006, the Company issued 11,473,500 shares of its Class A Common Stock. Of those shares, 2,100,000 shares were issued in connection with exercise of employee stock options and warrants, 383,500 were issued for services and prepayments, 3,990,000 were issued pursuant to a private offering and 5,000,000 were issued in the StarTrak acquisition.

Alanco has paid no Common Stock cash dividends and has no current plans to do so. During fiscal years ended June 30, 2006 and 2005, holders of Series A Convertible Preferred Stock received "paid-in-kind" dividends of 341,700 shares valued at $512,500 and 304,400 shares valued at $456,600, respectively. Holders of Series B Convertible Preferred Stock received "paid-in-kind" dividends during fiscal years ended June 30, 2006 and 2005 of 7,000 shares, valued at $70,200, and 6,500 shares, valued at $64,500, respectively.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Critical Accounting Policies

"Management's Discussion and Analysis of Financial Condition and Results of Operations" discusses our consolidated financial statements that have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amount of assets

and liabilities at the date of the financial statements, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. On an on-going basis, we evaluate our estimates and judgments, including those related to revenue recognition, valuation allowances for inventory and receivables, warranty and impairment of long-lived and intangible assets. We base our estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. The result of these estimates and judgments form the basis for making conclusions about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The SEC suggests that all registrants list their most "critical accounting policies" in Management's Discussion and Analysis. A critical accounting policy is one which is both important to the portrayal of the Company's financial condition and results and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Management has identified the critical accounting policies presented below as those accounting policies that affect its more significant judgments and estimates in the preparation of its consolidated financial statements. The Company's Audit Committee has reviewed and approved the critical accounting policies identified.

8

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

These policies include, but are not limited to, the carrying value of goodwill and other intangible assets, estimates related to the valuation of inventory and receivables, the actual net realizable value of net assets held for sale and the ultimate resolution of the current litigation with TSIN and Arraid L.L.C. that is more fully discussed in Item 3, Legal Proceedings.

Results of Operations

In accordance with accounting principles generally accepted in the United States of America, the Company is reporting consolidated revenues for fiscal years ended June 30, 2006 and 2005 from its Computer Data Storage segment and its RFID Technology segment.

	Data Storage	RFID Technology	Wireless Asset Management	Corporate	Total
Fiscal year 2006					
Revenue	$ 6,028,100	$ 631,500	$ -	$ -	$ 6,659,600
Cost of Goods Sold	3,877,800	479,900	-	-	4,357,700
Gross Profit	2,150,300	151,600	-	-	2,301,900
Selling, General & Administrative	2,081,600	2,669,600	-	1,553,100	6,304,300
Operating Income (Loss)	$ 68,700	$ (2,518,000)	$ -	$ (1,553,100)	$ (4,002,400)
Accounts Receivable	$ 645,400	$ 178,300	$ 919,700	$ 17,300	$ 1,760,700

Inventory	$ 1,317,500	$ 940,500	$ 885,900	$ -	$ 3,143,900
Total Assets	$ 2,344,200	$ 7,239,800	$ 17,572,200	$ 528,300	$ 27,684,500
Capital Expenditures	$ 15,800	$ 54,400	$ -	$ 600	$ 70,800
Depreciation & Amortization	$ 24,200	$ 355,600	$ -	$ 3,200	$ 383,000
Fiscal year 2005					
Revenue	$ 6,363,300	$ 820,900	$ -	$ -	$ 7,184,200
Cost of Goods Sold	4,161,200	514,300	-	-	4,675,500
Gross Profit	2,202,100	306,600	-	-	2,508,700
Selling, General & Administrative	1,918,300	2,697,600	-	1,755,400	6,371,300
Operating Income (Loss)	$ 283,800	$ (2,391,000)	$ -	$ (1,755,400)	$ (3,862,600)
Accounts Receivable	$ 827,600	$ 246,400	$ -	$ 17,400	$ 1,091,400
Inventory	$ 1,091,900	$ 810,700	$ -	$ -	$ 1,902,600
Total Assets	$ 2,398,800	$ 6,987,600	$ -	$ 1,157,500	$ 10,543,900
Capital Expenditures	$ 41,600	$ 108,900	$ -	$ 2,400	$ 152,900
Depreciation & Amortization	$ 20,300	$ 326,400	$ -	$ 3,100	$ 349,800

Consolidated revenues for fiscal year 2006 were $6,659,600, a decrease of 7.3% when compared to $7,184,200 revenues for fiscal year 2005. Revenue decreased in both the Data Storage and the RFID Technology segments. The decrease in Data Storage segment revenue of $335,200, or 5.3%, resulted from a trend towards lower priced storage products, government redirecting military defense expenditures from computer system support to the war effort and a general reduction in selling prices of data storage products.

The RFID Technology segment reported revenues of $631,500 for fiscal year ended June 30, 2006, a 23% decrease when compared to $820,900 reported for the previous year. Sales for fiscal year 2005 include a single installation plus additions to an existing installation that represented approximately 75% of total revenues. The remaining 25% was due to sale of extended warranty. Fiscal 2006 did not have a significant installation which is reflected by a 23% decrease in revenue. The Company did not change its pricing structure utilized in fiscal year 2006 compared to fiscal year 2005. The Company believes the lack of significant sales progress for the RFID Technology segment is due to an extraordinarily complex and lengthy government procurement process that, in some cases, takes several years to complete due to government funding constraints. The sales process for the TSI PRISM products is protracted because it generally involves four separate phases: 1) product presentation to a state director of corrections, 2) obtaining the state director of correction's agreement to

position the product among the top priorities of his budget, 3) competing with other state projects for funding and 4) publishing the RFP (request for proposal) and awarding the contract. RFID segment customers are currently at various phases in the procurement process and we believe that TSI PRISM sales will increase significantly in fiscal 2007 as the funding phase is completed and contracts are awarded.

Customers are also studying various methods to finance the adoption of RFID technology for their corrections facilities. Based upon meetings the Company has had with various State governments to discuss federal grants available to assist in funding the acquisition of the TSI PRISM system, we are confident that numerous State governments are considering, in addition to their normal legislative funding, applying for federal grants under programs such as PREA (Prison Rape Elimination Act of 2003), grants awarded from VOIT/TIS funds available under a 1999 program to reduce prison violence administered by the U.S. Department of Justice and grants awarded by the National Institute of Justice. In addition, potential customers are reviewing lease financing options available through one of the largest providers of tax exempt leasing in the United States.

The Company's gross profit for fiscal year 2006 was $2,301,900 (34.6% of sales), a decrease of $206,800 or 8.2%, when compared to $2,508,700 (34.9% of sales) for the prior year. The Data Storage segment reported gross profit of $2,150,300, a decrease of $51,800, or 2.4%, compared to $2,202,100 gross profit reported for the prior year. Gross margin for fiscal year 2006 for the Data Storage segment was 35.7%, compared to 34.6% reported in the prior year. The $51,800 decrease in Data Storage gross profit resulted from a decrease in sales of $335,200 offset slightly by a 1.1% increase in gross margin resulting from changes in product mix to higher margin products. The Data Storage segment is continually reselling new technology products and integrating those products to meet customer expectations. This constant product evolution results in continuous changes in product offerings and consequently gross margins. The RFID Technology segment reported a decrease in gross profit to $151,600, a 50.6% decrease from the $306,600 reported for the prior fiscal year. The $155,000 decrease was due to both reduced revenues in the amount of $189,400 and a reduction in gross margin to 24% from 37.4% reported in the prior year. The 13.4% reduced gross margin for the RFID segment was due to the minimum sales reported in the current fiscal year which did not adequately cover fixed production costs. We believe that reported gross margin for fiscal 2006 is not reflective of the gross margin percentage anticipated under higher sales levels.

