ISLAND PACIFIC INC
Form 10-Q
November 15, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2004 OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM
____________ TO ____________

Commission file number 0-23049

ISLAND PACIFIC, INC.
(Exact name of registrant as specified in its charter)

DELAWARE	33-0896617
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

19800 MACARTHUR BOULEVARD, 12TH FLOOR, IRVINE, CALIFORNIA	92612
(Address of principal executive offices)	(Zip Code)

(949) 476-2212
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 [ ]

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

Common Stock, $0.0001 Par Value - 62,894,387 shares as of October 31, 2004.

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PART I. - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

ISLAND PACIFIC, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share amounts)

	SEPTEMBER 30 2004
ASSETS	

Current assets:	
Cash and cash equivalents	$ 96
Accounts receivable, net of allowance for doubtful accounts of $1,341 and $409, respectively	4,83
Other receivables, including $14 and $37 from related parties, respectively	11
Inventories	3
Current portion of non-compete agreements	31
Current portion of note receivable	3
Prepaid expenses and other current assets	70
Total current assets	6,99
Note receivable	11
Property and equipment, net	96
Goodwill, net	31,93
Other intangibles, net	20,62
Other assets	29
Total assets	$ 60,94
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current Liabilities:	
Current portion of notes payable to related parties	$ 98
Current portion of notes payable	1,79
Current portion of convertible debentures	2,29
Current portion of capital leases	16
Accounts payable	68
Accrued expenses	3,22
Deferred revenue	4,68
Income tax payable	12
Total current liabilities	13,96
Notes payable to related parties, less current maturities	1,56
Notes payable, less current maturities	26
Convertible debentures, net, less current maturities	4,15
Capital lease obligations, less current maturities	1
Deferred revenue	87
Long term liabilities	19
Total liabilities	21,04
Commitments and contingencies	
Stockholders' equity:	
Preferred Stock, $.0001 par value; 5,000,000 shares authorized: Series A Convertible Preferred, 7.2% cumulative 141,100 shares issued and outstanding with a stated value of $100 per share, dividends in arrears of $2,581 and $2,002, respectively	14,10
Common Stock, $.0001 par value; 100,000,000 shares authorized; 62,761,436 and 52,427,799 shares issued and outstanding, respectively	
Additional paid in capital	84,29
Accumulated deficit	(58,49
Total stockholders' equity	39,90
Total liabilities and stockholders' equity	$ 60,94

The accompanying notes are an integral part of these condensed consolidated financial statements.

ISLAND PACIFIC, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Three Months Ended September 30,		Six Mo Septe
	2004	2003	2004
		(As restated)	
Revenues:			
Product	$ 4,926	$ 1,825	$ 9,397
Services	1,757	954	2,569
Total revenues	6,683	2,779	11,966
Cost of revenues:			
Product	2,124	1,177	4,357
Services	956	476	1,434
Total cost of revenues	3,080	1,653	5,791
Gross profit	3,603	1,126	6,175
Expenses:			
Application development	1,802	585	3,049
Depreciation and amortization	530	280	936
Restructuring	681	--	681
Selling, general and administrative	3,988	3,001	8,299
Total expenses	7,001	3,866	12,965
Loss from operations	(3,398)	(2,740)	(6,790)
Other income (expense):			
Interest income	4	(17)	4
Other income (expense)	5	(167)	102
Interest expense	(2,088)	(1,504)	(2,389)
Total other expenses	(2,079)	(1,688)	(2,283)
Loss before provision for income taxes (benefits)	(5,477)	(4,428)	(9,073)
Provision for income taxes (benefits)	6	67	6
Net loss	(5,483)	(4,495)	(9,079)

Cumulative preferred dividends	(294)	(282)	(580)
Net loss available to common stockholders	$ (5,777)	$ (4,777)	$ (9,659)
Basic and diluted loss per share:			
Net loss	$ (0.09)	$ (0.13)	$ (0.16)
Cumulative preferred dividends	(0.01)	(0.01)	(0.01)
Net loss available to common stockholders	$ (0.10)	$ (0.14)	$ (0.17)
Basic and diluted weighted-average common shares outstanding	57,432	34,417	55,197

The accompanying notes are an integral part of these condensed consolidated financial statements.

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ISLAND PACIFIC, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	SIX SEP 2004
Cash flows from operating activities:	
Net loss	$ (9,07
Adjustments to reconcile net loss to net cash used for operating activities:	
Depreciation and amortization	2,68
Amortization of debt discount and conversion option	1,18
Gain on disposal of furniture and fixtures	
Provision for allowance for doubtful accounts, net of recoveries	34
Stock-based compensation	2
Common stock issued for services rendered and settlement cost	-
Changes in assets and liabilities net of effects from acquisitions:	
Accounts receivable and other receivables	97
Income tax refund receivable	-
Inventories	
Prepaid expenses and other assets	25
Accounts payable and accrued expenses	(2,08
Income tax payable	-
Accrued interest on stockholders' loans, convertible notes and term loan	31
Deferred revenue	21
Net cash used for operating activities	(5,15
Cash flows from investing activities:	
Payment from note receivable	
Proceeds from acquisition of Retail Technologies International, Inc., net	56

Purchases of furniture and equipment	(5
Capitalized software development costs	(35
Net cash provided by (used for) investing activities	15
Cash flows from financing activities:	
Sale of common stock, net of offering costs	
Decrease in amount due to stockholders, net	(30
Proceeds from convertible debts	7,00
Payments on capital leases	(8
Payments on term loans and convertible debentures	(2,77
Net cash provided by financing activities	3,84
Effect of exchange rate changes on cash	
Net decrease in cash and cash equivalents	(1,14
Cash and cash equivalents, beginning of period	2,10
Cash and cash equivalents, end of period	$ 96
Supplemental disclosure of cash flow information:	
Interest paid	$ 27
Income taxes paid	$
Supplemental schedule of non-cash investing and financing activities:	
Issued 7,551,696 shares of common stock upon conversion of 2,517,232 shares of Series B Convertible Preferred Stock issued in connection with the acquisition of Retail Technologies International, Inc.	$ 5,70
Issued 1,546,733 shares of common stock in connection with the acquisition of Retail Technologies International, Inc.	$ 1,16
Issued promissory notes in connection with the acquisition of Retail Technologies International, Inc.	$ 3,62
Issued 600,000 shares of common stock as payment for liquidated damages	$ 24
Issued 223,052 shares of common stock upon cashless exercise of an incentive stock option	$ 2
Issued 4,103,161 shares of common stock upon conversion of the 9% debentures	-
Issued 2,287,653 shares of common stock upon conversion of the note due to stockholders	-
Issued 500,000 shares of common stock as payment for dividend on preferred stock	-
Retired 10,700,000 shares of treasury stock	-
Issued 84,849 shares of common stock as payments for bonuses and services rendered in prior periods	-

The accompanying notes are an integral part of these condensed consolidated financial statements.

ISLAND PACIFIC, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND BASIS OF PREPARATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles applicable to interim financial statements. Accordingly, they do not include all of the information and notes required for complete financial statements. In the opinion of management, all adjustments necessary to present fairly the financial position, results of operations and cash flows at September 30, 2004 and for all the periods presented have been made.

Certain amounts in the prior periods have been reclassified to conform to the presentation for the six months ended September 30, 2004. The financial information included in this quarterly report should be read in conjunction with the consolidated financial statements and related notes thereto in our Form 10-K/A for the year ended March 31, 2004.

The results of operations for the six months ended September 30, 2004 and 2003 are not necessarily indicative of the results to be expected for the full year.

NOTE 2 - ACQUISITIONS

PAGE DIGITAL INCORPORATED

Effective January 30, 2004, we acquired all of the issued and outstanding shares of Page Digital Incorporated ("Page Digital"), a Colorado-based developer of multi-channel commerce software, through a merger with our newly-formed wholly-owned subsidiary. The purchase price for the acquisition was $7.1 million, consisting of $2.0 million in cash, 2.5 million shares of our common stock valued at $2.00 per share and acquisition costs of $138,000. Upon the consummation of this transaction, we entered into two-year employment agreements for executive officer positions with two of the principals of Page Digital and a two-year non-compete agreement with one of the two principals of Page Digital.

The following unaudited pro forma consolidated results of continuing operations for the three and six months ended September 30, 2003 assume the acquisition of Page Digital occurred as of April 1, 2003. The pro forma results are not necessarily indicative of the actual results that would have occurred had the acquisitions been completed as of the beginning of the period presented, nor are they necessarily indicative of future consolidated results.

	Three Months Ended September 30, 2003
Revenues	$ 4,307
Net loss	$ (4,734)
Net loss available to common stockholders	$ (5,016)
Basic and diluted loss per share of common stock	$ (0.14)
Basic and diluted loss per share available to common stockholders	$ (0.15)

RETAIL TECHNOLOGIES INTERNATIONAL, INC.

Pursuant to an agreement dated June 1, 2004, we acquired Retail Technologies International, Inc. ("RTI") from Michael Tomczak, Jeffrey Boone and Intuit Inc. ("Intuit") in a merger transaction. On March 12, 2004, we, RTI, IPI Merger Sub, Inc., ("Merger Sub") and Michael Tomczak and Jeffrey Boone (the "Shareholders") entered the initial Agreement of Merger and Plan of Reorganization (the "March 12, 2004 Merger Agreement") which provided we would acquire RTI in a merger transaction in which RTI would merge with and into Merger Sub. The merger

consideration contemplated by the March 12, 2004 Merger Agreement was a combination of cash and shares of our common stock. The March 12, 2004 Merger Agreement was amended by the Amended and Restated Agreement of Merger and Plan of Reorganization, dated June 1, 2004, by and between us, RTI, Merger Sub, IPI Merger Sub II, Inc. ("Merger Sub II") and the Shareholders (the "Amended Merger Agreement").

