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ISLAND PACIFIC INC
Form 10-Q
February 14, 2005

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

FORM 10-Q

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 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 No

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

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 - 63,486,885 shares as of January 31, 2005.

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TABLE OF CONTENTS

PART I. - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

Consolidated Balance Sheets as of December 31, 2004
and March 31, 2004.....

Consolidated Statements of Operations for the Three
Months and the Nine Months Ended December 31, 2004 and 2003.....

Consolidated Statements of Cash Flows for the Nine
Months Ended December 31, 2004 and 2003.....

Notes to Consolidated Financial Statements

Item 2. Management's Discussion and Analysis of Financial Condition
and Results of Operations.....

Item 3. Quantitative and Qualitative Disclosures About Market Risk.....

Item 4. Controls and Procedures.....

PART II. - OTHER INFORMATION

Item 1. Legal Proceedings.....

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.....

Item 3. Defaults Upon Senior Securities.....

Item 4. Submission of Matters to a Vote of Security Holders.....

Item 5. Other Information.....

Item 6. Exhibits and Reports on Form 8-K.....

SIGNATURES.....

PART I. - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

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ASSETS

Current assets:

| | |
|--|--------|
| Cash and cash equivalents | \$ 1,1 |
| Accounts receivable, net of allowance for doubtful accounts of \$1,363 and \$409, respectively | 6,1 |
| Other receivables, including \$14 and \$37 from related parties, respectively | |
| Inventories | |
| Current portion of non-compete agreements | 1 |
| Current portion of note receivable | |
| Prepaid expenses and other current assets | 6 |
| | ----- |
| Total current assets | 8,2 |

| | |
|-----------------------------|---------|
| Note receivable | 1 |
| Property and equipment, net | 8 |
| Goodwill, net | 31,9 |
| Other intangibles, net | 19,5 |
| Other assets | 2 |
| | ----- |
| Total assets | \$ 61,0 |
| | ===== |

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:

| | |
|---|--------|
| Current portion of notes payable to related parties | \$ 1,5 |
| Current portion of notes payable | 1,2 |
| Current portion of convertible debentures | 1,6 |
| Current portion of capital leases | 1 |
| Accounts payable | 1,1 |
| Accrued expenses | 2,8 |
| Deferred revenue | 7,8 |
| Income tax payable | 1 |
| | ----- |
| Total current liabilities | 16,5 |

| | |
|---|-------|
| Notes payable to related parties, less current maturities | 9 |
| Notes payable, less current maturities | 1 |
| Convertible debentures, net, less current maturities | 3,9 |
| Capital lease obligations, less current maturities | |
| Deferred revenue | 8 |
| Long term liabilities | 1 |
| | ----- |
| Total liabilities | 22,6 |
| | ----- |

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 \$2,881 and \$2,002, respectively | 14,1 |
| Common Stock, \$.0001 par value; 100,000,000 shares authorized; 63,270,576 and 52,427,799 shares issued and outstanding, respectively | |
| Additional paid in capital | 85,9 |
| Accumulated deficit | (61,7) |
| | ----- |
| Total stockholders' equity | 38,3 |
| | ----- |

| | |
|--|---------|
| Total liabilities and stockholders' equity | \$ 61,0 |
|--|---------|

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

3

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

| | Three Months Ended December 31, | | Ni |
|---|------------------------------------|----------|-------|
| | 2004 | 2003 | 20 |
| | (As restated) | | |
| Revenues: | | | |
| Product | \$ 5,859 | \$ 4,207 | \$ 15 |
| Services | 1,343 | 683 | 3 |
| Total revenues | 7,202 | 4,890 | 19 |
| Cost of revenues: | | | |
| Product | 2,583 | 1,627 | 6 |
| Services | 746 | 434 | 2 |
| Total cost of revenues | 3,329 | 2,061 | 9 |
| Gross profit | 3,873 | 2,829 | 10 |
| Expenses: | | | |
| Application development | 1,757 | 361 | 4 |
| Depreciation and amortization | 388 | 272 | 1 |
| Restructuring | -- | -- | |
| Selling, general and administrative | 4,018 | 2,808 | 12 |
| Total expenses | 6,163 | 3,441 | 19 |
| Loss from operations | (2,290) | (612) | (9) |
| Other income (expense): | | | |
| Interest income | 1 | 7 | |
| Other income (expense) | 37 | 112 | |
| Interest expense | (965) | -- | (3) |
| Total other expenses | (927) | 119 | (3) |
| Loss before provision for income taxes (benefits) | (3,217) | (493) | (12) |
| Provision for income taxes (benefits) | -- | (19) | |

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| | | | |
|--|------------|-----------|---------|
| Net loss | (3,217) | (474) | (12) |
| Cumulative preferred dividends | (300) | (184) | |
| Net loss available to common stockholders | \$ (3,517) | \$ (658) | \$ (13) |
| Basic and diluted loss per share: | | | |
| Net loss | \$ (0.05) | \$ (0.01) | \$ (0) |
| Cumulative preferred dividends | (0.01) | (0.00) | (0) |
| Net loss available to common stockholders | \$ (0.06) | \$ (0.01) | \$ (0) |
| Basic and diluted weighted-average common shares outstanding | 63,031 | 46,172 | 57 |

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

4

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

Cash flows from operating activities:

Net loss

Adjustments to reconcile net loss to net cash used for operating activities:

 Depreciation and amortization

 Amortization of debt discount and conversion option

 Gain on disposal of furniture and fixtures

 Provision for allowance for doubtful accounts, net of recoveries

 Stock-based compensation

 Common stock issued for services rendered and settlement cost

Changes in assets and liabilities net of effects from acquisitions:

 Accounts receivable and other receivables

 Income tax refund receivable

 Inventories

 Prepaid expenses and other assets

 Accounts payable and accrued expenses

 Income tax payable

 Accrued interest on stockholders' loans, convertible notes and term loan

 Deferred revenue

Net cash used for operating activities

Cash flows from investing activities:

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Payment from note receivable
Proceeds from acquisition of Retail Technologies International, Inc., net
Purchases of furniture and equipment
Capitalized software development costs

Net cash provided by (used for) investing activities

Cash flows from financing activities:

Sale of common stock, net of offering costs
Decrease in amount due to stockholders, net
Proceeds from convertible debts
Payments on capital leases
Payments on term loans and convertible debentures

Net cash provided by financing activities

Effect of exchange rate changes on cash

Net decrease in cash and cash equivalents
Cash and cash equivalents, beginning of period

Cash and cash equivalents, end of period

Supplemental disclosure of cash flow information:

Interest paid
Income taxes paid

Supplemental schedule of non-cash investing and financing activities:

Issued 7,551,696 shares of common stock upon conversion of 2,517,233 shares of Series B Convertible Preferred Stock issued in connection with the acquisition of Retail Technologies International, Inc.
Issued 1,546,733 shares of common stock in connection with the acquisition of Retail Technologies International, Inc.
Issued promissory notes in connection with the acquisition of Retail Technologies International, Inc.
Issued 600,000 shares of common stock as payment for liquidated damages penalty
Issued 223,052 shares of common stock upon cashless exercise of an incentive stock option
Issued 132,433 shares of common stock to Midsummer for monthly convertible debenture payment
Issued 169,340 shares of common stock to Midsummer for monthly convertible debenture payment
Issued 188,998 shares of common stock to Midsummer for monthly convertible debenture payment
Issued 5,428 shares of common stock upon cashless exercise of an incentive stock option
Issued 4,103,161 shares of common stock upon conversion of the 9% debentures
Repaid a convertible note by offsetting against outstanding account receivable
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 pe

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

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(The financial statements for the three and nine months ended December 31, 2003 have been restated.)