Consolidated selling, general and administrative expenses for the year ended June 30, 2006 decreased by $67,000, or 1.0%, to $6,304,300, compared to $6,371,300 in fiscal 2005. Selling, general and administrative expense for the Data Storage segment increased by $163,300, or 8.5%, when compared to the prior year. The $163,300 increase in Data Storage segment selling, general and administrative costs resulted from increases in sales and administrative costs related to adding sales personnel and enhancing sales support. Selling, general and administrative expenses for the RFID Technology segment decreased by $28,000, or 1.0%. Corporate administrative expenses decreased by $202,300, or 11.5%, compared to the prior year primarily due to a decrease in legal expenses related to TSIN and other litigations previously discussed. The Company has committed to pursue reimbursement of legal expense incurred.

The operating loss for fiscal year ended June 30, 2006 was $4,002,400, a $139,800, or 3.6%, increase when compared to the operating loss for the prior fiscal year of $3,862,600. The $139,800 increase resulted from increased operating losses of $127,000 in the RFID Technology segment and a $215,100 reduction in operating income in the Data Storage segment, offset by a $202,300 decrease in corporate expenses. The RFID Technology segment increased operating losses by approximately $127,000 in fiscal year 2006 compared to the prior year due to reductions in revenue of $189,400 and gross profit of $155,000 without a

corresponding reduction in selling, general and administrative expenses, which decreased $28,000. The Data Storage segment reported operating income of $68,700, compared to operating income of $283,800 reported in the fiscal year ended June 30, 2005. The $215,100 decrease in operating income was due to a reduction in revenues of $335,200 and gross profit of $51,800, while increasing selling, general and administrative expenses by $163,300 to enhance the sales and marketing effort.

Management believes the key quantitative factors in evaluating the performance of both the RFID Technology and Data Storage segments are the growth in revenues and operating profits. The RFID Technology segment has been in development for a number of years and has reported significant operating losses. The Company believes the RFID Technology segment's operating results will improve as potential customers complete their procurement process (that in some cases have continued for several years) and the tracking and monitoring technology becomes accepted as the standard for prison management. The Company is continuing its efforts to increase revenues and gross profit for the Data Storage segment by adding sales personnel and increasing marketing efforts.

The loss from operations for the fiscal year ended June 30, 2006 was $4,009,200, a $218,600 or 5.8%, increase when compared to a loss of $3,790,600 for the prior fiscal year. The $218,600 increase resulted from $55,600 increase in net interest expense, a $23,200 reduction in other income and a $139,800 increase in operating losses previously discussed. Fiscal year 2006 interest expense, net of interest income, was $90,300, compared to net interest expense of $34,700 for the previous year. The $55,600 increase in net interest expense reflects increased average borrowing and interest rates under the Company's line of credit agreement during fiscal 2006. Other income for the year ended June 30, 2006 was $83,500, compared to $106,700 for the prior year. Other income for the current fiscal year includes $54,200 related to the collection of notes receivable associated with the sale of "net assets held for sale" in a prior year and $30,000 income from the sale of "net assets held for sale" in fiscal year 2006. Fiscal year 2005 included a gain of $89,600 related to the collection of notes receivable associated with the sale of "net assets held for sale" in the prior year and $17,100 of income from the sale of "net assets held for sale."

Preferred Stock dividends paid in-kind for the year ended June 30, 2006 for both Series A and Series B Convertible Preferred Stock amounted to $582,700, compared to Preferred Stock dividends of $521,100 for the prior year, an increase of $61,600, or 11.8%. Series A Preferred shareholders received in-kind dividends of 341,700 shares valued at $512,500, compared to 304,400 shares valued at $456,600 in the prior year. Series B Preferred shareholders received 7,000 shares valued at $70,200 compared to 6,500 shares valued at $64,500 in fiscal year 2005. See Footnote 12 - Shareholders' Equity for additional discussion of Preferred Stock transactions.

Consolidated net loss attributable to Common stockholders for fiscal year ended June 30, 2006 was $4,591,900, or ($.16) per share, an increase of 6.5% when compared to a net loss attributable to Common stockholders of $4,311,700, or ($.17) per share, for the prior year. The increase in net loss attributable to Common stockholders of $280,200 was due to increases in operating losses of the RFID Technology segment in the amount of $127,000 and a $61,600 increase in preferred stock dividends, partially offset by a reduction in legal expenses.

Net cash used in operating activities for the fiscal year ended June 30, 2006 was $3,713,500 compared with net cash used in operating activities for the prior fiscal year of $3,514,000. The increase of $199,500, or 5.7%, resulted primarily from an increase in loss from operations of $218,600. See "Liquidity and Capital Resources" below for management's discussion of major items

affecting the Consolidated Statement of Cash Flow.

Any new Statements of the Financial Accounting Standards affecting the Company are disclosed in the "Notes to Consolidated Financial Statements."

Liquidity and Capital Resources

At June 30, 2006 the Company's current liabilities exceeded current assets by approximately $7.2 million, resulting in negative working capital and a current ratio of .5 to 1. At June 30, 2005, the Company's current assets exceeded current liabilities by $2.8 million, reflecting a current ratio of 3.1 to 1. The substantial decrease in working capital resulted from an increase of approximately $9.4 million in net current liabilities related to the acquisition of StarTrak Systems, LLC. $5.7 million of the increase, or 41% of total current liabilities, is presented as Deferred stock payment, StarTrak, a liability that relates to the Company's commitment as part of the StarTrak merger agreement to issue, after shareholder approval expected at the next annual meeting of the Company's shareholders, up to 8.2 million shares of the Company's Class A Common Stock. The liability to issue 8.2 million shares is valued at market value on June 30, 2006. In addition, approximately $4.1 million of the increase in net current liabilities is related to current liabilities of StarTrak assumed in excess of current assets. The balance of the increase in net liabilities relates to incurred expenses related to the transaction. Excluding the $5.7 million liability reflecting the obligation to issue 8.2 million shares of the Company's Class A Common Stock after shareholder approval, the Company is still reporting negative working capital of approximately $1.6 million.

Accounts receivable at June 30, 2006 of $1,760,700 reflects an increase of $669,300 from the $1,091,400 reported as consolidated accounts receivable at the end of fiscal year 2005. $919,700, or 52.2% of the current fiscal year end balance, was acquired in the acquisition of StarTrak Systems, LLC, effective June 30, 2006. Receivables for the Data Storage and RFID Technology segments decreased by $250,300, or 23.3%. Data Storage segment accounts receivable balances at June 30, 2006 amounted to $645,400, a decrease of $182,200, or 22.0%, compared to the previous year. The Data Storage segment accounts receivable balance at June 30, 2006 of $178,300 represented twenty-eight days'

sales in receivables compared to $246,400, or thirty-four days, at fiscal year end 2005. The decrease in days' sales of six days is due to higher credit card sales and is not considered a trend towards faster receivable collection. Days' sales for the RFID Technology segment are distorted due to the lack of significant reported sales. In addition, a receivable in the amount of $62,200, representing the final payment for a system installation, was significantly past our normal terms due to a special arrangement whereby the Company was allowed to utilize the site for a research and development project. The project has been completed and the customer is processing the invoice for payment.