Pursuant to the Amended Merger Agreement, the Merger (as defined below) was completed with the following terms: (i) we assumed RTI's obligations under those certain promissory notes issued by RTI on December 20, 2002 with an aggregate principal balance of $2.3 million; (ii) the total consideration paid at the closing of the Merger was $11.6 million paid in shares of our common stock with fair value of $1.2 million, newly designated Series B convertible preferred stock ("Series B Preferred") with fair value of $5.7 million, promissory notes totaling $3.6 million, assumption of incentive stock options with fair value of $1.0 million and acquisition costs of $110,000; (iii) the Shareholders and Intuit are entitled to price protection payable if and to the extent that the average trading price of our common stock is less than $0.76 at the time the shares of our common stock issued in the Merger and issuable upon conversion of the Series B Preferred are registered pursuant to the registration rights agreement dated June 1, 2004 between us, the Shareholders and Intuit (the "Registration Rights Agreement"); and (iv) the merger consisted of two steps (the "Merger"), first, Merger Sub merged with and into RTI, Merger Sub's separate corporate existence ceased and RTI continued as the surviving corporation (the "Reverse Merger"), immediately thereafter, RTI merged with and into Merger Sub II, RTI's separate corporate existence ceased and Merger Sub II continued as the surviving corporation (the "Second-Step Merger").

As a result of the Merger, each Shareholder received 1,258,616 shares of Series B Preferred and a promissory note payable monthly over two years in the principal amount of $1,295,000 bearing interest at 6.5% per annum. As a result of the Merger, Intuit, the holder of all of the outstanding shares of RTI's Series A Preferred stock, received 1,546,733 shares of our common stock and a promissory note payable monthly over two years in the principal amount of $530,700 bearing interest at 6.5% per annum.

The Shareholders and Intuit were also granted registration rights. Under the Registration Rights Agreement, we agreed to register the common stock issuable upon conversion of the Series B Preferred issued to the Shareholders within 30 days of the automatic conversion of the Series B Preferred into common stock. The automatic conversion occurred upon us filing an amendment to our certificate of incorporation with the Delaware Secretary of State increasing the authorized number of shares of our common stock ("Certificate of Amendment"). The Shareholders and Intuit are entitled to price protection payments of up to a maximum of $0.23 per share payable by promissory note, if and to the extent that the average closing price of our common stock for the 10 days immediately preceding the date the registration statement covering their shares is declared effective by the Securities and Exchange Commission, is less than the 10 day average closing price as of June 1, 2004, which was $0.76. We have not recorded the liability relating to the price protection at the date of acquisition as the contingency is based on future events and cannot yet be determined. We will compute the total liability as soon as it can be determined and recorded as a liability. The total cost of the price protection contingency will be deferred and amortized over the shortest of the remaining useful lives of the assets acquired in the acquisition in accordance with SFAS 141, "Business Combinations".

Upon the consummation of the Merger, Michael Tomczak, RTI's former President and Chief Executive Officer, was appointed our President, Chief Operating Officer and director and Jeffrey Boone, RTI's former Chief Technology Officer, was appointed our Chief Technology Officer. We entered into two-year employment agreements and non-competition agreements with Mr. Tomczak and Mr. Boone.

We entered into an employment agreement with Michael Tomczak on June 1, 2004. The term of the agreement is two years. Under the agreement, Mr. Tomczak is entitled to $360,000 in annual compensation. He also received an option to purchase 1,772,354 shares of our common stock. Mr. Tomczak's right to purchase 886,178 of the shares subject to the option shall vest at the first anniversary date of this agreement, thereafter, the remaining option shall vest at the rate of 73,848 shares per month during the second year of this agreement. If Mr. Tomczak's employment with us is terminated without cause during the term of the agreement, he will receive severance in the amount of the lesser of $360,000 or the balance of compensation payable over the remaining term of the agreement, but in no event should the amount be less than $180,000. We also entered into non-competition agreement with Mr. Tomczak, pursuant to which Mr. Tomczak agreed not to engage in any business or activity that in any way competes with us for a period of two years after the termination of his employment with us.

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We entered into an employment agreement with Jeffrey Boone on June 1, 2004. The term of the agreement is two years. Under the agreement, Mr. Boone is entitled to $240,000 in annual compensation. He also received an option to purchase 1,572,354 shares of our common stock. Mr. Boone's right to purchase 786,179 of the shares subject to the option shall vest at the first anniversary date of this agreement, thereafter, the remaining option shall vest at the rate of 65,514 shares per month during the second year of this agreement. If Mr. Boone's employment with us is terminated without cause during the term of the agreement, he will receive severance in the amount of the lesser of $240,000 or the balance of his compensation payable over the remaining term of the agreement, but in no event should the amount be less than $120,000. We also entered into non-competition agreement with Mr. Boone, pursuant to which Mr. Boone agreed not to engage in any business or activity that in any way competes with us for a period of two years after the termination of his employment with us.

The acquisition has been accounted for as a purchase. The results of the operations of RTI have been included in the consolidated financial statements since the date of the acquisition. The excess of purchase price over the fair values of net assets acquired was approximately $11.3 million and has been recorded as goodwill. The fair value of assets acquired and liabilities assumed were as follows (in thousands):

Cash	$ 672
Accounts receivable	1,348
Prepaid expenses	148
Other receivables	212
Property and equipment	496
Non-compete agreement	29
Software technology	1,410
Customer relationship	1,660
Trademark	800
Capital lease obligation	(11)
Accounts payable and accrued expenses	(1,644)
Deferred revenue	(2,689)

Income tax payable	(127)
Notes due to stockholders	(200)
Notes payable	(1,789)
Net assets	315
Excess of cost over fair value of net assets acquired	11,332
Total purchase price	$ 11,647

The following unaudited pro forma consolidated results for the three and six months ended September 30, 2004 and 2003 assume the acquisitions of RTI occurred as of April 1, 2004 and 2003, respectively, and Page Digital occurred as of April 1, 2003. The pro forma results are not necessarily indicative of the actual results that would have occurred had the acquisitions been completed as of the beginning of the period presented, nor are they necessarily indicative of future consolidated results.

	Three Months Ended		Six Months End	
	September 30, 2004	September 30, 2003	September 30, 2004	Sep
Revenues	$ 6,683	$ 6,488	$ 13,359	$
Net loss	$ (5,483)	$ (4,793)	$ (10,011)	$
Net loss available to common stockholders	$ (5,777)	$ (5,075)	$ (10,591)	$
Basic and diluted loss per share of common stock	$ (0.10)	$ (0.14)	$ (0.18)	$
Basic and diluted loss per share available to common stockholders	$ (0.10)	$ (0.15)	$ (0.19)	$

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NOTE 3 - NOTE RECEIVABLE

Effective April 1, 2003, we sold our wholly-owned subsidiary, SVI Training Products, Inc. ("Training Products"), to its former president, for the sale price of $180,000 plus earn-out payments equal to 20% of the total gross revenues of Training Products in each of its next two fiscal years, to the extent the revenues in each of those years exceed certain targets. We received a promissory note for the amount of $180,000 and the earn-out payments, if any, will be made in quarterly installments following each fiscal year, bearing an annual interest rate of 5%. We agreed to postpone the payments due January 2004 and April 2004 until April 2008. The note has a balance of $153,000 and $162,000 at September 30, 2004 and March 31, 2004, respectively, of which $36,000 is current.

NOTE 4 - INVENTORIES

Inventories consist of finished goods and are stated at the lower of cost or market, on a first-in, first-out basis.

NOTE 5 - GOODWILL AND OTHER INTANGIBLES

At September 30, 2004 and March 31, 2004, goodwill and other intangibles consist of the following (in thousands):

	SEPTEMBER 30, 2004			MARCH 31, 20	
	Gross carrying amount	Accumulated amortization	Net	Gross carrying amount	Accumulated amortizatio
Goodwill	$ 38,431	$ (6,492)	$ 31,939	$ 27,099	$ (6,49
Other intangibles:					
Amortized intangible assets					
Software technology	32,071	(14,917)	17,154	30,357	(13,21
Non-compete agreements	7,014	(6,704)	310	6,986	(6,31
Customer relationships	2,564	(176)	2,388	904	(3
Unamortized intangible:					
Trademark	1,085	--	1,085	285	-
	42,734	(21,797)	20,937	38,532	(19,56
Less: current portion of non-compete agreements	310	--	310	668	-
Long-term portion of other Intangibles	42,424	(21,797)	20,627	37,864	(19,56
Long-term portion of goodwill and other intangibles	$ 80,855	$ (28,289)	$ 52,566	$ 64,963	$ (26,05

During the six months ended September 30, 2004, we recorded approximately $11.3 million in goodwill, $1.4 million in software, $1.7 million in customer relationships, $800,000 in trademarks and $29,000 in a non-compete agreement in connection with the acquisition of RTI (see Note 2). In addition, we recorded $97,000 and $357,000 million in capitalized software during the three and six months ended September 30, 2004, respectively. Software and customer relationships are amortized on a straight-line basis over their useful lives, seven and ten years, respectively. The goodwill and the trademark have indefinite useful lives and are not subject to amortization. The non-compete agreement is being amortized its remaining useful life of seven months.

Transactions in goodwill during the six months ended September 30, 2004 and fiscal year ended March 31, 2004 are as follows (in thousands):

	September 30, 2004	March 31, 2004
Cost:		
Beginning balance	$ 27,099	$ 21,287
Goodwill from acquisition of RTI and Page Digital, respectively	11,332	5,812
Ending balance	$ 38,431	$ 27,099

Accumulated amortization	$ 6,492	$ 6,492

We found no indication of impairment of the goodwill during the six months ended September 30, 2004. Accordingly, absent of future indications of impairment, the next annual impairment test will be performed in fourth quarter of fiscal 2005.

We also evaluated the remaining useful lives of our intangible assets in the quarter ended June 30, 2004 and during the fourth quarter 2004. No adjustments have been made to the useful lives of our intangible assets.