NOTE 1 - ORGANIZATION AND BASIS OF PREPARATION

The accompanying unaudited 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 December 31, 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 nine months ended December 31, 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 nine months ended December 31, 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 nine months ended December 31, 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 December 31, 2003 | Ni Deco |
|---|---|------------|
| | ----- | ----- |
| Revenues | \$ 5,208 | \$ |
| Net loss | \$ (1,816) | \$ |
| Net loss available to common stockholders | \$ (2,000) | \$ |
| Basic and diluted loss per share of common stock | \$ (0.04) | \$ |
| Basic and diluted loss per share available to common stockholders | \$ (0.04) | \$ |

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.

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("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").

6

Pursuant to the Amended Merger Agreement, the Merger (as defined below) was completed with the following terms: (i) we assumed RTI's obligations under 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 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").

In 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. In 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 and to register the common stock issued to Intuit either on the next registration statement we filed after the closing or upon Intuit's demand. We filed a registration statement on Form S-3 covering Intuit's common stock on August 25, 2004. The automatic conversion occurred when we filed an amendment to our certificate of incorporation with the Delaware Secretary of State increasing our authorized shares of common stock on August 27, 2004. We filed a registration statement on Form S-3 covering the common stock issued on conversion of the Series B on September 13, 2004. The registration statements on Form S-3 filed on August 25, 2004 and September 13, 2004 were subsequently combined into one registration statement on Form S-3 pursuant to Amendment No. 1 to the Forms S-3 filed on December 2, 2004. We filed Amendment No. 2 to this Form S-3 on January

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25, 2005 but it has not yet become effective. 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 (the "SEC") 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 employment agreement with Michael Tomczak was executed 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 will vest on the first anniversary date of the employment agreement, thereafter, the remaining option will vest at the rate of 73,848 shares per month during the second year of this agreement. If Mr. Tomczak's employment 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 a non-competition agreement with Mr. Tomczak pursuant to which he 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.

7

The employment agreement with Jeffrey Boone was executed 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 will vest on the first anniversary date of this agreement, thereafter, the remaining option will vest at the rate of 65,514 shares per month during the second year of this agreement. If Mr. Boone's employment 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 a non-competition agreement with Mr. Boone pursuant to which he 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

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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 nine months ended December 31, 2004 and 2003 assume the acquisitions of RTI and Page Digital occurred as of April 1, 2004 and 2003, respectively. 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 | | Nine Months |
|---|----------------------|----------------------|----------------------|
| | December 31, 2004 | December 31, 2003 | December 31, 2004 |
| | ----- | ----- | ----- |
| Revenues | \$ 7,202 | \$ 7,488 | \$ 20,561 |
| Net loss | \$ (3,217) | \$ (2,037) | \$ (13,230) |
| Net loss available to common stockholders | \$ (3,517) | \$ (2,221) | \$ (14,110) |
| Basic and diluted loss per share of common stock | \$ (0.05) | \$ (0.04) | \$ (0.23) |
| Basic and diluted loss per share available to common stockholders | \$ (0.06) | \$ (0.05) | \$ (0.24) |

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

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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 \$144,000 and \$162,000 at December 31, 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 December 31, 2004 and March 31, 2004, goodwill and other intangibles consist of the following (in thousands):

| | DECEMBER 31, 2004 | | | Gross carrying amount |
|---|-----------------------|--------------------------|-----------|-----------------------|
| | Gross carrying amount | Accumulated amortization | Net | |
| | ----- | ----- | ----- | ----- |
| Goodwill | \$ 38,431 | \$ (6,492) | \$ 31,939 | \$ 27,099 |
| | ----- | ----- | ----- | ----- |
| Other intangibles: | | | | |
| Amortized intangible assets | | | | |
| Software technology | 32,071 | (15,864) | 16,207 | 30,357 |
| Non-compete agreements | 7,014 | (6,865) | 149 | 6,986 |
| Customer relationships | 2,564 | (263) | 2,301 | 904 |
| Unamortized intangible: | | | | |
| Trademark | 1,085 | -- | 1,085 | 285 |
| | ----- | ----- | ----- | ----- |
| | 42,734 | (22,992) | 19,742 | 38,532 |
| Less: current portion of non-compete agreements | 149 | -- | 149 | 668 |
| | ----- | ----- | ----- | ----- |
| Long-term portion of other intangibles | 42,585 | (22,992) | 19,593 | 37,864 |
| | ----- | ----- | ----- | ----- |
| Long-term portion of goodwill and other intangibles | \$ 81,016 | \$ (29,484) | \$ 51,532 | \$ 64,963 |
| | ===== | ===== | ===== | ===== |

During the nine months ended December 31, 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 non-compete agreements in connection with the acquisition of RTI (see Note 2). In addition, we recorded \$0 and \$357,000 million in capitalized software during the three and nine months ended December 31, 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 remaining balance of the non-compete agreement is being amortized over the remaining three months of its useful life.

Transactions in goodwill during the nine months ended December 31, 2004 and

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fiscal year ended March 31, 2004 are as follows (in thousands):

| | December 31, 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 |
| | ===== | ===== |

9

We found no indication of impairment of the goodwill during the nine months ended December 31, 2004. Accordingly, absent 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 December 31, 2004. No adjustments have been made to the useful lives of our intangible assets.

Amortization expense for the three months ended December 31, 2004 and 2003 was \$1.2 million and \$0.9 million, respectively. Amortization expense for nine months ended December 31, 2004 and 2003 was \$3.5 million and \$2.5 million. We expect amortization expense for the next five fiscal years to be as follows (in thousands):

| | |
|-----------|----------|
| March 31, | |
| 2005 | \$ 1,182 |
| 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 December 31, 2004, of which \$1.5 million 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

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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):

| | December 31, 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 | \$ 972 |
| 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 | 492 ----- |
| Total notes payable | \$ 1,464 ===== |
| Total notes payable (including accrued interest) | \$ 1,464 |
| Less: current maturities | 1,285 ----- |
| Long-term portion of notes payable | \$ 179 ===== |

10

CONVERTIBLE DEBENTURES

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

| | December 31, 2004 ----- |
|--|-------------------------------|
| Convertible note, secured by all of our assets, interest rate of prime plus two percent per annum and matures in July 2007 | \$ 7,042 |
| Convertible debentures, interest rate of 9% per annum and mature in May 2006 | 1,096 ----- |
| Total | 8,138 |
| Less: debt discount | 2,544 ----- |
| | \$ 5,594 ===== |
| Total convertible debentures (including accrued interest), net of debt discount | \$ 5,594 |
| Less: current maturities | 1,679 ----- |

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Long-term portion of convertible debentures

\$ 3,915
=====

LAURUS

On July 12, 2004, we sold and issued a secured convertible term note (the "Laurus Note") to Laurus Master Fund, Ltd. ("Laurus") for gross proceeds of \$7.0 million pursuant to a Securities Purchase Agreement. In addition, we issued Laurus a warrant to purchase up to 3,750,000 shares of our common stock at a price of \$0.71 per share (the "Laurus Warrant").