Consolidated inventories at June 30, 2006 amounted to $3,143,900 compared to $1,902,600 at the end of the prior fiscal year, an increase of $1,241,300, or 65.2%. $885,900 or 71% of the increase is due to inventory acquired in the merger with StarTrak. The Data Storage segment accounted for $225,600, or 18.2% of the inventory increase; and increases in the RFID Technology segment inventory accounted for $129,800 or 10.5% of the increase. The RFID Technology segment inventory levels increased due to a system installation in process at June 30, 2006 that required certain site specific equipment. The $225,600 Data Storage segment inventory increase resulted from inventory acquired to complete a warranty project, inventory acquired for new products evaluation and general inventory increases. The June 30, 2006 Data Storage segment inventory balance reflects an inventory turnover of 2.9 compared to 3.8 for inventory levels at June 30, 2005.

Net cash used in investing activities during the current year was $753,900, compared to net cash used in investing activities of $10,400 for the previous year. The $743,500 increase was due primarily to cash funding of StarTrak prior to the June 2006 acquisition in the amount of $774,300.

Net cash provided by financing activities during fiscal year ended June 30, 2006 amounted to $4,885,600, compared to $2,286,100 for the prior year. Cash provided by financing activities included $3,465,100 and $1,963,500 in proceeds from the sale of common stock, net of additional shares listing fees of $44,100 and $38,300, for fiscal years ended June 30, 2006 and 2005, respectively. Advances on borrowings amounted to $1,993,500 compared to $329,500 for the previous year. Cash repayments of borrowing and capital leases during the year amounted to $573,000, compared to $6,900 during the prior fiscal year.

The Company had a $2,000,000 line of credit balance at June 30, 2006 under a $2,000,000 line of credit agreement with a private trust that was last amended effective June 30, 2006. The secured line of credit is based upon accounts receivable and inventory values, and is secured by all assets of the Company. The line of credit has an interest rate of prime plus 2% (10.25% at June 30, 2006). Under an amendment to the line of credit agreement, the Company must maintain a balance due under the line of at least $1,500,000 through July 2007 (reduced to $1,000,000 under certain conditions controlled by the lender). Due to the minimum borrowing requirement and the July 2007 expiration date, $1.0 million of the balance due is presented at June 30, 2006 as notes payable, long term, more fully discussed in Note 7 to the consolidated financial statements.

Considering the negative working capital position the Company reported at year end and the projected cash requirements to fund operations, management estimates that the year end cash balance of $1,155,000 would only be adequate to meet cash requirements for approximately a three-month period. To address the working capital deficiency, the Company completed several transactions subsequent to year end including a debt financing that raised $1.3 million and the sale of units consisting of Series A Convertible Preferred Stock and warrants that provided an additional $410,400. In addition, the Company completed a transaction with an institutional investor for a $4 million debt financing to be used to repay short-term borrowing and provide working capital. The debt financing was completed on September 28, 2006.

Although management cannot assure that shareholder approval will be obtained to issue the shares related to the StarTrak merger, or that future operations will achieve projections, or that additional debt and/or equity will not be required, we believe our cash balances at year end, the additional capital raised subsequent to June 30, 2006 and the term loan completed on September 28, 2006 will provide adequate capital resources to maintain operations for the next year. However, if shareholder approval is not obtained for the issuance of shares in payment of the Deferred stock payment, StarTrak (valued at approximately $5.7 million) and the Company is required to pay the obligation in cash, or if additional working capital is required and not obtained through additional long-term debt, equity capital or operations, it could adversely affect future operations. Management has historically been successful in obtaining financing and has demonstrated the ability to implement a number of cost-cutting initiatives to reduce working capital needs. As previously discussed, the Company requires and continues to pursue additional capital for growth and strategic plan implementation. Accordingly, the accompanying consolidated financial statements have been prepared assuming the Company will continue to operate and do not include any adjustments that might be necessary if the Company is unable to continue as a going concern. As a result, the Company's independent certified public accountants have issued a going concern opinion on the consolidated financial statements of the Company for the fiscal year ended June 30, 2006.

Product and Environmental Contingencies

The Company is not aware of any material liabilities, either product or environmental related.

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

ITEM 7. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See Consolidated Financial Statements.

Index to Financial Statements

	Page
Report of Registered Public Accounting Firm	16
Consolidated Balance Sheets As of June 30, 2006 and 2005	17
Consolidated Statements of Operations For the Years Ended June 30, 2006 and 2005	18
Consolidated Statement of Changes in Shareholders' Equity and Preferred Stock For the Years Ended June 30, 2006 and 2005	19
Consolidated Statements of Cash Flows For the Years Ended June 30, 2006 and 2005	20
Notes to Consolidated Financial Statements	22

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

REPORT OF REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders
Alanco Technologies, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Alanco Technologies, Inc. and Subsidiaries as of June 30, 2006 and 2005, and the related consolidated statements of operations, changes in shareholders' equity and preferred stock, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that

we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits include consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Alanco Technologies, Inc. and Subsidiaries as of June 30, 2006 and 2005, and the results of its operations, changes in shareholders' equity and preferred stock, and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has incurred significant losses from operations, anticipates additional losses in the next year, and has insufficient working capital as of June 30, 2006 to fund the anticipated losses. These conditions raise substantial doubt as to the ability of the Company to continue as a going concern. These consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Semple & Cooper LLP
Certified Public Accountants

Phoenix, Arizona
September 15, 2006

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
AS OF JUNE 30,

	2006	2005
ASSETS		
CURRENT ASSETS		
Cash	$ 1,155,500	$ 737,300
Accounts receivable, net	1,760,700	1,091,400
Notes receivable, current	31,600	80,000
Inventories, net	3,143,900	1,902,600
Prepaid expenses and other current assets	556,600	378,200
Total current assets	6,648,300	4,189,500
PROPERTY, PLANT AND EQUIPMENT, NET	202,300	273,500

OTHER ASSETS		
Goodwill, net	20,417,100	5,356,300
Other intangible assets	339,200	560,700
Long-term notes receivable, net	-	8,000
Net assets held for sale	28,200	100,200
Other assets	49,400	55,700
Total other assets	20,833,900	6,080,900
TOTAL ASSETS	$ 27,684,500	$ 10,543,900
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable and accrued expenses	$ 5,066,200	$ 1,279,600
Credit Line	1,000,000	-
Billings in excess of cost and est. earnings on uncompleted contracts	43,500	4,200
Notes payable, current	875,300	-
Deferred stock payment, StarTrak	5,715,400	-
Customer advances	1,001,100	-
Deferred revenue, current	126,000	60,100
Total Current Liabilities	13,827,500	1,343,900
LONG TERM LIABILITIES		
Notes payable, long term	2,679,100	1,143,600
TOTAL LIABILITIES	16,506,600	2,487,500
Preferred Stock - Series B Convertible 500,000 shares authorized, 75,000 and 68,000 issued and outstanding, respectively	737,500	667,300
SHAREHOLDERS' EQUITY		
Preferred Stock - Series A Convertible 5,000,000 shares authorized, 3,122,900 and 2,781,200 shares issued and outstanding, respectively	3,925,200	3,412,700
Common Stock		
Class A - 75,000,000 shares authorized, 38,653,700 and 26,680,200 shares, net of treasury shares, outstanding, respectively	78,845,300	71,714,600
Class B - 25,000,000 shares authorized and none were issued	-	-
Treasury Stock, at cost 500,000 shares at June 30, 2006 and 2005	(375,100)	(375,100)
Accumulated deficit	(71,955,000)	(67,363,100)
Total shareholders' equity	10,440,400	7,389,100
TOTAL LIABILITIES & SHAREHOLDERS' EQUITY	$ 27,684,500	$ 10,543,900