Amortization expense for the three months ended September 30, 2004 and 2003 was $1.2 million and $0.8 million, respectively. Amortization expense for six months ended September 30, 2004 and 2003 was $2.3 million and $1.7 million. We expect amortization expense for the next five fiscal years to be as follows (in thousands):

March 31,	
2005	$ 2,376
2006	$ 4,047
2007	$ 3,792
2008	$ 3,760
2009	$ 3,613

NOTE 6 - DEBTS

NOTES PAYABLE TO RELATED PARTIES

In connection with the RTI acquisition, we issued promissory notes to RTI's two principal officers totaling $2.6 million, payable in installments totaling $20,000 per month for the period of June 1, 2004 through May 1, 2005 and increasing to $200,000 per month from June 1, 2005 through June 1, 2006, at 6.5% interest per annum. The notes have a balance of $2.5 million as of September 30, 2004, of which $982,000 is current. There were no notes payable due to related parties at March 31, 2004.

NOTES PAYABLE

In connection with the acquisition of RTI, we issued a promissory note to Intuit and assumed RTI's obligations totaling $1,789,000 under certain promissory notes originally issued by RTI and additional notes totaling $500,000 to the existing note holders of RTI. Notes payable consisted of the following (in thousands):

	September 30, 2004
Notes payable, secured by common stock of our new subsidiary, IP Retail Technologies International, Inc. ("IP RTI"), payable in monthly installments totaling $197,000 including interest at 6.5% per annum beginning May 31, 2004 through May 31, 2005	$ 1,542
Note payable, to Intuit, secured by IP RTI's common stock, payable in	

monthly installments of $4,000 for the period from June 1, 2004 through December 1, 2004 and $30,000 from January 1, 2005 through June 1, 2006, including interest at 6.5% per annum	522
Total notes payable	$ 2,064
Total notes payable (including accrued interest)	$ 2,064
Less: current maturities	1,798
Long-term portion of notes payable	$ 266

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CONVERTIBLE DEBENTURES

Convertible debentures at September 30, 2004 and March 31, 2004 consist of the following (in thousands):

	September 30, 2004
Convertible note, secured by all of our assets, interest rate of prime plus two percent per annum and matures in July 2007	$ 7,038
Convertible debentures, interest rate of 9% per annum and mature in May 2006	1,209
Total	8,247
Less: debt discount	1,794
	$ 6,453
Total convertible debentures (including accrued interest), net of debt discount	$ 6,453
Less: current maturities	2,294
Long-term portion of convertible debentures	$ 4,159

Pursuant to a Securities Purchase Agreement dated July 12, 2004, we sold and issued to Laurus Master Fund, Ltd. ("Laurus") a secured convertible term note ("Laurus Note") for gross proceeds of $7.0 million. In addition, we issued to Laurus a warrant to purchase up to 3,750,000 shares of our common stock at a price of $0.71 per share ("Laurus Warrant"). Our obligations under the Laurus Note are secured by all of our assets. All our wholly owned subsidiaries guaranteed our obligations under the Laurus Note. We also pledged all of our interests in the outstanding stock of our subsidiaries as security for our obligations under the Laurus Note.

The Laurus Note would have originally matured on September 1, 2004; however, the maturity of the Laurus Note was automatically extended to July 12, 2007 ("Maturity Date") upon the stockholders approving an amendment to our Certificate of Amendment to increase our authorized share capital limit to 250 million shares and us filing an amendment to our Certificate of Amendment to effect the increase with the Secretary of State of Delaware by August 31, 2004.

We would have been obligated to make monthly payments in the amount of $212,000 plus any unpaid interest commencing on August 1, 2004. In August 2004, Laurus agreed to defer the August 1, 2004 payment until the Maturity Date.

In October 2004, Laurus agreed to amend the Laurus Note and defer the payments due in September 2004 through February 2005 until the Maturity Date. Pursuant to the amendment, we are required to make monthly payments in the amount of $212,121 commencing on March 1, 2005 with a balloon payment of $1.1 million in July 2007. We also issued Laurus a warrant to purchase 250,000 shares of our common stock at a price of $0.41 per share ("October `04 Laurus Warrant").

The Laurus Note accrues interest at a rate per annum (the "Interest Rate") equal to the "prime rate" (4.75% as of October 31, 2004) published in The Wall Street Journal from time to time, plus two percent. Interest under the Laurus Note is payable monthly in arrears commencing on August 1, 2004. The Interest Rate is calculated on the last day of each month (the "Determination Date") and is subject to adjustment as follows: (1) if the shares issuable upon conversion of the Laurus Note or exercise of the Laurus Warrant have been registered with the U.S. Securities and Exchange Commission ("SEC") under the Securities Act of 1933, as amended (the "Securities Act") and the market price of our common stock for the five trading days immediately preceding the Determination Date exceeds the then applicable conversion price for the Laurus Note by at least 25%, then the Interest Rate for the succeeding calendar month shall be reduced by 2% for each incremental 25% increase over the then applicable conversion price or (2) if all of the conditions set forth in subparagraph (1) have been satisfied, except that the shares issuable upon conversion of the Laurus Note or exercise of Warrant have not been registered, then the Interest Rate for the succeeding calendar month shall be reduced by 1% for each incremental 25% increase over the then applicable conversion price. The initial conversion price under the Laurus Note is $0.56 per share, subject to adjustment upon our issuance of securities at a price per share below the fixed conversion price, a stock split or combination, declaration of a dividend on our common stock or reclassification of our common stock. We have the option to redeem the Laurus Note by paying Laurus 125% of the principal amount due under the Laurus Note together with all accrued and unpaid interest. Pursuant to the Amendment No. 1 to the Laurus Note, the conversion price for $2.0 million of the $7.0 million Laurus Note was reduced to $0.37 per share.

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The Laurus Warrant and October `04 Laurus Warrant (collectively "Laurus Warrants") are immediately exercisable and have a seven year term. We have the right to require exercise of the Laurus Warrants in whole or in part if: (1) all of our obligations under the Laurus Note have been irrevocably paid in full, (2) the common stock underlying the Laurus Warrants has been registered on a registration statement declared effective by the SEC, and such registration statement remains effective, and (3) the average closing price of our common stock for the ten (10) trading days immediately prior to the proposed date of the mandatory exercise of the Laurus Warrants is greater than three hundred percent (300%) of the then applicable exercise price.

We were obligated to file a registration statement on Form S-3 (or if Form S-3 is not available another appropriate form) (the "Registration Statement") registering the shares of our common stock issuable upon conversion of the Laurus Note or exercise of the Laurus Warrants (the "Underlying Shares") pursuant to the Registration Rights Agreement between us and Laurus (the "Registration Rights Agreement"). We filed the Registration Statement on September 10, 2004 (the "Filing Date") and we are required to have the Registration Statement declared effective by the SEC no later than 120 days after it is filed (the "Effectiveness Date"). If the Registration Statement is not declared effective by the Effectiveness Date, ceases to be effective for more than 30 days in any calendar year or 10 consecutive calendar days or if our common stock is not listed or traded or is suspended from trading for three consecutive trading days, we are required to pay Laurus liquidated damages equal to 2% of original principal balance on the Laurus Note for each 30 day period (with partial periods prorated) that such event continues. We are obligated to keep the Registration Statement effective until the earlier of when (1) all of the Underlying Shares have been sold or (2) such time as all of the Underlying Shares can be sold without registration or volume restrictions under Rule 144(k) of the Securities Act (the "Effectiveness Period"). If there is not an effective Registration Statement covering the Underlying Shares at any time during the Effectiveness Period and we propose to file a registration statement for our own account or the account of others, we will be obligated to include the Underlying Shares on that registration statement.

In accordance with generally accepted accounting principles, the difference between the original conversion price of $0.56 and our stock price on the date of issuance of the Laurus Note amounted to $281,000 and is being amortized over the term of the Laurus Note. We amortized $20,000 in the three and six months ended September 30, 2004.

We allocated the proceeds received from the Laurus Note with a detachable warrant using the relative fair market value of the individual elements at the time of issuance. The amount allocated to the warrant was $531,000 and is being amortized as interest expense over the life of the Laurus Note. We amortized $37,000 in the three and six months ended September 30, 2004.

In connection with the amendment in October 2004, we will compute the difference between the conversion price of $0.37 for the first $2.0 million of the Laurus Note and our stock price on the date of issuance of the Laurus Note and will amortize the difference over the remaining term of the Laurus Note.

In connection with the sale of $7.0 million Laurus Note, we had adjusted the exercise price of outstanding warrants previously issued to certain investors to $0.56 per share pursuant to the anti-dilution protection provision. Accordingly, we recorded a charge of $254,000 as interest expense in the quarter ended September 30, 2004.

In March 2004, we entered into a Securities Purchase Agreement for the sale of convertible debentures (the "March '04 Debenture") to Omicron Master Trust ("Omicron") for gross proceeds of $1.75 million ("Omicron Debenture") and Midsumer Investments, Ltd. ("Midsummer") for gross proceeds of $1.25 million ("Midsummer Debenture"). The debentures would have matured in May 2006, bore an interest rate of 9% per annum and provided for interest only payments on a quarterly basis, payable, at our option, in cash or shares of our common stock. The debentures would have been convertible into shares of our common stock at a conversion price of $1.32 per share, subject to adjustment if we offered or sold any securities for an effective per share price that was less than 87% of the then current conversion price, negatively restated any of our financial statements or made any public disclosures that negatively revised or supplemented any prior disclosure regarding a material transaction consummated prior to March 15, 2004 or triggered other customary anti-dilution protections. If certain conditions were met, we would have the option to redeem the March '04

Debentures at 110% of their face value, plus accrued but unpaid interest.

We would have been obligated to redeem the Omicron Debenture and Midsummer Debenture at the initial monthly amounts of $136,110 and $97,223, respectively, commencing on February 1, 2005. If the daily volume weighted average price of our common stock on the American Stock Exchange exceeded $1.15 by more than 200% for 15 consecutive trading days, we would have the option to cause the Purchasers to convert the then outstanding principal amount of March '04 debentures into our common stock at the conversion price then in effect.

With the proceeds from the sale of the Laurus Note in July 2004 for $7.0 million as discussed above, we paid off in full the Omicron Debenture with a balance of $1.75 million plus $0.2 million in accrued interest, liquidated damages and prepayment penalty.

In accordance with generally accepted accounting principles, the difference between the original conversion price of $1.32 and our stock price of the date of issuance of the Omicron Debenture amounted to $155,000 and was being amortized over the term of the debt. A total of $21,000 had been amortized during the period from the date of issuance to the date the debt was repaid. Upon repayment of the debt, the remaining balance of $134,000 was expensed.