The Laurus Note initially matured on September 1, 2004, however, the maturity date was automatically extended to July 12, 2007 (the "Maturity Date") upon our stockholders approving an increase to our authorized common stock from 100 to 250 million shares and our filing an amendment to our certificate of incorporation to effect such change on August 27, 2004. The Laurus Note accrues interest at a rate per annum (the "Interest Rate") equal to the "prime rate" published in The Wall Street Journal from time to time, plus two percent. Interest under the Note is payable monthly in arrears and interest payments commenced on August 1, 2004. The Interest Rate is calculated on the last day of each month and is subject to adjustment based on the then-current price of our common stock. The initial conversion price under the Note was \$0.56 per share, subject to adjustment upon our issuance of securities at a price 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. Our obligations under the Laurus Note are secured by all of our assets. In addition, all our wholly owned subsidiaries guaranteed our obligations under the Laurus Note and we pledged all of our interests in the outstanding stock of our subsidiaries as security for our obligations under the Laurus Note.

The Laurus Warrant is immediately exercisable and has a seven year term. We have the right to require exercise of the Laurus Warrant 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 Warrant 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 Warrant is greater than three hundred percent (300%) of the then applicable exercise price.

In August 2004, Laurus agreed to defer the interest payments due under the Laurus Note on August 1, 2004 until the Maturity Date. In October 2004, Laurus agreed to amend the Laurus Note and defer the payments due from 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 due in July 2007. In connection with the amendment to the Laurus Note and the related amendment to the Laurus Registration Rights Agreement (as defined below): (1) the conversion price on \$2 million of the \$7 million Laurus Note was reduced to \$0.37, (2) we issued Laurus an additional warrant (the "October '04 Warrant") to purchase 250,000 shares of our common stock at a price of \$0.41 per share with the same terms as the Laurus Warrant, and (3) the Effectiveness Date (as defined below) under the Laurus Registration Rights Agreement was extended. We have assessed but not recorded any charge to expense in connection with the issuance of the October '04 Warrant because the impact on the statement of operations is not material.

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Pursuant to the registration rights agreement between us and Laurus executed in connection with the sale of the Laurus Note (the "Laurus Registration Rights Agreement"), we were obligated to file a registration statement registering the shares of our common stock issuable upon conversion of the Laurus Note or exercise of the Laurus Warrant or the October '04 Warrant (the "Underlying Shares") within 60 days of July 12, 2004 and have the Registration Statement declared effective by the SEC no later than March 1, 2005. If (1) the Registration Statement is not filed or declared effective within the requisite periods, (2) the Registration Statement ceases to be effective for more than 30 days in any calendar year or any 10 consecutive calendar days, or (3) 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 filed a registration statement for the Underlying Shares on Form S-3 (the "Laurus Registration Statement") on September 13, 2004 and filed amendments to the Form S-3 on December 2, 2004 and January 25, 2005. The Laurus Registration Statement has not yet been declared effective.

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 \$23,000 in the three months and \$43,000 in the nine months ended December 31, 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 \$44,000 in the three months and \$81,000 in the nine months ended December 31, 2004.

In connection with the amendment to the Laurus Note in October 2004, 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 amounted to \$1.0 million and is being amortized over the remaining term of the Laurus Note. We amortized \$62,000 in the three and nine months ended December 31, 2004.

In connection with the amendment to the Laurus Note in October 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 \$24,000 and is being amortized as interest expense over the life of the Laurus Note. We amortized \$2,000 in the three and nine months ended December 31, 2004.

The balance of the Laurus Note, including accrued interest, is \$7.0 million at December 31, 2004.

OMICRON/MIDSUMMER

On March 15, 2004, we sold Omicron Master Trust ("Omicron") and Midsummer Investment, Ltd. ("Midsummer") convertible debentures (the "March 2004 Debentures") for an aggregate price of \$3.0 million pursuant to a securities purchase agreement (the "March 2004 Debenture Purchase Agreement"). The March 2004 Debentures bear interest at a rate of 9% per annum, and provide for interest only payments on a quarterly basis, payable, at our option, in cash or shares of our common stock. The March 2004 Debentures mature on May 15, 2006.

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The March 2004 Debentures were initially convertible into shares of our common stock at a conversion price of \$1.32 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 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.

We also issued Omicron and Midsummer two warrants each as follows: (i) Series A Warrants to purchase up to an aggregate of 1,043,479 shares of our common stock at an exercise price of \$1.15 per share 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 (ii) Series B Warrants to purchase up to an aggregate of 8,500,000 shares of our common stock with an exercise price of \$5 per share, 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. The Series B Warrants are immediately exercisable and expire on the earlier of the six-month anniversary of the effective date of the registration statement covering the shares underlying the warrant or 18 months from March 15, 2004.

12

In July 2004, with the proceeds from the sale of the Laurus Note, we paid Omicron \$1.75 million, the full amount due under its March 2004 Debenture, plus \$0.2 million in accrued interest, liquidated damages pursuant to the Omicron/Midsummer Registration Rights Agreement (described below) and prepayment penalties. In accordance with generally accepted accounting principles, the difference between the original conversion price of \$1.32 and our stock price on the date Omicron's March 2004 Debenture was issued 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.

In July 2004, we issued 600,000 shares of our common stock, which we valued at \$240,000, to Midsummer as payments for liquidated damages due under the Omicron/Midsummer Registration Rights Agreement (described below) and as partial consideration for Midsummer consenting to our issuance of the Laurus Note. We also amended Midsummer's March 2004 Debenture in exchange for its consent to the transaction with Laurus. Pursuant to Amendment No. 1 to the 9% Debenture Due May 15, 2006 Issued to Midsummer Investments, Ltd. And Waiver, the terms of Midsummer's March 2004 Debenture were amended as follows: (i) the prepayment penalty was eliminated, (ii) the conversion price was reduced to \$0.56 per share, (iii) interest payments are due on a monthly, rather than quarterly, basis, (iv) the commencement of monthly redemption payments was accelerated to September 1, 2004 and (v) the monthly redemption payments were revised such that payments of \$50,000 are due monthly commencing September 1, 2004 and increase to \$62,500 starting February 1, 2005. In connection with the issuance of the Laurus Note, the exercise price of the Series A Warrants held by both Omicron and Midsummer was reduced to \$0.56 per share. During the months of October, November and December 2004 132,433, 169,340 and 188,998 shares of common stock were issued, respectively, valued at \$50,000, \$58,905 and \$58,533, respectively, for payment of principal and interest. Computation of the number of shares is in

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accordance with agreement and share price is based upon 20 day average VWAP less 20% discount. Management considers this to be the fair value of the shares of common stock issued.

We entered into a registration rights agreement with Omicron and Midsummer dated March 15, 2004 (the "Omicron/Midsummer Registration Rights Agreement"), pursuant to which we were required to file a registration statement respecting the common stock issuable upon the conversion of the March 2004 Debentures and exercise of the warrants within 30 days after March 15, 2004, and to use best efforts to have the registration statement declared effective at the earliest date but in no event later than 90 days after March 15, 2004 (or 120 days in the event of full review). If we fail to file a registration statement within such 30 day period or have it declared effective within such 90 day period (or 120 day period in the event of a full review), we are obligated to pay liquidated damages to Omicron and Midsummer equal to 2% per month of each of their initial subscription amounts plus the value of any outstanding warrants. A registration statement on Form S-3 registering the shares issuable upon conversion of Midsummer's March 2004 Debenture and the shares issuable on exercise of both Omicron's and Midsummer's Series A Warrants was filed on August 25, 2004. A registration statement on Form S-3 registering the shares issuable upon exercise of Midsummer's and Omicron's Series B Warrants was filed on September 13, 2004. The registration statements were combined into one registration statement on Form S-3 pursuant to Amendment No. 1 to the Forms S-3 filed on December 2, 2004. Amendment No. 2 to the registration statement was filed on January 25, 2005, but it has not been declared effective as of February 10, 2005. Outstanding liquidated damages totaling \$201,000 were paid in July 2004. Additional liquidated damages were waived pursuant to Amendment No. 2 to Midsummer's March 2004 Debenture (as described below). We will accrue liquidated damages beginning February 1, 2005 until the registration statement is declared effective.