See accompanying notes to the consolidated financial statements

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEAR ENDED JUNE 30,

	2006	2005
NET SALES	$ 6,659,600	$ 7,184,200
Cost of goods sold	4,357,700	4,675,500
GROSS PROFIT	2,301,900	2,508,700
Selling, general and administrative expense	6,304,300	6,371,300
OPERATING LOSS	(4,002,400)	(3,862,600)
OTHER INCOME & EXPENSES		
Interest expense, net	(90,300)	(34,700)
Other income, net	83,500	106,700
LOSS FROM OPERATIONS	(4,009,200)	(3,790,600)
Preferred stock dividend - in kind	(582,700)	(521,100)
NET LOSS ATTRIBUTABLE TO COMMON STOCKHOLDERS	$ (4,591,900)	$ (4,311,700)
NET LOSS PER SHARE - BASIC AND DILUTED - Net Loss Attributable to Common Shareholders	$ (0.16)	$ (0.17)
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	29,106,100	25,355,500

See accompanying notes to the consolidated financial statements

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY & PREFERRED S
FOR THE YEARS ENDED JUNE 30, 2006 AND 2005

	COMMON STOCK		SERIES A PREFERRED STOCK		TREASURY STOCK	
	SHARES	AMOUNT	SHARES	AMOUNT	SHARES	AMOU
Balances, June 30, 2004	23,732,800	$ 69,334,700	2,476,800	$ 2,956,100	500,000	$ (375,1
Options, warrants exercised	3,113,200	2,025,100	-	-	-	-
Shares & warrants issued for services	334,200	319,700	-	-	-	-
Preferred Dividend, Series A, paid in kind	-	-	304,400	456,600	-	-
Warrants issued for loan amendment and licensing agreement	-	73,400	-	-	-	-
NASDAQ listing of additional shares	-	(38,300)	-	-	-	-
Net Loss	-	-	-	-	-	-
Balances, June 30, 2005	27,180,200	$ 71,714,600	2,781,200	$ 3,412,700	500,000	$ (375,1
Options, warrants exercised	2,100,000	1,235,000	-	-	-	-
Shares & warrants issued for services	158,500	110,400	-	-	-	-
Shares issued for prepaid services	225,000	135,000	-	-	-	-
Private Offerings, Net	3,990,000	2,274,100	-	-	-	-
Acquisition of StarTrak	5,000,000	3,485,000	-	-	-	-
Preferred Dividend, Series A, paid in kind	-	-	341,700	512,500		
Stock adjustment	-	(64,700)	-	-	-	-
NASDAQ listing of additional shares	-	(44,100)	-	-		
Net loss	-	-	-	-	-	-
Balances, June 30, 2006	38,653,700	$ 78,845,300	3,122,900	$ 3,925,200	500,000	$ (375,1

See accompanying notes to the consolidated financial

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR FISCAL YEARS ENDED JUNE 30,

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss from operations	$ (4,009,200)	$ (3,790,600)
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	383,100	349,800
Stock and warrants issued for services	51,100	82,400
Income from assets held for sale	(30,000)	(106,700)
Loss on disposal of asset	22,600	-

Changes in:		
Accounts receivable, net	250,300	(434,200)
Inventories, net	(355,500)	379,700
Prepaid expenses and other current assets	(125,600)	(46,900)
Accounts payable and accrued expenses	103,300	34,800
Deferred revenue	(53,900)	33,000
Billings and estimated earnings in excess of costs on uncompleted contracts	39,300	(21,600)
Other assets	11,000	6,300
Net cash used in continuing operations	(3,713,500)	(3,514,000)
CASH FLOWS FROM INVESTING ACTIVITIES		
Net cash from assets held for sale	101,900	73,000
Collection of notes receivable	56,400	149,600
Cash advances - TSIN litigation	-	(80,000)
Purchase of property, plant and equipment	(70,800)	(153,000)
Goodwill, acquisition	(67,100)	-
Cash funding of StarTrak prior to acquisition	(774,300)	-
Net cash provided by (used in) investing activities	(753,900)	(10,400)
CASH FLOWS FROM FINANCING ACTIVITIES		
Advances on borrowings	1,993,500	329,500
Repayment on borrowings	(573,000)	(6,900)
Net Proceeds from sale of Common Stock	3,465,100	1,963,500
Net cash provided by financing activities	4,885,600	2,286,100
NET INCREASE (DECREASE) IN CASH	418,200	(1,238,300)
CASH AND CASH EQUIVALENTS, beginning of period	737,300	1,975,600
CASH AND CASH EQUIVALENTS, end of period	$ 1,155,500	$ 737,300
SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION		
Net cash paid during the period for interest	$ 90,300	$ 34,700
Non-cash activities:		
Value of stock issued for services and prepayments	$ 245,400	$ 303,200
Value of warrants issued for credit line extension and licensing agreement	$ -	$ 113,200
Value of shares issued in payment of notes receivable	$ 107,000	$ -
Stock issued for StarTrak acquisition	$ 3,485,000	$ -
Purchase of goodwill that is accrued at year-end	$ 67,100	$ -
StarTrak liabilities assumed in excess of assets acquired	$ 5,425,800	$ -
Net value of equipment written off during the		

period	$ 22,700	$ -
Preferred Stock issued, in kind	$ 552,800	$ 521,100

See accompanying notes in the consolidated financial statements

18

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

1. NATURE OF OPERATIONS AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations - Alanco Technologies, Inc. was incorporated in Arizona in 1969.

Alanco Technologies, Inc. and subsidiaries (the "Company") business operations for the past several years have emphasized a plan to strategically position the Company as a provider of information technology. The plan was initiated in fiscal year 2000 by acquiring Arraid, Inc. ("Arraid"), a manufacturer of proprietary storage products to upgrade older "legacy" computer systems, and Excel/Meridian Data, Inc. ("Excel"), a manufacturer of Network Attached Storage ("NAS") systems for mid-range organizations. These acquisitions formed the Company's Computer Data Storage business segment.

Concurrent with the implementation of the strategic plan, Alanco established a formal plan to sell the previously reported business segments. During fiscal years ended June 30, 2006 and 2005, the only activity related to the previously reported business segments was the continued liquidation of restaurant equipment assets, the net value of which is presented in the balance sheets at June 30, 2006 and 2005 as "net assets held for sale."