On July 30, 2004, we also amended the Midsummer Debenture. Pursuant to the amendment agreement, we issued 600,000 shares of common stock which we valued at $240,000 to Midsummer as payment in liquidated damages and as consideration for Midsummer consenting to the sale of the $7.0 million Laurus Note.

The amended Midsummer Debenture matures in May 2006 and bears an interest rate of 9% per annum. Interest only payments, payable, at our option, in cash or shares of common stock, are payable on a monthly basis. The amended Midsummer Debenture is convertible into shares of our common stock at a conversion price of $0.56 per share, subject to adjustment if we offer or sell any securities for an effective per share price that is less than 87% of the then current conversion price, negatively restate any of our financial statement or make any public disclosure that negatively restate any of our financial statement or make any public disclosure that negatively revises or supplements any prior disclosure regarding a material transaction consummated prior to March 15, 2004 or trigger other customary anti-dilution protections. If certain conditions are met, we have the option to redeem the amended Midsummer Debenture at 100% of its face value, plus accrued but unpaid interest. Triggering events have occurred and we are currently in discussions with Midsummer concerning an adjustment of the current conversion price.

We must redeem the amended Midsummer Debenture at the initial monthly amount of $50,000 which commenced on September 1, 2004 and increases to $62,500 starting February 1, 2005. If the daily volume weighted average price of our common stock on the American Stock Exchange exceeds the then current conversion price by more than 200% for 15 consecutive trading days, we have the option to cause Midsummer to convert the then outstanding principal amount of amended Midsummer Debenture into our common stock at the conversion price then in effect.

In accordance with generally accepted accounting principles, the difference between the original conversion price of $1.32 and our stock price of the date of issuance of the Midsummer Debenture amounted to $110,000 and was being amortized over the term of the debt. Upon amending the debt, we computed the difference between the amended conversion price of $0.56 and out stock price of

the date of issuance. We recorded an additional maximum charge of $785,000 and will amortize it over the remaining term of the debt. We had amortized $115,000 and $128,000 in the three and six months ended September 30, 2004.

We also issued Omicron and Midsummer two warrants as follows: (1) Series A Warrants to purchase up to an aggregate of 1,043,479 shares of our common stock at an exercise price of $1.32 per share, which was adjusted to $0.56 in July 2004 as a result of the sale of $7.0 Laurus Note, with a five-year term, exercisable at anytime after September 16, 2004, subject to adjustment if we offer or sell any securities for an effective per share price that is less than the then current exercise price, negatively restate any of our financial statements or make any public disclosure that negatively revises or supplements any prior disclosure regarding a material transaction consummated prior to March 15, 2004 or trigger other customary anti-dilution protections and (2) Series B Warrants to purchase up to 8,500,000 shares of our common stock with an exercise price of $5 per share, these warrants are immediately exercisable and expire on the earlier of the six-month anniversary of the effective date of the registration statement that is required to be filed or 18 months from March 15, 2004, subject to adjustment upon the issuance or sale of securities in a public offering for an effective per share price that is less than the then-current exercise price and upon the trigger of other customary anti-dilution protections.

For a period of one hundred eighty (180) days following the date the registration statement is declared effective ("Effective Date"), each Purchaser has the right, in its sole discretion, to elect to purchase such Purchaser's pro rata portion of additional Debentures and Series A Warrants for an aggregate purchase price of up to $2,000,000 in a second closing (the "Second Closing"). The terms of the Second Closing shall be identical to the terms set forth in the Purchase Agreement and related documents, except that, the conversion price for the additional debentures and the exercise price for the additional warrants shall be equal to 115% of the average of the daily volume weighted average price of our common stock on the American Stock Exchange for the ten (10) days preceding the Second Closing ("Second Closing Price"). The Series A Warrant coverage for the Second Closing shall be 40% of each Purchaser's subscription amount divided by the Second Closing Price.

For a period of one hundred eighty (180) days following the Effective Date, if the daily volume weighted average price of our common stock for twenty (20) consecutive trading days exceeds $2.00, subject to adjustment, we may, on one occasion, in our sole determination, require the Purchasers to purchase each such Purchaser's pro rata portion of additional debentures and Series A Warrants for an aggregate purchase price of up to $2,000,000. Any such additional investment shall be under the terms set forth in the Purchase Agreement and related documents, except that, the conversion price for the additional Debentures and the exercise price for the additional warrants shall be equal to the then current conversion price and warrant exercise price for the 9% Debentures and warrants purchased on March 15, 2004.

For a period of six (6) months from the Effective Date, the Purchasers have a right of first refusal to participate in certain future financings by us involving the sale of our common stock or equivalent securities. The Purchasers were also granted registration rights under a Registration Rights Agreement dated March 15, 2004, pursuant to which we were required to file a registration statement respecting the common stock issuable upon the conversion of the debentures and exercise of the warrants within thirty (30) days after March 15,

2004, and to use best efforts to have the registration statement declared effective at the earliest date. If a registration statement was not filed within such thirty (30) day period or declared effective within such ninety (90) day period (or within one hundred twenty (120) days in the event of a full review by the SEC), we became obligated to pay liquidated damages to the Purchasers equal to 2% per month of each such Purchasers' subscription amount under the Purchase Agreement plus the value of any warrants issued pursuant to the Purchase Agreement then held by such Purchaser. The registration statement was filed on August 24, 2004, but it has not been declared effective as of November 15, 2004. As a result, liquidated damages in the amounts of $81,000 and $120,000 have been recorded in the six months ended September 30, 2004 and the fiscal year ended March 31, 2004, respectively. Outstanding liquidated damages totaling $201,000 were paid in July 2004.

We allocated the proceeds received from convertible debt with detachable warrants using the relative fair market value of the individual elements at the time of issuance and amortize the change over the term of the debt. The amount allocated to the warrants issued to Omicron was $420,000. A total of $57,000 had been amortized during the period from the issuance to the date the note was repaid. Upon repayment of the Omicron Debenture, the remaining balance of $363,000 was expensed. As a result of adjusting the exercise price of Omicron's warrant to $0.56, we also recorded a charge of $112,000 as interest expense in the quarter ended September 30, 2004.

The amount allocated to the warrants issued to Midsummer was originally $300,000. Upon amending the Midsummer Debenture, we recomputed the amount allocated warrants and recorded an additional maximum charge of $54,000. The additional charge is being amortized over the remaining term of the debt. We amortized $42,000 and $76,000 in the three and six months ended September 30, 2004, respectively.

NOTE 7 - CAPITAL LEASES

In connection with the acquisition of Page Digital, we assumed capital lease obligations on certain office equipment and fixtures leases expiring from November 2004 through November 2006. The capital leases bear interest at rates between 7% and 11% per annum and monthly lease payments range between approximately $1,000 to $8,000.

In connection with the acquisition of RTI, we assumed a capital lease obligation for certain office equipment, expiring in February 2006. The capital lease bears interest at a rate of approximately 11% per annum and monthly lease payments of approximately $600.

The balance of capital leases is $187,000 and $258,000 at September 30, 2004 and March 31, 2004, respectively, of which the current portion is $169,000.

NOTE 8 - LINE OF CREDIT

In connection with the acquisition of RTI, we assumed obligation under a line of credit with a balance of $182,000 at June 30, 2004. The line of credit was paid off in full in July 2004.

NOTE 9 - DEFERRED REVENUE

Deferred revenue at September 30, 2004 and March 31, 2004 consists of the

following (in thousands):

	June 30, 2004	March 31, 2004
Prepaid support services	$ 5,040	$ 2,528
Customer deposits	518	129
Total	5,558	2,657
Long-term portion	873	--
Current portion	$ 4,685	$ 2,657

NOTE 10 - PREFERRED STOCK

The Series A Convertible Preferred Stock (the "Series A Preferred") has a stated value of $100 per share and is redeemed at our option any time prior to the maturity date of December 31, 2006 for 107% of the stated value and accrued and unpaid dividends. The preferred shares are entitled to cumulative dividends of 7.2% per annum, payable semi-annually, and have cumulative dividends of $2.6 million, or $18.31 per share, and $2.0 million, or $14.19 per share, at September 30, 2004 and March 31, 2004, respectively. The holders may convert each share of Series A Preferred at any time into the number of shares of our common stock determined by dividing the stated value plus all accrued and unpaid dividends, by a conversion price initially equal to $0.80. The conversion price increases at an annual rate of 3.5% calculated on a semi-annual basis. The conversion price as of July 1, 2004 is $0.87. The Series A Preferred is entitled upon liquidation to an amount equal to its stated value plus accrued and unpaid dividends in preference to any distributions to common stockholders. The Series A Preferred has no voting rights prior to conversion into common stock, except with respect to proposed impairments of the Series A Preferred rights and preferences, or as provided by law. We have the right of first refusal to purchase all but not less than all of any shares of Series A Preferred or shares of common stock received on conversion which the holder may propose to sell to a third party, upon the same price and terms as the proposed sale to a third party.

On November 14, 2003, the Sage Group plc (the "Sage Group") acquired substantially all the assets of Softline, including Softline's 141,000 shares of our Series A Preferred, 8,923,915 shares of our common stock and options to purchase 71,812 shares of our common stock. On September 17, 2003, 500,000 shares of common stock constituting accrued dividends on our Series A Preferred were issued to various financial institutions.

The Series B Convertible Preferred Stock (the "Series B Preferred") had no stated value and was entitled to cumulative dividends at the rate of $0.136 per share per annum, payable annually commencing on January 1, 2005. Upon our filing of an amendment to our Certificate of Incorporation increasing the number of shares of common stock in August 2004, all Series B Preferred was converted into 7,551,696 shares of common stock. No dividends had been declared.