On November 30, 2004, we entered into Amendment No. 2 to Midsummer's March 2004 Debenture ("Amendment No. 2"). Pursuant to Amendment No. 2, the terms of Midsummer's March 2004 Debenture were amended as follows: (i) the conversion price for the March 2004 Debenture and the exercise price for the Series A Warrant were reduced to \$0.37 per share, (ii) all outstanding accrued and unpaid liquidated damages and all liquidated damages that may accrue through January 31, 2005 were waived, (iii) until the shares are registered, we may make monthly redemption and interest payments in shares of restricted stock valued at 80% of the value weighted average price for the 20 days prior to either the interest payment date or the date the shares are issued, whichever is lower and (iv) the date by which the registration statement covering the shares issuable upon conversion of Midsummer's March 2004 Debenture and the related warrants must be declared effective was extended to January 31, 2005. In addition, we issued Midsummer an additional warrant to purchase 200,000 shares of our common stock with an exercise price of \$0.41. We have assessed but not recorded any charge to expense in connection with the issuance of the additional warrant to Midsummer because the impact on the statement of operations is not material.

In accordance with generally accepted accounting principles, the difference between the original conversion price of \$1.32 and our stock price on the date of issuance of the Midsummer March 2004 Debenture amounted to \$110,000 and was being amortized over the term of the debt. Upon amending the debt, we recomputed the difference between the amended conversion price of \$0.56 and our stock price on 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

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\$115,000 and \$243,000 in the three and nine months ended December 31, 2004. No additional amounts were recorded for the second amendment of the Midsummer's March 2004 Debenture as maximum amounts were recorded in the first amendment.

For a period of 180 days following the date the registration statement covering the shares issuable upon conversion of the March 2004 Debentures and related warrants is declared effective (the "Omicron/Midsummer Registration Effective Date"), both Omicron and Midsummer have the right, in their sole discretion, to elect to purchase their pro rata portion of additional March 2004 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 would be identical to the terms set forth in the March 2004 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 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 180 days following the Omicron/Midsummer Registration Effective Date, if the daily volume weighted average price of our common stock for 15 consecutive trading days exceeds the then current conversion price by more than 200%, subject to adjustment, we may, on one occasion, in our sole determination, require Omicron and Midsummer to purchase each of their 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 March 2004 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 March 2004 Debenture and Series A Warrants.

For a period of 6 months from the Omicron/Midsummer Registration Effective Date, Omicron and Midsummer have a right of first refusal to participate in certain future financings by us involving the sale of our common stock or equivalent securities.

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 amortized 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 debenture was repaid. Upon repayment of the Omicron Debenture, the remaining balance of \$363,000 was expensed.

The amount allocated to the warrants issued to Midsummer was originally \$300,000. Upon amending Midsummer's March 2004 Debenture, we recomputed the amount allocated to the 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 \$118,000 in the three and nine months ended December 31, 2004, respectively. No additional amounts were recorded for the second amendment as maximum amounts were recorded in the first amendment.

In connection with the sale and subsequent amendments of the convertible notes during the quarters ended September 30, 2004 and December 31, 2004, we adjusted the exercise price of outstanding warrants previously issued to certain investors to \$0.56 per share pursuant to the anti-dilution protection provisions. Accordingly, we recorded charges of \$366,000 and \$417,000 as interest expense in the quarters ended September 30, 2004 and December 31, 2004, respectively.

The outstanding balance of Midsummer Debenture, including accrued interest, is

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\$1.0 million at December 31, 2004.

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.

14

The balance of capital leases is \$157,000 and \$258,000 at December 31, 2004 and March 31, 2004, respectively, of which the current portion is \$154,000 and \$169,000, respectively.

NOTE 8 - LINE OF CREDIT

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

NOTE 9 - DEFERRED REVENUE

Deferred revenue at December 31, 2004 and March 31, 2004 consists of the following (in thousands):

| | December 31, 2004 | March 31, 2004 |
|--------------------------|----------------------|-------------------|
| | ----- | ----- |
| Prepaid support services | \$ 7,250 | \$ 2,528 |
| Customer deposits | 1,401 | 129 |
| | ----- | ----- |
| Total | 8,651 | 2,657 |
| Long-term portion | 849 | -- |
| | ----- | ----- |
| Current portion | \$ 7,802 | \$ 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 \$2.9 million, or \$20.44 per share, and \$2.0 million, or \$14.19 per share, at December 31, 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

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price as of January 1, 2005 is \$0.89. 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 Limited ("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 our authorized common stock in August 2004, all of the 2,517,232 shares of Series B Preferred outstanding were converted into 7,551,696 shares of common stock. No dividends had been declared.

NOTE 11 - EQUITY TRANSACTIONS

During the quarter ended December 31, 2004, we had the following equity transactions:

- o Issued 132,433 shares of common stock, with a fair value of \$50,000, to Midsummer as monthly principal and interest payment of convertible debenture,
- o Issued 169,340 shares of common stock, with a fair value of \$58,905, to Midsummer as monthly principal and interest payment of convertible debenture,
- o Issued 188,998 shares of common stock, with a fair value of \$58,533, to Midsummer as monthly principal and interest payment of convertible debenture,

15

- o Granted incentive stock options to employees to purchase an aggregate of 49,000 shares of common stock at exercise prices ranging from \$0.39 to \$0.43,
- o Granted options to purchase an aggregate of 82,500 shares of common stock at exercise prices ranging from \$0.41 to \$0.42 to outside directors of the Board as directors' fees for the quarter ended December 31, 2004,
- o Employees, pursuant to the RTI acquisition, exercised options to purchase 18,369 shares of common stock at exercise price of \$0.02.