The Company continued its new strategic direction in fiscal year 2002 when Alanco/TSI PRISM, Inc. ("ATSI") acquired wireless tracking RFID (Radio Frequency Identification) technology designed to be used in the corrections market, through its acquisition of the operations of Technology Systems International, Inc., a Nevada corporation ("TSIN"); and again in fiscal year 2006 when the Company expanded its footprint in wireless tracking and data services into wireless asset management for the refrigerated or "Reefer" market through the acquisition, effective June 30, 2006, of StarTrak Systems, LLC, a provider of GPS tracking and wireless data services for the Reefer segment of the transport industry.

In fiscal years 2006 and 2005, the Company had continuing operations in the RFID Technology segment and in the Computer Data Storage segment. The StarTrak acquisition, effective June 30, 2006, created the Company's new Wireless Asset Management segment, the accounts of which are included in the consolidated balance sheet at June 30, 2006. Operating results for the Wireless Asset Management will be reported starting in the quarter ending September 30, 2006.

Principles of Consolidation - The consolidated financial statements for the years ended June 30, 2006 and 2005 include the accounts of Alanco Technologies, Inc. and its wholly-owned subsidiaries, ATSI, Arraid, Excel, Fry Guy Inc. and StarTrak Systems, LLC (collectively, the "Company"). StarTrak Systems, LLC operations were acquired effective June 30, 2006 and therefore are not included in the Company's consolidated Statement of Operations. All subsidiaries are Arizona corporations, except Fry Guy Inc., which is a Nevada corporation and StarTrak Systems,

LLC, which is a Delaware LLC. All significant intercompany accounts and transactions have been eliminated in consolidation.

Cash Equivalents - The Company considers all highly liquid debt instruments with original maturities of three months or less to be cash equivalents.

Accounts Receivable Trade - The Company provides for potentially uncollectible accounts receivable by use of the allowance method. An allowance is provided based upon a review of the individual accounts outstanding and the Company's prior history of uncollectible accounts. Provision for uncollectible accounts receivable amounted to approximately $71,600 and $60,200 at June 30, 2006 and 2005, respectively. The Company does not typically accrue interest or fees on past due amounts.

Inventories - Inventories consist of materials and parts, work-in-process, and finished goods. Inventories are stated at the lower of cost or market. Cost is calculated using the average-cost method for the Data Storage segment and first-in, first-out ("FIFO") for the RFID Technology and the Wireless Asset Management segments.

Property, Plant and Equipment - Property, plant and equipment are stated at cost. Depreciation is computed over the estimated useful lives of the assets using the straight-line method, generally over a 3 to 10-year period. Leasehold improvements are amortized on the straight-line method over the lesser of the lease term or the useful life. Expenditures for ordinary maintenance and repairs are charged to expense as incurred. Betterments are capitalized as incurred. Upon retirement or disposal of assets, the cost and accumulated depreciation are eliminated from the account and any gain or loss is reflected in the statement of operations.

Fair Value of Financial Instruments - The estimated fair values for financial instruments are determined at discrete points in time based on relevant market information. These estimates involve uncertainties and cannot be determined with precision. The carrying amounts of accounts receivable, notes receivable, accounts payable, accrued liabilities, and notes payable approximate fair value.

Goodwill and Other Intangible Assets - In June 2001, the Financial Accounting Standards Board issued SFAS No.141, "Business Combinations," and SFAS No. 142, "Goodwill and Other Intangible Assets". SFAS No. 141 requires the use of the purchase method of accounting for all business combinations initiated after June 30, 2001. It also provides guidance on purchase accounting related to the recognition of intangible assets. SFAS No. 142 requires that goodwill and identifiable acquired intangible assets with indefinite useful lives shall no longer be amortized, but tested for impairment annually and whenever events or circumstances occur indicating that goodwill might be impaired. SFAS No. 142 also requires the amortization of identifiable assets with finite useful lives. Identifiable acquired intangible assets, which are subject to amortization, are to be tested for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

The Company elected to adopt the provisions of SFAS No. 142 as of July 1, 2001, and identified its reporting units (components) to be two separate units (Arraid and Excel), which continue to make up the Company's Data Storage segment. In May of 2002 the Company added its ATSI unit and, effective June 30, 2006, it added its StarTrak unit. The Company

determines the carrying value of each reporting unit by assigning assets and liabilities, including the existing goodwill and intangible assets, to the reporting units. Upon adoption of SFAS No. 142, amortization of goodwill recorded for business combinations consummated prior to June 30, 2001 ceased, and intangible assets acquired prior to June 30, 2001 that did not meet the criteria for recognition apart from goodwill under SFAS No. 141 were reclassified to goodwill. In connection with the adoption of SFAS No. 142, the Company was required to perform a transitional goodwill impairment assessment. The annual goodwill impairment assessment involves estimating the fair value of the reporting unit and comparing it with the carrying amount. If the carrying amount of the reporting unit exceeds its fair value, additional steps are followed to recognize a potential impairment loss. Calculating the fair value of the reporting units requires significant estimates and assumptions by management. The Company estimates the fair value of its reporting units by applying third-party market value indicators to the reporting unit's projected earnings before interest, taxes, depreciation and amortization. The Company completed its impairment tests with no adjustment to the carrying value of its goodwill as of June 30, 2006.

Intangible assets consist of goodwill, the excess of purchase price over fair value of net assets acquired in connection with the acquisitions of its wholly owned subsidiaries, and other intangible assets, including cost of licenses, patents, developed software, etc. Prior to fiscal year 2002, goodwill was being amortized over 15 years. Commencing in year 2002, the Company adopted SFAS 142 and ceased amortizing goodwill balances over a specific period pursuant to SFAS 142. However, per Company policy, goodwill balances are reviewed at least annually to determine appropriateness of valuation and presentation based upon anticipated cash flows. See Impairment of Intangibles and Other Long-lived assets below for additional discussion of valuation for Intangible Assets.

The following is a summary of Goodwill, net:

	RFID Technology	Data Storage	StarTrak	Total
Balance as of June 30, 2005 & 2004	5,076,700	279,600	-	5,356,300
Goodwill related to acquisition	-	-	15,060,800	15,060,800
Balance as of June 30, 2006	$ 5,076,700	$ 279,600	$15,060,800	$20,417,100

The Company completed the acquisition of StarTrak effective June 30, 2006. The purchase price, considering the 5 million Class A Common Shares issued at closing (valued at $3,485,000), 8.2 million Class A shares to be issued upon shareholder approval (valued at $5,715,400 on June 30, 2006), StarTrak net liabilities assumed of $5,425,800 and the related costs of the acquisition of $434,500, was valued at of $15,060,800. The Company has engaged an independent consultant for valuation services related to FASB 141 required disclosures of the allocation of the

purchase price paid to the assets acquired and liabilities assumed by balance sheet caption. We believe the allocation will focus primarily on intangible assets other than goodwill. The consultant's report has not been received by the date of this audit report and therefore the entire transaction value is presented as goodwill. The consultant's report is expected in the next few weeks when the appropriate allocation of the purchase price will be completed.

Other intangible assets, excluding any allocations required due to the StarTrak acquisition, consist of the following:

	Amortization Period (in years)	Gross Carrying Value	Accumulated Amortization	Net Other Intangible Assets
As of June 30, 2005				
Patents license	3	$ 51,900	$ (51,900)	$ -
Manufacturing license	6	500,000	(256,900)	243,100
Software development	5	600,000	(370,000)	230,000
Technology license	5	90,000	(2,400)	87,600
Total Other Intangible Assets		$1,241,900	$ (681,200)	$ 560,700
As of June 30, 2006				
Patents license	3	$ 51,900	$ (51,900)	$ -
Manufacturing license	6	500,000	(340,200)	159,700
Software development	5	600,000	(490,000)	110,000
Technology license	5	90,000	(20,500)	69,500
Total Other Intangible Assets		$1,241,900	$ (902,600)	$ 339,200

The amortization expenses for aggregate other intangible assets for the fiscal years ended June 30, 2006 and 2005 were $221,500 and $222,900, respectively.