NOTE 11 - EQUITY TRANSACTIONS

During the quarter ended September 30, 2004, we had the following equity transactions:

- Issued 600,000 shares of common stock, with a fair value of $240,000, to Midsummer as payment for liquidated damages and as consideration for its consent to the sale of the Laurus Note,
- Issued an aggregate of 7,551,696 shares of common stock, with a fair value of $5,709,000, to Michael Tomczak, our President and COO, and

Jeffrey Boone, our CTO, upon conversion of all of 2,517,232 shares of Series B Preferred Stock,

- Granted Laurus a warrant to purchase up to 3,750,000 shares of our common stock at an exercise price of $0.71 in connection with the sale of the Laurus Note,
- Granted incentive stock options to employees to purchase an aggregate of 3,340,000 shares of common stock at exercise prices ranging from $0.38 to $0.48,
- Granted a consultant a warrant to purchase up to 220,000 shares of common stock at an exercise price of $0.50 per share, with a fair value of $37,000, for public relation services, and
- Granted options to purchase an aggregate of 102,500 shares of common stock at an exercise price of $0.44 to outside directors of the Board as directors' fees for the quarter ended September 30, 2004.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148 ("SFAS 148"), "Accounting for Stock-Based Compensation-Transition and Disclosure." This Statement amends SFAS 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

The following table presents pro forma disclosures required by SFAS 123 and SFAS 148 of net loss and basic and diluted loss per share as if stock-based employee compensation had been recognized during the six months ended September 30, 2004 and 2003. The compensation expense for these periods has been determined under the fair value method using the Black-Scholes pricing model, and assumes graded vesting.

	Six Months Ended September 30,	
	2004	2003
	(in thousands, except per share amounts) (unaudited)	
Net loss as reported	$ (9,079)	$ (4,191)
Less: stock-based compensation expense, net of related tax effects	(1,005)	(1,081)
Pro forma net loss	$(10,084)	$ (5,272)
Basic and diluted earnings (loss) per share - as reported	$ (0.16)	$ (0.13)
Basic and diluted earnings (loss) per share - pro forma	$ (0.18)	$ (0.16)

NOTE 12 - EARNINGS (LOSS) PER SHARE

Basic loss per common share are calculated by dividing net loss by the weighted average number of common shares outstanding during the reporting period. Diluted

earnings per common shares ("diluted EPS") reflect the potential dilutive effect, determined by the treasury method, of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. Earnings per share for the three and six months ended September 30, 2004 and 2003 is calculated as follows (in thousands):

	Three months ended September 30, 2004	Three months ended September 30, 2003	Six months ended September 30, 2004	Six months ended September 30, 2003
Net loss available to common stockholders	$ (5,777)	$ (4,777)	$ (9,659)	$ (4,745)
Basic and diluted weighted average shares	57,432	34,417	55,197	33,264
Basic and diluted loss per share	$ (0.10)	$ (0.14)	$ (0.17)	$ (0.14)

The following potential common shares have been excluded from the computation of diluted net loss per share for the six months ended September 30, 2004 and 2003, because the effect would have been anti-dilutive:

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003
Outstanding options under our stock option plans	8,609,547	4,866,240
Outstanding options granted outside our stock option plans	8,182,274	5,054,312
Warrants issued in conjunction with private placements and financing	17,098,760	6,330,281
Warrants issued for services rendered	1,451,898	748,169
Series A Convertible Preferred Stock	19,124,693	18,444,424
Convertible debt	14,642,857	2,723,214
Total	69,110,029	38,166,640

NOTE 13 - RESTRUCTURING CHARGE

We recorded a $681,000 restructuring charge in the quarter ended September 30, 2004 for one-time termination benefits related to workforce reduction of nine full-time employees including 3 executive officers, 2 in sales and 4 in administrative functions in the Americas. The termination benefits include severance payments and benefits. All workforce reductions associated with this charge were made on or before September 30, 2004. A summary of the restructuring charge included in accrued expenses at September 30, 2004 is as follows (in thousands):

Initial reserve	$ 681
Paid	(320)

Balance	$ 361

$156,000 of the remaining balance will be paid in the third quarter of 2005, $47,000 each in the fourth quarter of 2005 and the first through third quarter of 2006 and $17,000 in the fourth quarter of 2006.

NOTE 14 - BUSINESS SEGMENTS AND GEOGRAPHIC DATA

We are a provider of software solutions and services to the retail industry. Our solutions and services have been developed specifically to meet the needs of the retail industry. We provide high value innovative solutions that help retailers understand, create, manage and fulfill consumer demand. Our solutions help retailers improve the efficiency and effectiveness of their operations and build stronger, longer lasting relationships with their customers. We acquired Page Digital, which offers multi-channel retail solutions, on January 31, 2004 and RTI, which offers point-of-sale and inventory management solutions, on June 1, 2004.

We currently operate in the Americas and Europe. On June 1, 2004, we began to operate in Asia. The geographic distribution of our revenues and long-lived assets are as follows (in thousands):

	Three months ended September 30,		Six months ended September 30,	
	2004	2003	2004	2003
Revenues:				
Americas	$ 5,538	$ 2,288	$ 9,770	$ 7,214
Europe	993	491	2,006	1,031
Asia	152	--	190	--
Total revenues	$ 6,683	$ 2,779	$11,966	$ 8,245

	September 30, 2004	March 31, 2004
Long-lived assets:		
Americas	$ 54,119	$ 40,783
Europe	24	30
Total identifiable assets	$ 54,143	$ 40,813

In the three months ended September 30, 2004, revenues from three customers represents 9%, 6% and 2%, respectively, of total revenues. In the six months ended September 30, 2004, revenues from these three customers represents 6%, 4% and 6% of total revenues, and accounts receivable balances at September 30, 2004 from these customers represent 3%, 0% and 10%, respectively, of total accounts receivable. In the three and six months ended September 30, 2003, another customer represents 7% and 18%, respectively, of total revenues and its account receivable balance at September 30, 2003 represents 45% of total accounts receivable.

We structure our operations into three business units that have separate reporting infrastructures. Each unit is evaluated primarily based on total revenues and operation income excluding depreciation and amortization. Identifiable assets are also managed by business units. Our three business units are as follows:

- RETAIL MANAGEMENT SOLUTIONS ("RETAIL MANAGEMENT") - offers suite of applications, which builds on our long history in retail software design and development. We provide our customers with an extremely reliable, widely deployed, comprehensive and fully integrated retail management solutions. Retail Management includes merchandise management that optimizes workflow and provides the highest level of data integrity. This module supports all operational areas of the supply chain including planning, open-to-buy purchase order management, forecasting, warehouse and store receiving distribution, transfers, price management, performance analysis and physical inventory. In addition, Retail Management includes a comprehensive set of tools for analysis and planning, replenishment and

  forecasting, event and promotion management, warehouse, ticketing, financials and sales audit. Through collaborations with strategic partners, Retail Management offers tools for loss prevention, communication with stores and vendors, integration needs, purchase and allocation decisions, analysis of weather impact, control and management of business processes, consumer research, tracking consumer shopping patterns, forecasting and replenishment, and analyzing store people productivity.

- STORE SOLUTIONS - offers suites of applications built on our long history of providing multi-platform, client server in-store solutions. We market these sets of applications under the name "OnePointe," TM and "Retail Pro"(R). With more than 15 years of development, OnePointe TM is a solution with a high degree of fit and value out of the box. Additionally, the software was designed for easy customization, enabling our development team to quickly develop solutions to meet retailers' specific point-of-sale ("POS") and in-store processor (server) requirements. Retail Pro(R) is a leading point-of-sale and inventory management software used by specialty retailers worldwide.

- MULTI-CHANNEL RETAIL SOLUTIONS ("MULTI-CHANNEL RETAIL") - Page Digital designs its application to specifically address direct commerce business processes, which primarily relate to interactions with the end-user. Having developed its software out of necessity to manage its own former direct commerce operation, Page Digital has been extremely attentive to functionality, usability and scalability. Its software components include applications for customer relations management, order management, call centers, fulfillment, data mining and financial management. Specific activities like partial ship orders, payments with multiple tenders, back order notification, returns processing and continuum marketing, represent just a few of the more than 1,000 parameterized direct commerce activities that have been built into its "Synaro"(R) applications. Page Digital makes these components and its interfacing technology available to customers, systems integrators and independent software developers who may modify them to meet their specific needs. This growing base of inherited functionality continues to improve the market relevance of its products.

A summary of the revenues and operating income (loss) and identifiable assets attributable to each of these business units are as follows (in thousands):

	Three months ended September 30, 2004	Three months ended September 30, 2003	Six months ended September 30, 2004	Six months ended September 30, 2003
Revenues:				
Retail Management Solutions	$ 2,063	$ 2,406	$ 5,028	$ 7,470
Store Solutions	2,914	373	4,077	775
Multi-channel Retail	1,706	--	2,861	--
Total revenues	$ 6,683	$ 2,779	$ 11,966	$ 8,245
Operating income (loss):				
Retail Management Solutions	$ (1,375)	$ (1,344)	$ (2,066)	$ (375
Store Solutions	(468)	(415)	(827)	(639
Multi-channel Retail	(207)	--	(721)	-
Other (see below)	(1,348)	(981)	(3,176)	(1,715
Total operating income (loss)	$ (3,398)	$ (2,740)	$ (6,790)	$ (2,729
Other operating loss:				
Depreciation	$ (4)	$ (8)	$ (8)	$ (25
Administrative costs and other non-allocated expenses	(1,344)	(973)	(3,168)	(1,690
Total other operating loss	$ (1,348)	$ (981)	$ (3,176)	$ (1,715

	September 30, 2004	March 31, 2004
Identifiable assets:		
Retail Management Solutions	$ 29,872	$ 32,757
Store Solutions	20,448	3,790
Multi-channel Retail	9,729	10,093
Total identifiable assets	$ 60,049	$ 46,640
Goodwill, net:		
Retail Management Solutions	$ 13,903	$ 13,903
Store Solutions	12,224	892
Multi-channel Retail Solutions	5,812	5,812
Total goodwill, net	$ 31,939	$ 20,607

Operating income (loss) in Retail Management, Store Solutions and Multi-channel Retail includes direct expenses for software licenses, maintenance services,

programming and consulting services, sales and marketing expenses, product development expenses, and direct general and administrative expenses. The "Other" caption includes non-allocated costs and other expenses that are not directly identified with a particular business unit and which we do not consider in evaluating the operating income of the business unit.