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

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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 nine months ended December 31, 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.

| | Nine Months Ended December 31, | |
|---|--|------------|
| | 2004 | 2003 |
| | ----- (in thousands, except per share amounts) (unaudited) | |
| Net loss as reported | \$ (12,298) | \$ (4,665) |
| Less: stock-based compensation expense, net of related tax effects | (1,507) | (1,621) |
| | ----- | ----- |
| Pro forma net loss | \$ (13,805) | \$ (6,286) |
| | ===== | ===== |
| | | |
| Basic and diluted earnings (loss) per share - as reported | \$ (0.21) | \$ (0.12) |
| Basic and diluted earnings (loss) per share - pro forma | \$ (0.24) | \$ (0.16) |

NOTE 12 - EARNINGS (LOSS) PER SHARE

Basic loss per common share is 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 nine months ended December 31, 2004 and 2003 is calculated as follows (in thousands):

| | Three months ended December 31, | | Nine months end 2004 |
|--|---------------------------------|-----------|-------------------------|
| | 2004 | 2003 | |
| | ----- ----- ----- | | |
| Net loss available to common Stockholders | \$ (3,517) | \$ (658) | \$ (13,178) |
| Basic and diluted weighted average shares | 63,031 | 46,712 | 57,818 |
| Basic and diluted loss per share | \$ (0.06) | \$ (0.01) | \$ (0.23) |

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The following potential common shares have been excluded from the computation of diluted net loss per share for the nine months ended December 31, 2004 and 2003, because the effect would have been anti-dilutive:

| | Three Months Ended December 31, | |
|--|------------------------------------|------------|
| | 2004 | 2003 |
| | ----- | ----- |
| Outstanding options under our stock option plans | 8,364,575 | 4,371,974 |
| Outstanding options granted outside our stock option plans | 7,682,274 | 4,994,312 |
| Warrants issued in conjunction with private placements and financing | 17,548,760 | 3,830,281 |
| Warrants issued for services rendered | 1,243,565 | 1,108,898 |
| Series A Convertible Preferred Stock | 19,469,045 | 18,449,674 |
| Convertible debt | 17,272,723 | 239,739 |
| | ----- | ----- |
| Total | 71,580,942 | 32,994,878 |
| | ===== | ===== |

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 December 31, 2004 is as follows (in thousands):

| | | |
|-----------------|----|-------|
| Initial reserve | \$ | 681 |
| Paid | | (476) |
| | | ----- |
| Balance | \$ | 205 |
| | | ===== |

Of the remaining balance, \$47,000 will be paid quarterly from the fourth quarter of 2005 through the third quarter of 2006. The balance of \$17,000 will be paid 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.

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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 2004 | December 31, 2003 | Nine months ended 2004 | |
|---------------------------|----------------------------|----------------------|---------------------------|-------|
| | ----- | ----- | ----- | ----- |
| Revenues: | | | | |
| Americas | \$ 5,816 | \$ 3,275 | \$ 15,586 | \$ |
| Europe | 1,263 | 1,615 | 3,269 | |
| Asia | 123 | -- | 314 | |
| | ----- | ----- | ----- | ----- |
| Total revenues | \$ 7,202 | \$ 4,890 | \$ 19,168 | \$ |
| | ===== | ===== | ===== | ===== |
| | | December 31, 2004 | March 31, 2004 | |
| | | ----- | ----- | |
| Long-lived assets: | | | | |
| Americas | | \$ 52,797 | \$ 40,783 | |
| Europe | | 26 | 30 | |
| | | ----- | ----- | |
| Total identifiable assets | | \$ 52,823 | \$ 40,813 | |
| | | ===== | ===== | |

In the three months ended December 31, 2004, revenues from three customers represents 2%, 3% and 1%, respectively, of total revenues. In the nine months ended December 31, 2004, revenues from these three customers represents 4%, 3% and 4% of total revenues, and accounts receivable balances at December 31, 2004 from these customers represent 10%, 0% and 3%, respectively, 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:

- o 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,

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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.

- o 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.

- o 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

18

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 December 31, | | Nine mo Dece |
|-----------------------------|------------------------------------|----------|-----------------|
| | 2004 | 2003 | 2004 |
| Revenues: | | | |
| Retail Management Solutions | \$ 2,655 | \$ 4,602 | \$ 7,683 |
| Store Solutions | 3,318 | 288 | 7,395 |
| Multi-channel Retail | 1,229 | -- | 4,090 |
| | \$ 7,202 | \$ 4,890 | \$ 19,168 |
| | \$ 7,202 | \$ 4,890 | \$ 19,168 |

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| | | | |
|---|----------------------|-------------------|------------|
| Operating income (loss): | | | |
| Retail Management Solutions | \$ (670) | \$ 300 | \$ (2,736) |
| Store Solutions | 15 | (299) | (812) |
| Multi-channel Retail | (610) | -- | (1,331) |
| Other (see below) | (1,025) | (613) | (4,202) |
| | ----- | ----- | ----- |
| Total operating income (loss) | \$ (2,290) | \$ (612) | \$ (9,081) |
| | ===== | ===== | ===== |
| Other operating loss: | | | |
| Depreciation | \$ (4) | \$ (4) | \$ (13) |
| Administrative costs and other non-allocated expenses | (1,021) | (609) | (4,189) |
| | ----- | ----- | ----- |
| Total other operating loss | \$ (1,025) | \$ (613) | \$ (4,202) |
| | ===== | ===== | ===== |
| | December 31, 2004 | March 31, 2004 | |
| | ----- | ----- | |
| Identifiable assets: | | | |
| Retail Management Solutions | \$ 30,918 | \$ 32,757 | |
| Store Solutions | 20,010 | 3,790 | |
| Multi-channel Retail | 9,687 | 10,093 | |
| | ----- | ----- | |
| Total identifiable assets | \$ 60,615 | \$ 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 nine months ended December 31, 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 nine month ended December 31, 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 nine months ended December 31, 2003.

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NOTE 15 - COMMITMENTS AND CONTINGENCIES

Effective April 1, 2004, we entered into an agreement with Newco PTY, a company owned by QQQ ("Newco"). 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 a three year option to purchase the OnePointe product line of our Store Solutions business unit ("OnePointe") 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/Island Pacific) for the twelve months ended March 31, 2006 and 70%/30% (Newco/Island Pacific) for the twelve months ended April 1, 2007. Newco may exercise its option at anytime with thirty day written notice. We 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/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. At September 30, 2004, we have incurred Newco's total losses of \$56,000. No additional losses have been incurred during the three months ended December 31, 2004. As of December 31, 2004, the book value of OnePointe was approximately \$2.2 million.

In the third quarter of fiscal 2002 we sold certain assets of our Australian subsidiary to the former management of such subsidiary, and ceased 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 required 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, Debora Hintz, an employee who was out on disability/worker's compensation leave, 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 responded appropriately to both the wage claim and the discrimination allegations, both of which we believe 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 statute, 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. A mandatory settlement conference in this matter is scheduled for April 14, 2005. We have initiated settlement discussions with Ms. Hintz but at this time management cannot predict the outcome of the discussion or any liability.

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.

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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 will 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. ("5R Online"), 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 involvement in a development arrangement between us and 5R Online. 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 our complaint was due on August 9, 2004. A settlement was entered, which was conditioned upon payment by the defendants of a first installment of \$50,000. The defendants failed to pay the first installment and the litigation is therefore proceeding.

20

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. We believe the claims made against RTI are without merit and we intend to vigorously defend them.

On November 30, 2004, MPB Contractors, Inc. ("MPB") filed a lawsuit against our subsidiary, IPI Acquisition, Inc., a Delaware corporation (now known as Page Digital Incorporated) as successor in interest to Page Digital Incorporated, a Colorado corporation ("Page"), in the District Court in the County of Arapahoe, in the State of Colorado. The lawsuit alleges that Page breached the contract between Page and MPB dated on or about December 1, 2000, pursuant to which MPB provided tenant finish services to Page at 6450 South Revere Parkway, Englewood, Colorado, by failing to pay \$86,793.00 due under such contract. The response was due on December 20, 2004. The Company has demanded that Lawrence Page and David Joseph indemnify the Company in this matter based on the obligations in the Agreement of Merger and Plan of Reorganization by and among the Company, Page and IPI Acquisition, Inc. dated November 20, 2003. Lawrence Page and David Joseph have agreed to defend and indemnify the Company. An answer to the compliant and counterclaim was filed by counsel to Mr. Page. MPB filed a reply to the counter-claim denying certain allegations and asserting certain affirmative defenses on January 10, 2005.