The following table summarizes the estimated amortization charges related to the other intangible assets as of June 30, 2006, excluding any allocations required due to the StarTrak acquisition, which will be determined after an independent consultant has completed valuation pursuant to FASB 141:

June 30th	Amount
2007	$ 211,400
2008	94,100
2009	18,100
2010	15,600
	$ 339,200

Net Assets Held For Sale - At June 30, 2006 and 2005, the "net assets held for sale" consist of the remaining restaurant equipment assets. The Company is continuing to sell the equipment in small quantities and believes the carrying value is supportable under the small unit sales. "Net assets held for sale" at June 30, 2006 and 2005 are valued at the lower of cost or market.

Income Taxes - The Company accounts for income taxes under the asset and liability method, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement basis and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

Use of Estimates - The preparation of the Company's financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company's management to make estimates and assumptions that affect the amounts reported in these financial statements and accompanying notes. Actual results could differ from those estimates.

The Company makes significant assumptions concerning the realizability of its goodwill and other intangible assets, warranty reserves, percentage of completion method of accounting, deferred tax assets, investments and assets held for sale. Due to the uncertainties inherent in the estimation process and the significance of these items, it is at least reasonably possible that the estimates in connection with these items could be further materially revised within the next year.

Impairment of Other Long-Lived Assets - The Company performs an assessment for impairment whenever events or changes in circumstances indicate that the carrying amount of a long-lived asset may not be recoverable. If the net carrying value of the asset exceeds estimated future net cash flows, then impairment is recognized to reduce the carrying value to the estimated fair value. No impairment to Other Long-Lived Assets was recorded during fiscal years ended June 30, 2006 or 2005.

Revenue Recognition - The Company recognizes revenue from computer data storage sales, net of anticipated returns, at the time products are shipped to customers, or at the time service is provided. Revenues from material long-term contracts that extend over a reporting period in both the Computer Data Storage segment and the RFID Technology segment are recognized on the percentage-of-completion method for individual contracts, commencing when significant costs are incurred and adequate estimates are verified for substantial portions of the contract to where experience is sufficient to estimate final results with reasonable accuracy. Revenues are recognized in the ratio that costs incurred bear to total estimated costs. Changes in job performance, estimated profitability and final contract settlements would result in revisions to costs and income, and are recognized in the period in which the revisions are determined.

Contract costs include all direct materials, subcontracts, labor costs and those direct and indirect costs related to contract performance. General and administrative costs are charged to expense as incurred. At the time a loss on a contract becomes known, the entire amount of the estimated ultimate loss is accrued.

Loss Per Share - The loss per share ("EPS") is presented in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 128, Earnings Per Share. Basic EPS is calculated by dividing the income or loss available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

22

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

Basic and diluted EPS were the same for fiscal 2006 and 2005, as the Company had losses from operations and therefore the effect of all potential common stock equivalents is antidilutive (reduces loss per share). Stock options representing 14,302,500 shares of Class A Common Stock were outstanding at year-end with exercise prices ranging between $0.37 and $2.75. The weighted average exercise price for all outstanding options was $0.79. Stock warrants representing 7,191,700 Class A Common Shares were outstanding at year-end with exercise prices ranging between $0.50 and $2.00. The weighted average exercise price was $0.93.

At June 30, 2006, there were 3,122,900 shares of Series A Convertible Preferred Stock and 75,000 shares of Series B Convertible Preferred Stock outstanding. The Series A Convertible Preferred shares are convertible into Class A Common shares at a ratio of 3 shares of common stock for each share of Series A Preferred. The Series B Convertible Preferred shares are convertible into Class A Common shares at a ratio of 13 shares of common stock for each share of Series B Preferred. If the preferred shares had been converted into common shares at June 30, 2006, there would have been an additional 10,344,700 Class A Common shares outstanding.

Stock-Based Compensation - At June 30, 2006 and 2005, the Company had stock-based compensation plans accounted for under the recognition and measurement principles of Accounting Principles Board Opinion ("APBO") No. 25 "Accounting for Stock Issued to Employees," and related interpretations, as more fully described in Note 12. Pro forma information regarding the impact of stock-based compensation on net income and earnings per share is required by SFAS No. 123 "Accounting for Stock-Based Compensation," and SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." Such pro forma information, determined as if the Company had accounted for its employee stock options under the fair value recognition provisions of SFAS No. 123, is illustrated in the following table:

	Year Ended June 30, 2006	2005
Net loss attributable to Common Shareholders	$ (4,591,900)	$(4,311,700)
Deduct: Total stock-based compensation expense determined under fair value-based method for all awards, net of related tax effects	(1,881,900)	(255,600)

Pro Forma Net Loss	$ (6,473,800)	$ (4,567,300)
Loss per Share		
Basic and Diluted, as Reported	$ (0.16)	$ (0.17)
Pro Forma Basic and Diluted	$ (0.21)	$ (0.18)
Weighted Shares Outstanding, Basic and Diluted	29,106,100	25,355,500
Pro Forma Weighted Shares Outstanding, Basic and Diluted	30,657,771	25,590,800

The fair value for these options was estimated as of the date of grant using a Black-Scholes option-pricing model with the following weighted average assumptions for all options granted.

	Year Ended June 30,	
	2006	2005
Volatility	27%	30%
Risk free interest	4.5%	3.5%
Expected dividends	none	none
Expected term in years	5-10	10

Concentrations of Credit Risks and Significant Customers - The Company sells products and extends credit based on an evaluation of the customer's financial condition, generally without requiring collateral. Exposure to losses on receivables is principally dependent on each customer's financial condition. The Company monitors its exposure for credit losses and maintains allowances for anticipated losses.

The RFID Technology segment utilizes various domestic suppliers for purchases of materials and parts used to manufacture its products. Due to the advantage of volume manufacturing, one domestic supplier represented approximately 34% of those purchases for fiscal year ended June 30, 2005. No supplier accounted for 10% or more of those purchases for fiscal year ended June 30, 2006.

The Company anticipates that due to the advantages of volume manufacturing, a concentration of vendor purchases may occur in the RFID Technology segment; however, additional suppliers are readily available at competitive pricing levels. The Company does not foresee any future significant shortages or substantial price increases that cannot be recovered from its customers.

No Data Storage customer accounted for more than 10% of the segment sales in fiscal year 2006 and one Data Storage customer account for 10.2% of the segment sales in fiscal year 2005. Four state governments accounted for substantially all of the RFID Technology segment's revenues for fiscal year 2006, while two state governments accounted for substantially all of the revenues for fiscal year 2005.

The largest accounts receivable balance in the Data Storage segment represented 15.6% and 8.9% of consolidated accounts receivable (41.6% and 11.7% of Data Storage receivables) at June 30, 2006 and 2005, respectively. The largest accounts receivable balance in the RFID Technology segment at June 30, 2006 represented 6.9% of consolidated accounts receivable (56.7% of RFID receivables) compared to 13.3% (61% of RFID receivables) at June 30, 2005. The largest accounts receivable in the Wireless Asset Management segment amounted to 17.1% of consolidated receivables and 32.6% of the Wireless Asset Management segment receivables.