During the six months ended September 30, 2004, the Store Solutions business unit acquired $11.3 million goodwill in connection with the acquisition of RTI. There are no changes in goodwill of the Retail Management Solutions and Multi-channel Retail Solutions business units.

In addition, during the three months and six month ended September 30, 2004, we recorded restructuring charges in the amount of $82,000 in Store Solutions, $10,000 in Retail Management, $5,000 in Multi-channel Retail and $584,000 in corporate business units (see Note 13). There were no restructuring charges recorded in the three and six months ended September 30, 2003.

NOTE 15 - COMMITMENTS AND CONTINGENCIES

Effective April 1, 2004, we entered into an agreement with a company ("Newco PTY") 100% wholly-owned by QQQ. We previously purchased capitalized software from QQQ, a company affiliated with the former management of our Australian Subsidiary, which was sold in the third quarter of fiscal 2002. Under this agreement, we granted Newco PTY a three year option to purchase our Store Solutions subsidiary for the existing book value at the time of the option exercise. After three years, the agreement automatically renews, but either party may terminate this agreement with one month's written notice. Until the option is exercised, the profit and losses of Newco shall be split as follows: For profit, 50%/50% for the twelve months ended March 31, 2005, 60%/40% (Newco PTY/Island Pacific) for the twelve months ended March 31, 2006 and 70%/30% (Newco PTY/Island Pacific) for the twelve months ended April 1, 2007. Newco PTY may exercise its option at anytime with thirty day written notice. Island Pacific shall bear all losses of Newco until September 30, 2004 and then split any further losses 50/50 for the six months to March 31, 2005, 60/40 (Newco PTY/Island Pacific) for the twelve months ended March 31, 2005 and 70/30 (Newco PTY/Island Pacific) for the twelve months ended April 1, 2007. As of September 30, 2004, we have incurred Newco's total losses of $56,000. As of September 30, 2004, the book value of the Store Solutions subsidiary was approximately $2.2 million.

We decided in the third quarter of fiscal 2002 to sell certain assets of our Australian subsidiary to the former management of such subsidiary, and then cease Australian operations. Such sale was, however, subject to the approval of National Australia Bank, the subsidiary's secured lender. The bank did not approve the sale and the subsidiary ceased operations in February 2002. The bank caused a receiver to be appointed in February 2002 to sell substantially all of the assets of the Australian subsidiary and pursue collections on any outstanding receivables. The receiver proceeded to sell substantially all of the assets for $300,000 in May 2002 to an entity affiliated with the former management, and actively pursued the collection of receivables. If the sale proceeds plus collections on receivables had been insufficient to discharge the indebtedness to National Australia Bank, we might have been called upon to pay the deficiency under our guarantee to the bank. At March 31, 2004 we accrued $187,000 as the maximum amount of our potential exposure. In June 2004, we settled this obligation by paying $69,000 to the bank. As a result, the $118,000 accrual in excess of settlement amount was written off to the consolidated

statement of operations as other income in the quarter ended June 30, 2004.

On May 15, 2002, an employee who was out on disability/worker's compensation leave, Debora Hintz, filed a claim with the California Labor Commissioner seeking $41,000 in alleged unpaid commissions. On or about December of 2002, Ms. Hintz filed a discrimination claim against us with the Department of Fair Employment and Housing, alleging harassment and sexual orientation discrimination. We had responded appropriately to both the wage claim and the discrimination allegations, which we believed lack merit based on present information. On December 1, 2003, the Department of Fair Housing and Employment closed the case on the basis of no probable cause to prove violation of statue, and gave notice of right to sue. In January 2004, we terminated Ms. Hintz's employment with us and, as a result, her medical insurance was terminated. On February 12, 2004, Ms. Hintz filed a petition for violation of Labor Code Section 132(a) before the Workers' Compensation Appeals Board of the State of California.

On November 22, 2002, we and Sabica Ventures, Inc. ("Sabica", our wholly-owned subsidiary), were sued in a matter entitled Stemley vs. Shea Homes, Inc. et. al. in San Diego Superior Court Case No. GIC 787680, as Pacific Cabinets. The case dealt with alleged construction defects. Pacific Cabinets was dismissed from the litigation for a waiver of fees and costs. At this time, neither we nor Pacific Cabinets are parties to this action. Because no significant discovery was done, it is not possible at this time to provide an evaluation of potential exposure, though it appears highly unlikely that Pacific Cabinets or we would be brought back into this suit.

On April 2, 2004, we filed a federal court action in the Southern District of California against 5R Online, Inc., John Frabasile, Randy Pagnotta, our former officers, and Terry Buckley for fraud, breach of fiduciary duty, breach of contract, and unfair business practice arising from their evaluation of, recommendation for, and ultimately engagement in a development arrangement between IPI and 5R. Pursuant to the development agreement entered into in June 2003 and upon reliance of the representations of the individual defendants that product development was progressing, we paid and expensed $640,000 in development payments in the fiscal year ended March 31, 2004 but received no product. The amount in controversy is the $640,000 development payments as well as a claim for punitive damages. Defendants Pagnotta and Buckley have counterclaimed against defendant Frabasile, who has moved to dismiss in light of a parallel action pending in Canada. Frabasile's and 5R Online, Inc.'s response to IPI's complaint was due on August 9, 2004. Settlement negotiations are currently underway.

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RTI was named as a cross-defendant in an action by General Electric Capital Corporation as plaintiff ("GE Capital"), against San Francisco City Stores LLC, dated May 10, 2004. The cross-complaint filed on behalf of San Francisco City Stores names GE Capital, Big Hairy Dog Information Systems, and RTI as cross-defendants, claiming breach of warranty and unfair competition (against RTI), and makes various other claims against GE Capital and Big Hairy Dog Information Systems. The claim is for approximately $83,000. However, we believe the claims made against RTI are without merit and we intend to vigorously defend them.

Certain of our standard software license agreements contain a limited infringement indemnity clause under which we agree to indemnify and hold harmless our customers and business partners against certain liability and

damages arising from claims of various copyright or other intellectual property infringement by our products. These terms constitute a form of guarantee that is subject to the disclosure requirements, but not the initial recognition or measurement provisions of Financial Accounting Standards Board issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of the Indebtedness of others." We have never lost an infringement claim and our cost to defend such lawsuits have been insignificant. Although it is possible that in the future third parties may claim that our current or potential future software solutions infringe on their intellectual property, we do not currently expect a significant impact on our business, operating results or financial condition.

Except as set forth above, we are not involved in any material legal proceedings, other than ordinary routine litigation proceedings incidental to our business, none of which are expected to have a material adverse effect on our financial position or results of operations. However, litigation is subject to inherent uncertainties, and an adverse result in existing or other matters may arise from time to time which may harm our business.

NOTE 16 - RELATED-PARTY TRANSACTIONS

Included in other receivables at September 30, 2004 and March 31, 2004 are amounts due from our officers and employees in the amount of $14,000 and $37,000, respectively.

In connection with the Page Digital acquisition, we assumed a three-party lease agreement for our Colorado offices between CAH Investments, LLC ("CAH"), wholly owned by the spouse of one of our former executive officers, Larry Page, and Southfield Crestone, LLC, whereby Page Digital agreed to lease offices for ten years expiring on December 31, 2013. CAH and Southfield Crestone LLC are equal owners of the leased property. Rent expense related to this lease is $200,000 and $0 for the three months ended September 30, 2004 and 2003, respectively, and $400,000 and $0 for the six months ended September 30, 2004 and 2003, respectively. A security deposit of $170,000 relating to this lease is included in other long-term assets at September 30, 2004 and March 31, 2004.

We retained our former CEO and Chairman of the Board, Barry Schechter, to provide consulting services starting August 2003. For three months ended September 30, 2004 and 2003, the expense for this service was $108,000 and $0, respectively. For the six months ended September 30, 2004 and 2003, the expense for this service was $219,000 and $108,000, respectively.

In fiscal 2004, we retained an entity owned by an immediate family member of our former CEO and Chairman, Harvey Braun, to provide recruiting and marketing services. For the three months ended September 30, 2004 and 2003, the expense for this service was $0 and $98,000, respectively. For the six months ended September 30, 2004 and 2003, the expense for this service was $0 and $108,000, respectively.

In May 2004, Mr. Braun resigned from his position as Chief Executive Officer. Subsequent to September 30, 2004, we entered into a severance and separation agreement with Mr. Braun. Pursuant to this agreement, we agreed to pay Mr. Braun a total of $192,000 with $96,000 payable on October 28, 2004 and the remaining $96,000 payable on November 28, 2004. In addition, Mr. Braun agreed to forfeit an option for 500,000 shares. We accrued a severance payment of $192,000 in the six months ended September 30, 2004 and included in accrued expenses at September 30, 2004. As of November 10, 2004, the outstanding balance is $192,000.

Effective as of July 14, 2004, Steven Beck resigned from our board of directors and effective July 29, 2004, Mr. Beck resigned from his position as executive officer. On July 29, 2004, we entered into an agreement to pay Mr. Beck

$325,000, including $30,000 of vacation accrual balance, with $109,000 payable on July 29, 2004 and the balance payable in four monthly installments of $54,000 commencing on August 15, 2004. We accrued a restructuring charge of $295,000 in the three and six months ended September 30, 2004. As of November 10, 2004, the outstanding balance is $54,000.

NOTE 17 - SUBSEQUENT EVENTS

On October 25, 2004, we determined that our financial statements for the fiscal year ended March 31, 2004 and our quarterly financial statements for the second and third quarters of the fiscal year ending March 31, 2003, the first, second and third quarters of the fiscal year ending March 31, 2004 and the first quarter of the fiscal year ending March 31, 2005 needed to be restated in accordance with GAAP. In connection with the restatements, we filed an 8-k on October 29, 2004.

We completed the restatements and made the following revised filings: 10-K/A for the fiscal year ended March 31, 2004; and a 10-Q/A for fiscal quarters ended September 30, 2002, December 31, 2002, June 30, 2003, September 30, 2003, December 31, 2003 and June 30, 2004. We do not intend to file a revised 10K for the year ended March 31, 2003 due to the immateriality of the impact of the restatements in that filing.