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

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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 December 31, 2004 and March 31, 2004 are amounts due from our 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 directors' and former executive officer, 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 December 31, 2004 and 2003, respectively, and \$600,000 and \$0 for the nine months ended December 31, 2004 and 2003, respectively. A security deposit of \$170,000 relating to this lease is included in other long-term assets at December 31, 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 December 31, 2004 and 2003, the expense for this service was \$108,000 and \$113,000, respectively. For the nine months ended December 31, 2004 and 2003, the expense for this service was \$327,000 and \$187,000, respectively. We terminated our consulting arrangement with Mr. Schechter effective as of January 1, 2005 (see Note 18 - Subsequent Events below).

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 December 31, 2004 and 2003, the expense for this service was \$0 and \$10,000, respectively. For the nine months ended December 31, 2004 and 2003, the expense for this service was \$0 and \$118,000, 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

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an option for 500,000 shares. We accrued a severance payment of \$192,000 in the six months ended September 30, 2004 and included it in accrued expenses at September 30, 2004. As of December 31, 2004, the outstanding balance is \$0.

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 December 31, 2004, the outstanding balance is \$0.

NOTE 17 - RESTATEMENT OF FINANCIAL STATEMENTS

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 filed the following revised filings on November 16, 2004: 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 determined that prior presentation 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 and related amortization;
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, April '03, May '03 and March '04 convertible debentures;
6. Recognition and amortization of debt discount on the March '03, April '03, May '03 and Toys "R" Us, Inc. convertible debt as interest expense;
7. Capitalization of legal fees related to the acquisition of Page Digital and RTI;
8. Reclassify amortization of software technology to cost of product revenue;
9. Record fair value of RTI's stock options assumed at acquisition;
10. Reclassification of impairment of prepaid development expense from other expense to selling, general and administrative expense; and
11. Reclassification of a gain on debt forgiveness from extraordinary item to other income.

NOTE 18 - SUBSEQUENT EVENTS

Ran Furman resigned from the position of Chief Financial Officer effective January 10, 2005. We entered into a separation agreement dated January 7, 2005 to pay Mr. Furman \$50,000 in severance over the next four months and \$5,059 of

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accrued vacation. Corinne Bertrand replaced Mr. Furman as our Chief Financial Officer effective January 10, 2005.

On February 8, 2005, we filed 10-Q/As amending our quarterly reports for the quarters ended September 30, 2002, December 31, 2002, June 30, 2003 and September 30, 2003. On February 10, 2005, we filed 10-Q/As amending our quarterly reports for the quarters ended June 30, 2004 and September 30, 2004. The foregoing amendments did not include any additional adjustments to our financial statements; they included additional information and revised the officers' certifications to be consistent with the current forms required by the SEC.

On January 5, 2005, we entered into Amendment No. 2 (the "Amendment") to the Retail Pro Software License Agreement dated December 6, 2002 between Intuit Inc. and Retail Technologies International, Inc. ("RTI") (the "License Agreement"), which we were assigned and assumed in connection with its acquisition of RTI.

22

Pursuant to the License Agreement, certain license rights were to expire on December 6, 2005 and December 6, 2006. The Amendment extends the term of those license rights as follows: (1) the definition of Existing RTI Customer was amended to include any person or entity that purchases or licenses Retail Pro Software from the effective date of the License Agreement through December 31, 2006; the previous definition only applied to customers through December 31, 2005, (2) our license to use the source code for the Retail Pro Software for support and development purposes was extended one year to December 6, 2007, (3) our license to the object code for the Retail Pro Software, which provides us the right to resell the Retail Pro Software, was extended one year to December 6, 2006, and (4) our license to use and distribute upgrades and updates to the Retail Pro Software developed for or by us was extended one year to December 6, 2007.

Effective January 1, 2005, we terminated our consulting arrangement with Barry Schechter, our former CEO and Chairman. In connection with the termination of this arrangement, we agreed to continue to provide certain services and benefits to Mr. Schechter, including permitting him to continue to use office space in our La Jolla office and certain of our computer and telecommunications equipment and furniture and providing certain healthcare benefits, for a period of six months. Mr. Schechter agreed to continue to be available to our board to advise them regarding historical information about the company or provide further services going forward.

23

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

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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 a new license and when we provide services and support, an increase in license revenue will generally lead to an

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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:

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

24

- o Implemented cost containment measures;
- o Improved our IBM-based core products through continuing internal research and development;

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

RECENT DEVELOPMENTS

- o In June 2004, we completed the acquisition of RTI. See "Acquisition of RTI" below.
- o 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.
- o 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.
- o Mr. Page resigned from the position of executive officer in September 2004.
- o In July, we sold and issued a secured convertible note for a gross proceed of \$7.0 million. See "Indebtedness - Laurus" below.
- o On August 27, 2004 we increased the number of shares of common stock we are authorized to issue to 250 million shares.
- o 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.

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- o Ran Furman resigned from the position of Chief Financial Officer in January 2005. The company entered into a separation agreement with Mr. Furman dated January 7, 2005. Corinne Bertrand replaced Mr. Furman as our CFO on January 10, 2005.
- o On February 8, 2005 and February 10, 2005, we filed 10-Q/As amending our quarterly reports for the quarters ended September 30, 2002, December 31, 2002, June 30, 2003, September 30, 2003, June 30, 2004 and September 30, 2004. The foregoing amendments did not include any additional adjustments to our financial statements; they included additional information and revised the officers' certifications to be consistent with the current forms required by the SEC.
- o On January 5, 2005, we entered into Amendment No. 2 (the "Amendment") to the Retail Pro Software License Agreement dated December 6, 2002 between Intuit Inc. and Retail Technologies International, Inc. ("RTI") (the "License Agreement"), which we were assigned and assumed in connection with its acquisition of RTI. Pursuant to the Amendment, we extended certain of our license rights under the License Agreement.

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

25

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 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

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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

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs". SFAS No. 151 amends the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage) under the guidance in ARB No. 43, Chapter 4, "Inventory Pricing." Paragraph 5 of ARB No. 43, Chapter 4, previously stated that "...under some circumstances, items such as idle facility expense, excessive spoilage, double freight, and rehandling costs may be so abnormal as to require treatment as current period charges..." This statement requires that those items be recognized as current period charges regardless of whether they meet the criterion of "so abnormal". In addition, this statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. We do not expect adoption of SFAS No. 151 to have a material impact, if any, on its financial position or results of operations.

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In December 2004, the FASB issued SFAS No. 152, "Accounting for Real Estate Time-Sharing Transactions." The FASB issued this Statement as a result of the guidance provided in AICPA Statement of Position (SOP) 04-2, "Accounting for Real Estate Time-Sharing Transactions." SOP 04-2 applies to all real estate time-sharing transactions. Among other items, the SOP provides guidance on the recording of credit losses and the treatment of selling costs, but does not change the revenue recognition guidance in SFAS No. 66, "Accounting for Sales of Real Estate," for real estate time-sharing transactions. SFAS No. 152 amends Statement No. 66 to reference the guidance provided in SOP 04-2. SFAS No. 152 also amends SFAS No. 67, "Accounting for Costs and Initial Rental Operations of Real Estate Projects," to state that SOP 04-2 provides the relevant guidance on accounting for incidental operations and costs related to the sale of real estate time-sharing transactions. We do not expect adoption of SFAS No. 152 to have a material impact, if any, on its financial position or results of operations.