Segment Information - SFAS No. 131, "Disclosure About Segments of an Enterprise and Related Information," defines operating segments as components of a company about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company had identified RFID Technology and Data Storage as the continuing operating segments of the Company for fiscal year 2006 and 2005. The acquisition of StarTrak Systems, LLC, effective June 30, 2006 added an additional reporting segment for future reporting periods that is referred to as Wireless Asset Management. All assets related to previously disclosed segments have either been sold or have been classified as "net assets held for sale" at June 30, 2006 and 2005. See Note 14 for further information related to the Company's operating segments.

Recent Accounting Pronouncements - In November 2004, the FASB issued Statement No. 151 ("SFAS 151"), "Inventory Cost - An Amendment of ARB No. 43, Chapter 4." SFAS 151 clarifies accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material. It requires that those items be recognized as current-period charges regardless of whether they meet the criterion of abnormal. Currently, we do not have any inventory items that fall into the classifications discussed; accordingly, adoption of SFAS 151 does not have a significant impact on our financial statements.

In December 2004, the FASB issued Statement No. 153 ("SFAS 153"), "Exchanges of Nonmonetary Assets - An Amendment of APB Opinion No. 29." SFAS 153 amends APB Opinion No. 29 to eliminate the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. Adoption of SFAS 153 does not have a significant impact on our financial statements.

In December 2004, the FASB issued Statement No. 123R ("SFAS 123R"), "Share-Based Payment." This Statement focuses primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. It requires that the fair-value-based method be

used to account for these transactions for all public entities. This Statement is effective for small business issuers for the first reporting period after December 15, 2005, subject to additional extensions granted by the SEC, and will affect any stock-based compensation for options issued after that date, or not vested as of that date. The effect of the adoption should not be significantly different than provided in the previously reported proforma presentation in the notes to the consolidated financial statements.

In May 2005, the FASB issued Statement No. 154 ("SFAS 154"), "Accounting Changes and Error Corrections". SFAS 154 replaces APB Opinion No. 20, (APB 20") and SFAS No. 3 to require retrospective application of changes to all prior period financial statements so that those financial statements are presented as if the current accounting principle had always been applied. APB 20 previously required most voluntary changes in accounting principles to be recognized by including in net income of the period of change the cumulative effect of changing to the new accounting principle. In addition SFAS 154 carries forward without change the guidance contained in APB 20 for reporting a correction of an error in previously issued financial statements and a change in accounting estimate. SFAS 154 is effective for changes and corrections made after January 1, 2006, with early adoption permitted. The Company is currently not contemplating changes that would be impacted by SFAS 154.

2. LIQUIDITY AND GOING CONCERN

The Company incurred significant losses and negative cash flows from operations during fiscal year ended June 30, 2006 and in prior fiscal years, and anticipates additional losses and negative cash flows in early fiscal year 2007. These factors, as well as the uncertain conditions that the Company faces regarding its ability to secure significant contracts for the TSI PRISM installations, creates an uncertainty about the Company's ability to finance its operations and remain a going concern. Although management cannot assure that future operations will be profitable or that additional debt and/or equity capital will be raised, management believes cash balances at June 30, 2006 of approximately $1,155,500 and the $410,400 of additional equity capital raised subsequent to the end of fiscal 2006 through the sale of stock, and the additional long-term debt financing anticipated to close shortly, will provide adequate capital resources to maintain the Company's net cash requirements for the next year. However, if additional working capital is required and not obtained through long-term debt, equity capital or operations, it could adversely affect future operations. Management has historically been successful in obtaining financing and has demonstrated the ability to implement a number of cost-cutting initiatives to reduce working capital needs. The Company requires and continues to pursue additional capital for growth and strategic plan implementation. Accordingly, the accompanying consolidated financial statements have been prepared assuming the Company will continue to operate and do not include any adjustments that might be necessary if the Company is unable to continue as a going concern.

3. NOTES RECEIVABLE

Notes receivable at June 30, 2006 and 2005 consisted of the following:

	2006	2005
TSIN Board of Directors	$ 29,600	$ 80,000
Notes receivable - other	2,000	10,200
	31,600	90,200
Less - allowance for uncollectible	-	(2,200)
Net notes receivable	$ 31,600	$ 88,000

At June 30, 2006 and 2005, Notes - "TSIN Board of Directors" consisted of notes receivable related to advances made to TSIN in fiscal year ended June 30, 2005 to assist the newly elected TSIN board of directors in obtaining legal representation. The new board required legal representation since the previous board was attempting to stop the new board from assuming their responsibilities. The notes incur interest at 9% and are due on demand. During fiscal 2006, the Company received payments on the notes of approximately $50,000. At June 30, 2006, the TSIN Board of Directors had filed for reimbursement from TSIN under the Directors indemnification provisions of the Articles of Incorporation, Bylaws of TSIN and corporate laws of the State of Nevada. The new board is awaiting payment so the funds received can be used to repay the notes.

4. INVENTORIES

Inventories consist of the following at June 30:

	2006	2005
Raw materials and purchased parts	$ 3,251,000	$ 2,011,900
Work-in-progress	98,100	106,000
Finished goods	198,700	99,300
	3,547,800	2,217,200
Less reserves for obsolescence	(403,900)	(314,600)
	$ 3,143,900	$ 1,902,600

5. PROPERTY, PLANT AND EQUIPMENT

Property, Plant and Equipment consist of the following at June 30:

	2006	2005
Machinery and equipment	$ 351,500	$ 202,600
Furniture and office equipment	608,000	586,800
Marketing site equipment	50,000	250,000
Leasehold improvement	9,700	9,700
	1,019,200	1,049,100
Less accumulated depreciation	(816,900)	(775,600)

Net book value	$ 202,300	$ 273,500

Related depreciation expense for the years ended June 30, 2006 and 2005, was $161,600 and $126,900, respectively.

6. NET ASSETS HELD FOR SALE

Several years ago, the Company formally adopted a plan to sell all business segment assets not related to information technology. The only remaining assets presented as "net assets held for sale" at both June 30, 2006 and 2005 related to restaurant equipment assets.

7. LINE OF CREDIT AND NOTES PAYABLE

At June 30, 2006, the Company has a $2,000,000 outstanding balance, $1,000,000 presented in current liabilities as Credit Line and $1,000,000 presented as Notes payable - long term, under a $2.0 million line of credit Agreement. The Agreement is with a private trust, initially entered into in June 2002, for a credit line of $1.3 million. The Agreement has been amended various times since June 2002 with the last amendment in June 2006. Under the current amended agreement, which expires on July 1, 2007, the Company must maintain a minimum outstanding balance under the line of $1.5 million through July 1, 2007 and pay interest on the outstanding balance at a rate of prime plus 2% (10.25% at June 30, 2006). Under the Agreement, the lender has the unilateral right to reduce the line of credit Agreement to $1.5 million, at which time the minimum outstanding balance under the Agreement reduces from $1.5 million to $1.0 million. At June 30, 2006 the Company was fully drawn under the line of credit Agreement. At June 30, 2005, the Company had an outstanding balance of $829,500 under the Agreement. Interest payments made under the Agreement amount to $89,500 and $34,700 in fiscal years ended June 30, 2006 and 2005, respectively.