We determined that prior presentation of the financial statements as discussed above needed to be restated for the following items, where applicable:

1. Reversal of revenue recognized on a one-time sale of software technology rights;
2. Presentation of net sales and cost of sales as product and services revenues and corresponding costs of revenues;
3. Reversal of a purchase of software technology;
4. Accrual of a royalty liability pursuant to the purchase agreement of software technology;
5. Capitalization and amortization of the beneficial conversion charges related to the March '03 and March '04 convertible debentures;
6. Capitalization of legal fees related to the acquisition of Page Digital Incorporated and Retail Technologies International, Inc.,
7. Reclassification of the unamortized cost of debt discount and beneficial conversion charges from additional paid in capital to interest expense, and
8. Inclusion of the value of options assumed in the acquisition of RTI as a purchase price adjustment.

ITEM 2. - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

THIS REPORT CONTAINS FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933 AND SECTION 21E OF THE SECURITIES EXCHANGE ACT

OF 1934 AND THE COMPANY INTENDS THAT CERTAIN MATTERS DISCUSSED IN THIS REPORT ARE "FORWARD-LOOKING STATEMENTS" INTENDED TO QUALIFY FOR THE SAFE HARBOR FROM LIABILITY ESTABLISHED BY THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. THESE FORWARD-LOOKING STATEMENTS CAN GENERALLY BE IDENTIFIED BY THE CONTEXT OF THE STATEMENT WHICH MAY INCLUDE WORDS SUCH AS THE COMPANY ("IPI," "WE" OR "US") "BELIEVES," "ANTICIPATES," "EXPECTS," "FORECASTS," "ESTIMATES" OR OTHER WORDS SIMILAR MEANING AND CONTEXT. SIMILARLY, STATEMENTS THAT DESCRIBE FUTURE PLANS, OBJECTIVES, OUTLOOKS, TARGETS, MODELS, OR GOALS ARE ALSO DEEMED FORWARD-LOOKING STATEMENTS. THESE FORWARD-LOOKING STATEMENTS ARE SUBJECT TO CERTAIN RISKS AND UNCERTAINTIES THAT COULD CAUSE ACTUAL RESULTS TO DIFFER MATERIALLY FROM THOSE FORECASTED OR ANTICIPATED AS OF THE DATE OF THIS REPORT. CERTAIN OF SUCH RISKS AND UNCERTAINTIES ARE DESCRIBED IN CLOSE PROXIMITY TO SUCH STATEMENTS AND ELSEWHERE IN THIS REPORT INCLUDING ITEM 2, "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS." STOCKHOLDERS, POTENTIAL INVESTORS AND OTHER READERS ARE URGED TO CONSIDER THESE FACTORS IN EVALUATING THE FORWARD-LOOKING STATEMENTS AND ARE CAUTIONED NOT TO PLACE UNDUE RELIANCE ON SUCH FORWARD-LOOKING STATEMENTS OR CONSTRUE SUCH STATEMENTS TO BE A REPRESENTATION BY US THAT OUR OBJECTIVES OR PLANS WILL BE ACHIEVED. THE FORWARD-LOOKING STATEMENTS INCLUDED IN THIS REPORT ARE MADE ONLY AS OF THE DATE OF THIS REPORT, AND WE UNDERTAKE NO OBLIGATION TO PUBLICLY UPDATE SUCH FORWARD-LOOKING STATEMENTS TO REFLECT SUBSEQUENT EVENTS OR CIRCUMSTANCES.

THE FOLLOWING DISCUSSION SHOULD BE READ IN CONJUNCTION WITH OUR CONSOLIDATED FINANCIAL STATEMENTS AND THE RELATED NOTES AND OTHER FINANCIAL INFORMATION APPEARING ELSEWHERE IN THIS FORM 10-Q. READERS ARE ALSO URGED TO CAREFULLY REVIEW AND CONSIDER THE VARIOUS DISCLOSURES MADE BY US WHICH ATTEMPT TO ADVISE INTERESTED PARTIES OF THE FACTORS WHICH AFFECT OUR BUSINESS, INCLUDING WITHOUT LIMITATION THE DISCLOSURES MADE UNDER THE CAPTION "MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS," AND THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS AND RELATED NOTES INCLUDED IN OUR ANNUAL REPORT FILED ON FORM 10-K/A FOR THE YEAR ENDED MARCH 31, 2004, AND THE DISCLOSURES UNDER THE HEADING "RISK FACTORS" IN THE FORM 10-K/A, AS WELL AS OTHER REPORTS AND FILINGS MADE WITH THE SECURITIES AND EXCHANGE COMMISSION.

OVERVIEW

We are a provider of software solutions and services to the retail industry. We provide solutions that help retailers understand, create, manage and fulfill consumer demand. We derive the majority of our revenues from three sources: the initial sale of application software licenses, or license revenues, professional services and support, and maintenance. Application software license fees are dependent upon the sales volume of our customers, the number of users of the application(s), and/or the number of locations in which the customer plans to install and utilize the application(s). As the customer grows in sales volume, adds additional users and/or adds additional locations, we charge additional license fees. Professional services relate to implementation of our software, training of customer personnel and modification or customization work. Support, maintenance and software updates are a source of recurring revenues and are generally based on a percentage of the software license revenues and are charged on an annual basis pursuant to renewable maintenance contracts. We typically charge for professional services including consulting, implementation and project management services on an hourly basis.

As the vast majority of our revenues are derived from the retail industry, we are heavily dependent on the financial strength of retailers and their capital budgets. Deterioration in the health of retailers, a reduction in their capital budget or a decision to delay the purchase of new systems have a direct impact on our business. Our sales cycles are long, generally three to twelve months, and our ability to close a pipeline of potential transaction is very unpredictable. As such, management believes that license revenue and growth in license revenue are the best indicator of the Company's business as they signify either new customers or an expansion of licenses of existing customers. While

there's generally a time lag between a sale of new license and when we provide services and support, an increase in license revenue will generally lead to an increase in services and support revenues in future quarters.

In recent periods, we have reported flat to decreased revenues and have suffered operating and net losses, largely attributable to general economic and competitive conditions. In this regard, we have taken a number of steps designed to improve our operations, including:

- Acquired two complementary companies with substantial revenues and earnings potential;
- Revamped our management team by adding a new President and COO and CTO, as well as a new CFO;

- Implemented cost containment measures;
- Improved our IBM-based core products through continuing internal research and development;
- Obtained the rights to distribute complementary products, including a new easy-to-install and easy-to-use, open-architecture software system for very small retailers, which we are currently offering;
- Established collaborations with several value added resellers to provide a variety of options and product extensions;
- Improved our distribution capabilities by adding new third party channels, such as IBM and IBM's resellers, and professional service firms, such as CGI and LakeWest.

We believe that these actions will position us to achieve revenue growth and profitability.

RECENT DEVELOPMENTS

- In June 2004, we completed the acquisition of RTI. See "Acquisition of RTI" below.

- Upon completion of RTI's acquisition, Michael Tomczak, RTI's CEO and President, was appointed our President, Chief Operating Officer and director and Jeffrey Boone, RTI's Chief Technology Officer, was appointed our CTO. Mr. Tomczak replaced Steve Beck, who was serving as our president and Mr. Page, who was serving as our COO. Mr. Boone replaced Mr. Page as our CTO. Mr. Beck served as our President from April 2003 to June 2004 and our COO from April 2003 to February 2004. Mr. Page served as our CTO from January 2004 to June 2004 and as our COO from February 2004 to June 2004.

- Mr. Beck resigned from the board of directors and the position of executive officer in July 2004. Donald Radcliffe, who previously served as our director from May 1998 to October 2003, was appointed to replace Mr. Beck as a director.

- Mr. Page resigned from the position of executive officer in September 2004.

- In July, we sold and issued a secured convertible note for a gross proceed of $7.0 million. See "Indebtedness - Laurus" below.

- In November 2004, we completed the restatements and made the following

revised filings: 10-K/A for the fiscal year ended March 31, 2004 and 10-Q/A for the fiscal quarter ended September 30, 2002, December 31, 2002, June 30, 2003, September 30, 2003, December 31, 2003 and June 30, 2004.

ACQUISITION OF RTI

Pursuant to an agreement dated June 1, 2004, we acquired RTI from Michael Tomczak, Jeffrey Boone and Intuit in a merger transaction. On March 12, 2004, we, RTI, Merger Sub and the Shareholders entered the March 12, 2004 Merger Agreement which provided we would acquire RTI in a merger transaction in which RTI would merge with and into Merger Sub. The merger consideration contemplated by the March 12, 2004 Merger Agreement was a combination of cash and shares of our common stock. The March 12, 2004 Merger Agreement was amended by the Amended Merger Agreement dated June 1, 2004.

Pursuant to the Amended Merger Agreement, the Merger was completed with the following terms: (i) we assumed RTI's obligations under those certain promissory notes issued by RTI on December 20, 2002 with an aggregate principal balance of $2.3 million; (ii) the total consideration paid at the closing of the Merger was $11.6 million paid in shares of our common stock with fair value of $1.2 million, newly designated Series B Preferred with fair value of $5.7 million, promissory notes totaling $3.6 million, assumption of incentive stock options with fair value of $1.0 million and acquisition costs of $110,000; (iii) the Shareholders and Intuit are entitled to price protection payable if and to the extent that the average trading price of our common stock is less than $0.76 at the time the shares of our common stock issued in the Merger and issuable upon conversion of the Series B Preferred are registered pursuant to the Registration Rights Agreement dated June 1, 2004 between us, the Shareholders and Intuit; and (iv) the Merger consisted of two steps, first, Merger Sub merged with and into RTI, Merger Sub's separate corporate existence ceased and RTI continued as the surviving corporation, immediately thereafter, RTI merged with and into Merger Sub II, RTI's separate corporate existence ceased and Merger Sub II continued as the surviving corporation.