In December 2004, the FASB issued SFAS No. 153, "Exchanges of Nonmonetary Assets," an amendment to Opinion No. 29, "Accounting for Nonmonetary Transactions." Statement No. 153 eliminates certain differences in the guidance in Opinion No. 29 as compared to the guidance contained in standards issued by the international Accounting Standards Board. The amendment to Opinion No. 29 eliminates the fair value exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. Such an exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. We do not expect adoption of SFAS No. 152 to have a material impact, if any, on its financial position or results of operations.

In December 2004, the FASB issued SFAS No. 123(R), "Share-Based Payment." SFAS 123(R) amends SFAS No. 123, "Accounting for Stock-Based Compensation," and APB Opinion 25 "Accounting for Stock Issued to Employees." SFAS No. 123(R) requires that the cost of share-based payment transactions (including those with employees and non-employees) be recognized in the financial statements. SFAS No. 123(R) applies to all share-based payment transactions in which an entity acquires goods or services by issuing (or offering to issue) its shares, share options, or other equity instruments (except those held by an ESOP) or by incurring liabilities (1) in amounts based (even in part) on the price of the entity's shares or other equity instruments, or (2) that require (or may require) settlement by the issuance of an entity's shares or other equity instruments. We currently disclose stock options granted to employees in accordance with SFAS No. 123 and SFAS 148 and are reported in Note 11 to the financial statements. Commencing in the first quarter of fiscal 2006, we will adopt SFAS No. 123(R) accordingly.

QUARTER ENDED DECEMBER 31, 2004 COMPARED TO QUARTER ENDED DECEMBER 31, 2003

REVENUES

Product revenues increased \$1.7 million, or 40%, to \$5.9 million in the quarter ended December 31, 2004 from \$4.2 million in the quarter ended December 31, 2003, primarily due to the inclusion, in the quarter ended December, 2004, of \$2.7 million and \$1.0 million of product revenues for RTI and Page Digital, respectively. Excluding RTI and Page Digital product revenues, product revenues decreased \$2.0 million to \$2.2 million, a 48% decrease, primarily due to \$1.4 million decrease in alliance revenue and \$0.6 million decrease in incremental licenses. Services revenues increased by \$0.7 million, or 97% to \$1.4 million in the quarter ended December 31, 2004 from \$.7 million in the quarter ended December 31, 2003 primarily due to the inclusion of \$0.3 million and \$0.3 million of services revenue for Page Digital and RTI, respectively. Excluding Page Digital and RTI services revenues, services revenues increased \$0.1 million

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to \$0.8 million, a 14% increase. Total revenues increased \$2.3 million, or 47%, to \$7.2 million in the quarter ended December 31, 2004 from \$4.9 million in the quarter ended December 31, 2003, due primarily to the inclusion of \$3.0 million and \$1.2 million of RTI and Page Digital revenues recognized in the quarter ended December 31, 2004. Excluding Page Digital and RTI, total revenues decreased \$1.9 million to \$3.0 million, a 39% decrease, primarily due to the decrease in sale of partner products and incremental licenses.

COST OF REVENUES/GROSS PROFIT

Cost of revenues increased by \$1.3 million, or 62%, to \$3.3 million in the quarter ended December 31, 2004 from \$2.0 million in the quarter ended December 31, 2003. Cost of product revenues increased \$1.0 million, or 59%, to \$2.6 million in the quarter ended December 31, 2004 from \$1.6 million in the quarter ended December 31, 2003. Amortization of capitalized software included in cost of product revenues increased to \$0.9 million in the quarter ended December 31, 2004 from \$0.6 million in the quarter ended December 31, 2003. Cost of services revenue increased \$0.3 million, or 72%, to \$0.7 million in the quarter ended December 31, 2004 from \$0.4 million in the quarter ended December 31, 2003. Total gross profit increased \$1.1 million, or 37%, to \$3.9 million in the quarter ended December 31, 2004 from \$2.8 million in the quarter ended December 31, 2003, primarily due to the inclusion of \$2.2 million and \$0.5 million of total gross profit from RTI and Page Digital in the quarter ended December 31, 2004. Excluding RTI and Page Digital, gross profit decreased \$1.6 million to \$1.2 million, a 57% decrease. Total gross profit margin was 54% and 58% for the quarter ended December 31, 2004 and December 31, 2003, respectively. Excluding

27

Page Digital and RTI, gross profit margin decreased to 38%. Gross profit margin on products was 56% and 61% for the quarters ended December 31, 2004 and December 31, 2003, respectively. The decrease is due to the reduction of higher margin alliance products offset by 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 33% for the quarter ended December 31, 2004 from 39% for the quarter ended December 31, 2003, due primarily to a \$2.0 million decrease in product revenues and a \$0.2 million increase in amortization of capitalized software. Gross profit margin on services was 44% and 36% for the quarters ended December 31, 2004 and December 31, 2003, respectively. Excluding Page Digital and RTI, gross profit margin increased to 52% 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 December 31, 2004 from the quarter ended December 31, 2003.

APPLICATION DEVELOPMENT EXPENSE

Application development expense increased by \$1.4 million, or 350%, to \$1.8 million in the quarter ended December 31, 2004 from \$0.4 million in the quarter ended December 31, 2003. The increase is primarily due to the inclusion of \$1.2 million of application development expenses from Page Digital and RTI in the quarter ended December 31, 2004 and larger capitalization in the nine months ended December 31, 2003.

DEPRECIATION AND AMORTIZATION

Depreciation and amortization increased to \$0.4 million in the quarter ended December 31, 2004 from \$0.3 million in the quarter ended December 31, 2003, primarily due to the inclusion of Page Digital and RTI.

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SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative ("SG&A") expenses increased by \$1.2 million, or 42%, to \$4.0 million in the quarter ended December 31, 2004 from \$2.8 million in the quarter ended December 31, 2003, primarily due to the inclusion of \$1.7 million of SG&A expenses from Page Digital and RTI that are included in the quarter ended December 31, 2004. Excluding Page Digital and RTI, SG&A expenses decreased to \$0.5 million, a 14% decrease, primarily due to reduction in personnel and a focus on cost containment. SG&A expenses as a percent of sales decreased to 55% in the quarter ended December 31, 2004 from 57% in the quarter ended December 31, 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 \$0.03 million and \$0 in the three months ended December 31, 2004 and December 31, 2003, respectively. Restructuring expenses were \$0.7 million and \$0 in the nine months ended December 31, 2004 and December 31, 2003, respectively. The restructuring expenses are a result of our cost containment measures and relate to one-time termination costs consisting of severance payments and benefits related to workforce reduction of nine full time employees. As of December 31, 2004, \$0.5 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 \$2.3 million for the quarter ended December 31, 2004, compared to an operating loss of \$0.6 million for the quarter ended December 31, 2003, as the \$1.0 million increase in gross profit, due primarily to the increase in sales from RTI and Page Digital, partially offset the \$2.7 million increase in total expenses.