Notes payable at June 30, 2006 and 2005 consist of the following:

	2006	2005
Notes payable - TSI Acquisition	$ 314,100	$ 314,100
Notes payable - Bank	1,000,000	829,500
Notes payable - StarTrak Acquisition	1,733,300	-
Notes payable - Other	507,000	-
Notes payable	3,554,400	1,143,600
Less current portion	(875,300)	-
Notes payable - long term	$ 2,679,100	$ 1,143,600

The Notes payable - TSI Acquisition primarily represent payables assumed as an obligation under the TSI acquisition agreement. The balance at June 30, 2006 and 2005 is payable to TSIN upon ATSI achieving a net profit of $1 million in any twelve-month period ending on June 30th. The Notes payable - TSI Acquisition balance of $314,100 at June 30, 2006 and 2005 has been reduced by approximately $10,500 for costs incurred and paid by

the Company that had been indemnified by TSIN in the acquisition agreement.

Notes payable - StarTrak Acquisition represent notes assumed in the acquisition and include a $1.5 million non interest bearing note payable to Tenix Holding, Inc. (a prior investor in StarTrak) due December 31, 2007 that has been discounted to $1.365 million due to the non interest bearing nature of the note, and $368,300 of notes due on demand (expected to be repaid in the quarter ended December 31, 2006) that bear interest at 7%.

Notes payable - Other includes a $257,000 non interest bearing note due to an investment banker involved in the StarTrak acquisition ($150,000 of which was paid August 31, 2006 and $107,000 is due by January 31, 2007 and may, if approved by shareholders, be paid in stock) and a $250,000 demand note bearing interest at 12% and due to the Company's Chief Executive Officer.

27

ALANCO TECHNOLOGIES, INC. AND SUBSIDIARIES

8. CONTRACTS IN PROGRESS

The Company had one fixed price contract in progress at June 30, 2006 and 2005, within the RFID Technology segment, for the installation of a TSI PRISM system. Billings in excess of costs and estimated earnings as of June 30, 2006 and 2005 consist of the following:

	June 30, 2006	June 30, 2005
Costs incurred on uncompleted contract	$ 97,100	$ 34,100
Gross profit earned to date	19,900	1,700
Revenues earned to date	117,000	35,800
Less: billings to date	(160,500)	(40,000)
Billings in excess of cost and estimated earnings on uncompleted contracts	$ (43,500)	$ (4,200)

9. INCOME TAXES

A reconciliation of anticipated statutory rates is as follows:

	2006	2005
Statutory Rate	34%	34%
State income taxes, net of Federal income tax benefit	5%	5%
Increase (reduction) in valuation allowance related to net operating loss carry-forwards and change in temporary differences	-39%	-39%
	0%	0%

The components of the net deferred tax asset (liability)recognized as of June 30, 2006 and 2005, are as follows:

	2006	2005
Deferred tax assets (liabilities):		
Net operating loss, capital loss carryforwards, amortization of intangibles	$ 14,498,000	$ 12,827,000
Property, plant and equipment	22,000	(49,000)
Other timing differences	23,000	62,000
Less: valuation allowance	(14,543,000)	(12,840,000)
Net deferred tax	$ -	$ -

A valuation allowance is recognized if it is more likely than not that some or all of the deferred income tax assets will not be realized. A valuation allowance is used to offset the related income tax assets due to uncertainties of realizing the benefits of certain net operating loss and tax credits. The valuation allowance reflects a 100% reserve for all years reported above. At June 30, 2006, the Company had net operating loss and capital loss carryforwards for Federal tax purposes of approximately $37,527,000. The loss carryforwards, unless utilized, will expire from 2007 through 2025.

28

10. RELATED PARTY TRANSACTIONS

At June 30, 2006, the Company had a line of credit agreement with a trust controlled by Donald Anderson, a member of the Company's Board of Directors. In addition, the Company also had a demand note payable to Mr. Robert Kauffman, CEO of the Company, in the amount of $250,000. See Note 7 for additional discussion of both the line of credit agreement and the note due to Mr. Kauffman.

During 2006, as more fully described in Note 12, Shareholders' Equity, the Company raised approximately $2.3 million in private offerings to accredited investors, with twenty-two percent being attributable to insiders.

11. COMMITMENTS AND CONTINGENCIES

Leases - The Company leases certain facilities under non-cancelable operating lease agreements that expire through fiscal year 2009. Future minimum payments under non-cancelable operating leases at June 30, 2006 are as follows:

Year Ended June 30,	Operating Leases
2007	$ 412,700
2008	197,200

2009	105,200
2010	-
2011	-
	$ 715,100

Rent expense related to these operating leases totaled approximately $340,400 and $342,600 for the years ended June 30, 2006 and 2005, respectively.

Legal Proceedings - The Company is a party to litigation that relates to the acquisition, in May of 2002, of substantially all the assets of Technology Systems International, Inc., a Nevada Corporation, to litigation arising out of Carolina Casualty Insurance Company's failure to pay a claim (relating to the TSIN litigation) pursuant to a Directors and Officers insurance policy, and to litigation arising from an expired property lease between the Company's subsidiary, Arraid, Inc., and Arraid Property L.L.C., an Arizona limited liability company. The actions are more fully described below:

On January 30, 2003, a shareholder of TSIN filed a derivative suit naming as defendants the Company and its wholly owned subsidiary, Alanco/TSI PRISM, Inc. The venue for this action is the Arizona Superior Court in and for Maricopa County, Arizona, as case number CV2003-001937. The complaint sets forth various allegations and seeks damages arising out of the Company's acquisition of substantially all of the assets of TSIN. This derivative suit was terminated and the action converted into a direct action by TSIN by stipulation and court order in July 2003.

TSIN is currently in Chapter 7 bankruptcy. The Chapter 7 Trustee failed to prosecute the action timely and the state court dismissed the action for lack of prosecution, but allowed the Trustee to restart the action, which the Trustee has done as case number CV2006-007398. The Company is seeking its attorney's fees with respect to the dismissed action, and will appeal the court's order allowing the Trustee to restart the action. The Company's management, in consultation with legal counsel, believes the plaintiff's claims are without merit and the Company will continue to aggressively defend the action. In addition, the Company will pursue reimbursement of legal expenses incurred from TSIN.

The Company is the plaintiff in a lawsuit (U.S. District Court No. CV-04-0789-PHX-DGC) arising out of Carolina Casualty Insurance Company's ("Carolina") failure to pay a claim regarding the TSIN litigation, that the Company made pursuant to its Directors and Officers Insurance Policy ("Policy") issued by Carolina. The Company seeks payment for its legal expenses in the TSIN litigation and reimbursement of legal fees incurred in the Carolina litigation. The District Court granted summary judgment in favor of Carolina and the Company has filed an appeal with the Ninth Circuit Court of Appeals.

On July 18, 2003, Arraid Property L.L.C., an Arizona limited liability company ("Arraid LLC"), filed a complaint in the Arizona Superior Court in and for Maricopa County, Arizona (case number CV 2003-13999) against the Company and its wholly owned subsidiary, Arraid, Inc., alleging breach of lease and seeking substantial monetary damages. The suit relates to an expired lease agreement for proper