As a result of the Merger, each Shareholder received 1,258,616 shares of Series B Preferred and a promissory note payable monthly over two years in the principal amount of $1,295,000 bearing interest at 6.5% per annum. As a result of the Merger, Intuit, the holder of all of the outstanding shares of RTI's Series A Preferred stock, received 1,546,733 shares of our common stock and a promissory note payable monthly over two years in the principal amount of $530,700 bearing interest at 6.5% per annum.

The Shareholders and Intuit were also granted registration rights. Under the Registration Rights Agreement, we agreed to register the common stock issuable upon conversion of the Series B Preferred issued to the Shareholders within 30 days of the automatic conversion of the Series B Preferred into common stock. The automatic conversion occurred when we filed the Certificate of Amendment with the Delaware Secretary of State increasing the authorized number of shares of our common stock. The Shareholders and Intuit are entitled to price protection payments of up to a maximum of $0.23 per share payable by promissory note, if and to the extent that the average closing price of our common stock for the 10 days immediately preceding the date the registration statement covering their shares is declared effective by the Securities and Exchange Commission, is less than the 10 day average closing price as of June 1, 2004, which was $0.76. We have not recorded the liability relating to the price

protection at the date of acquisition as the contingency is based on future events and cannot yet be determined. We will compute the total liability as soon as it can be determined and recorded as a liability. The total cost of the price protection contingency will be deferred and amortized over the shortest of the remaining useful lives of the assets acquired in the acquisition in accordance with SFAS 141, "Business Combinations.

Upon the consummation of the Merger, Michael Tomczak, RTI's former President and Chief Executive Officer, was appointed our President, Chief Operating Officer and director and Jeffrey Boone, RTI's former Chief Technology Officer, was appointed our Chief Technology Officer. We entered into two-year employment agreements and non-competition agreements with Mr. Tomczak and Mr. Boone.

The combination of Island Pacific and RTI, will enable us to offer a fully integrated solution to mid-tier retailers that will be unique in the marketplace. As a result of this transaction, smaller retailers will now be able to cost-effectively acquire a solution that provides both front and back-end support. The combination instantly expands our products, services offerings and distribution channels.

RECENT ACCOUNTING PRONOUNCEMENTS

None.

QUARTER ENDED SEPTEMBER 30, 2004 COMPARED TO QUARTER ENDED SEPTEMBER 30, 2003

REVENUES

Product revenues increased $3.1 million, or 172%, to $4.9 million in the quarter ended September 30, 2004 from $1.8 million in the quarter ended September 30, 2003, primarily due to the inclusion, in the quarter ended September 30, 2004, of $2.4 million and $0.9 million of product revenues for RTI and Page Digital, respectively. Excluding RTI and Page Digital product revenues, product revenues decreased $0.2 million to $1.6 million, a 11% decrease, primarily due to a $0.2 million decrease in sale of partner products as we focused on selling our core products. Services revenues increased by $0.8 million, or 84% to $1.8 million in the quarter ended September 30, 2004 from $1.0 million in the quarter ended September 30, 2003 primarily due to the inclusion of $0.8 million and $0.1 million of services revenue for Page Digital and RTI, respectively. Excluding Page Digital and RTI services revenues, services revenues decreased $0.1 million to $0.9 million, an 10% decrease. Toys accounted for $0 and $0.2 million of services in the quarter ended September 30, 2004 and September 30, 2003, respectively. Total revenues increased $3.9 million, or 139%, to $6.7 million in the quarter ended September 30, 2004 from $2.8 million in the quarter ended September 30, 2003, due primarily to the inclusion of $2.5 million and $1.7 million of RTI and Page Digital revenues recognized in the quarter ended September 30, 2004. Excluding Page Digital and RTI, total revenues decreased $0.3 million to $2.5 million, a 11% decrease, primarily due to the decrease in sale of partner products and the inclusion, in the prior year quarter, or TRU services revenue.

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COST OF REVENUES/GROSS PROFIT

Cost of revenues increased by $1.4 million, or 82%, to $3.1 million in the quarter ended September 30, 2004 from $1.7 million in the quarter ended September 30, 2003. Cost of product revenues increased $0.9 million, or 75%, to

$2.1 million in the quarter ended September 30, 2004 from $1.2 million in the quarter ended September 30, 2003. Amortization of capitalized software included in cost of product revenues increased to $0.9 million in the quarter ended September 30, 2004 from $0.6 million in the quarter ended September 30, 2003. Cost of services revenue increased $0.5 million, or 100%, to $1.0 million in the quarter ended September 30, 2004 from $0.5 million in the quarter ended September 30, 2003. Total gross profit increased $2.5 million, or 227%, to $3.6 million in the quarter ended September 30, 2004 from $1.1 million in the quarter ended September 30, 2003, primarily due to the inclusion of $2.1 million and $0.6 million of total gross profit from RTI and Page Digital in the quarter ended September 30, 2004. Excluding RTI and Page Digital, gross profit decreased $0.2 million to $0.9 million, a 18% decrease. Total gross profit margin was 54% and 39% for the quarter ended September 30, 2004 and September 30, 2003, respectively. Excluding Page Digital and RTI, gross profit margin decreased to 36%. Gross profit margin on products was 57% and 33% for the quarters ended September 30, 2004 and September 30, 2003, respectively. The increase is due to the inclusion of Page Digital and RTI product revenues which carry higher profit margins. Excluding Page Digital and RTI, gross profit margin on products decreased to 22%, due primarily to a $0.2 million decrease in product revenues and a $0.2 million increase in amortization of capitalized software. Gross profit margin on services was 44% and 50% for the quarters ended September 30, 2004 and September 30, 2003, respectively. Excluding Page Digital and RTI, gross profit margin increased to 62% as the percentage of modification revenues, which carry higher margins than typical services, as a percentage of total services revenue increased in the quarter ended September 30, 2004 from the quarter ended September 30, 2003.

APPLICATION DEVELOPMENT EXPENSE

Application development expense increased by $1.2 million, or 200%, to $1.8 million in the quarter ended September 30, 2004 from $0.6 million in the quarter ended September 30, 2003. The increase is primarily due to the inclusion of $0.4 million of application development expenses from Page Digital and RTI in the quarter ended September 30, 2004 and larger capitalization in the six months ended September 30, 2003.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization increased to $0.5 million in the quarter ended September 30, 2004 from $0.3 million in the quarter ended September 30, 2003, primarily due to the inclusion of Page Digital and RTI.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative ("SG&A") expenses increased by $1.0 million, or 33%, to $4.0 million in the quarter ended September 30, 2004 from $3.0 million in the quarter ended September 30, 2003, primarily due to the inclusion of $2.3 million of SG&A expenses from Page Digital and RTI that are included in the quarter ended September 30, 2004. Excluding Page Digital and RTI, SG&A expenses decreased to $1.7 million, a 43% decrease, primarily due to reduction in personnel and a focus on cost containment. SG&A expenses as a percent of sales decreased to 57% in the quarter ended September 30, 2004 from 108% in the quarter ended September 30, 2003. We anticipate that SG&A as a percentage of sales will continue to decrease in the future as we anticipate revenues increasing in the future at a faster rate than the growth in SG&A.

RESTRUCTURING EXPENSES

Restructuring expenses were $0.7 million and $0 in the three months ended September 30, 2004 and September 30, 2003, respectively. During the quarter ended September 30, 2004, we began a cost reduction program. This program was not contemplated as part of the acquisition of Page Digital or RTI, but rather

was implemented in the quarter ended September 30, 2004 after we analyzed our cost structure and determined that we needed to more properly align our operating expense with our current revenue levels. The restructuring expenses are a result of our cost containment measures across all business units and relate to one-time termination costs consisting of severance payments and benefits related to workforce reduction of nine full time employees. All employees impacted by this restructuring were notified of the plan of termination and the related benefits on or before September 30, 2004. As of September 30, 2004, $0.3 million has been paid with the balance to be paid through the fourth quarter of 2006.

OPERATING LOSS

Operating loss which included depreciation and amortization expense, was $3.4 million for the quarter ended September 30, 2004, compared to an operating loss of $2.7 million for the quarter ended September 30, 2003, as the $2.5 million increase in gross profit, due primarily to the increase in sales, was more than offset by the $3.1 million increase in total expenses.

INTEREST EXPENSE

Interest expense increased by $0.1 million, or 7%, to $1.6 million in the quarter ended September 30, 2004 from $1.5 million in the quarter ended September 30, 2003. Interest expense in the quarter ended September 30, 2004 was comprised primarily of $1.2 million financing costs and amortization of debt discount on the Laurus Note, as well as $0.2 million interest expense on the Laurus Note, the March '04 convertible debentures and notes due to the former RTI note holders. Interest expense in the quarter ended September 30, 2003 was comprised primarily of $1.4 million amortization of debt discount on the March '04 convertible debentures.

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PROVISION FOR INCOME TAXES

Provision for income taxes for the quarters ended September 30, 2004 and 2003 are $6,000 and $67,000, respectively.

CUMULATIVE PREFERRED DIVIDENDS

Cumulative dividends on the outstanding Series A Preferred attributable to the quarter ended September 30, 2004 and September 30, 2003 were $0.3 million.

SIX MONTHS ENDED SEPTEMBER 30, 2004 COMPARED TO SIX MONTHS ENDED SEPTEMBER 30, 2003

REVENUES

Product revenues increased $4.4 million, or 88%, to $9.4 million in the six months ended September 30, 2004 from $5.0 million in the six months ended September 30, 2003, primarily due to the inclusion, in the six months ended September 30, 2004, of $3.0 million and $1.6 million of product revenues for RTI and Page Digital, respectively. Excluding RTI and Page Digital product revenues, product revenues decreased $0.2 million to $4.8 million, a 4% decrease. Services revenues decreased by $0.6 million, or 19% to $2.6 million in the six months ended September 30, 2004 from $3.2 million in the six months ended September 30, 2003 primarily due to a decrease to $1.5 million from Toys R Us., Inc. "(Toys"), a $0.5 million decrease in services revenues, offset by the inclusion of $1.3mm

of Page Digital and RTI services revenues. Toys revenue in fiscal 2004 consisted primarily of implementation services. Toys had been a major customer since fiscal 2000 and terminated its contract in third quarter of