INTEREST EXPENSE

Interest expense increased by \$1.0 million, or 100%, to \$1.0 million in the quarter ended December 31, 2004 from \$0.0 million in the quarter ended December 31, 2003. Interest expense in the quarter ended December 31, 2004 was comprised primarily of \$0.2 million financing costs and amortization of debt discount on the Laurus Note, \$0.1 million financing costs and amortization of debt discounts on the Midsummer Debenture, as well as \$0.2 million interest expense on the Laurus Note, the March '04 Debentures and notes due to the former RTI note holders, and \$0.5 million due to revalue of outstanding warrants for Midsummer, Omicron, Crestview, Islandia, and MBSJ to \$0.37. Interest expense in the quarter ended December 31, 2003 was zero due to no interest-bearing debts outstanding in the quarter.

28

PROVISION FOR INCOME TAXES

Provision for income taxes for the quarters ended December 31, 2004 and 2003 are \$0 and \$19,000, respectively.

CUMULATIVE PREFERRED DIVIDENDS

Cumulative dividends on the outstanding Series A Preferred attributable to the

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quarter ended December 31, 2004 and December 31, 2003 were \$0.3 million and \$0.2 million, respectively.

NINE MONTHS ENDED DECEMBER 31, 2004 COMPARED TO NINE MONTHS ENDED DECEMBER 31, 2003

REVENUES

Product revenues increased \$6.0 million, or 65%, to \$15.3 million in the nine months ended December 31, 2004 from \$9.2 million in the nine months ended December 31, 2003, primarily due to the inclusion, in the nine months ended December 31, 2004, of \$5.7 million and \$2.7 million of product revenues for RTI and Page Digital, respectively. Excluding RTI and Page Digital product revenues, product revenues decreased \$2.3 million to \$6.9 million, a 25% decrease. Services revenues did not change year over year as we reported \$3.9 million in the nine months ended December 31, 2004 compared to \$3.9 million in the nine months ended December 31, 2003 primarily due to a decrease to \$1.5 million from Toys R Us., Inc. "(Toys)", a \$0.4 million decrease in services revenues, offset by the inclusion of \$1.4 million of Page Digital and \$0.5 million of 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 Development Agreement with us dated May 29, 2002 (the "Development Agreement") in third quarter of fiscal 2004. As we do not anticipate additional material revenue from Toys in the near future, the loss of Toys will have a significant impact on future revenues exclusive of Page Digital and RTI revenues as we attempt to replace those revenues with revenues generated from new customers. Total revenues increased \$6.0 million, or 46%, to \$19.1 million in the nine months ended December 31, 2004 from \$13.1 million in the nine months ended December 31, 2003, due primarily to the inclusion of \$6.2 million and \$4.0 million of RTI and Page Digital revenues recognized in the nine months ended December 31, 2004, offset by a decrease of \$1.5 million for Toys, decrease of \$1.6 million in incremental licenses, decrease of \$0.4 million in software licenses, and decrease of \$0.6 million in professional services. Excluding Page Digital and RTI, total revenues decreased \$4.2 million to \$8.9 million, a 32% decrease.

COST OF REVENUES/GROSS PROFIT

Cost of revenues increased by \$3.1 million, or 53%, to \$9.1 million in the nine months ended December 31, 2004 from \$6.0 million in the nine months ended December 31, 2003. Cost of product revenues increased \$2.9 million, or 72%, to \$6.9 million in the nine months ended December 31, 2004 from \$4.0 million in the nine months ended December 31, 2003. Amortization of capitalized software included in cost of product revenues increased to \$2.7 million in the nine months ended December 31, 2004 from \$1.9 million in the nine months ended December 31, 2003. Cost of services revenue increased \$0.3 million, or 13%, to \$2.2 million in the nine months ended December 31, 2004 from \$1.9 million in the nine months ended December 31, 2003. Total gross profit increased \$2.8 million, or 40%, to \$10.0 million in the nine months ended December 31, 2004 from \$7.2 million in the nine months ended December 31, 2003, primarily due to the inclusion of \$4.8 million and \$1.5 million of total gross profit from RTI and Page Digital in the nine months ended December 31, 2004. Excluding RTI and Page Digital, gross profit decreased \$3.5 million to \$3.7 million, a 49% decrease. Total gross profit margin decreased to 52% for the nine months ended December 31, 2004 compared to 55% for the nine months ended December 31, 2003. Excluding Page Digital and RTI, gross profit margin decreased to 41%. Gross profit margin on products was 55% and 56% for the nine months ended December 31, 2004 and December 31, 2003, respectively. Excluding Page Digital and RTI, gross profit margin on products decreased to 39%, due primarily to a \$2.3 million decrease in product revenues and a \$0.5 million increase in amortization of capitalized software. Gross profit margin on services was 44% and 51% for the nine months ended December 31, 2004 and December 31, 2003, respectively. Excluding Page

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Digital and RTI, gross profit margin on services remained the same year over year at 51%.

APPLICATION DEVELOPMENT EXPENSE

Application development expense increased by \$3.7 million, or 344%, to \$4.8 million in the nine months ended December 31, 2004 from \$1.1 million in the nine months ended December 31, 2003. The increase is primarily related to the capitalization of \$3.0 million development for new products in the nine months ended December 31, 2003.

29

DEPRECIATION AND AMORTIZATION

Depreciation and amortization increased \$0.5 million, or 58%, to \$1.3 million in the nine months ended December 31, 2004 from \$0.8 million in the nine months ended December 31, 2003, primarily due to an increase of \$0.6 million from Page Digital and RTI for the nine months ended December 31, 2004, offset by \$0.1 million of decrease in amortization of a fully amortized asset.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

SG&A expenses increased by \$3.7 million, or 43%, to \$12.3 million in the nine months ended December 31, 2004 from \$8.6 million in the nine months ended December 31, 2003, primarily due to the inclusion of \$5.0 million of SG&A expenses from Page Digital and RTI that are included in the nine months ended December 31, 2004. Excluding Page Digital and RTI, SG&A expenses decreased to \$1.4 million, a 16% decrease, primarily due to reduction in personnel and a focus on cost containment. SG&A expenses as a percent of sales decreased to 64% in the nine months ended December 31, 2004 from 66% in the nine months ended December 31, 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 nine months ended December 31, 2004 and December 31, 2003, respectively. The restructuring expenses are a result of our cost containment measures and relate to one-time termination costs consisting of severance payments and benefits related to workforce reduction of nine full time employees. As of December 31, 2004, \$0.5 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 \$9.1 million for the nine months ended December 31, 2004, compared to an operating loss of \$3.3 million for the nine months ended December 31, 2003, as the \$2.8 million increase in gross profit, due primarily to the increase in sales from RTI and Page Digital, was more than offset by the \$8.6 million increase in total expenses.

INTEREST EXPENSE

Interest expense increased by \$1.5 million, or 87%, to \$3.3 million in the nine months ended December 31, 2004 from \$1.8 million in the nine months ended

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December 31, 2003. Interest expense in the nine months ended December 31, 2004 was comprised primarily of \$1.9 million financing costs and amortization of debt discount on the Laurus Note and the March '04 Debentures, \$0.8 million due to revalue of outstanding warrants for Midsummer, Omicron, Crestview, Islandia and MBSJ to \$0.37, as well as \$0.5 million interest expense on the Laurus Note, the March '04 Debentures and notes due to the former RTI note holders. Interest expense in the nine months ended December 31, 2003 was comprised primarily of \$1.6 million amortization and \$0.2 million of debt discount and interest expense, respectively, on the March '04 convertible debentures.

PROVISION FOR INCOME TAXES

Provision for income tax was \$6,000 for the nine months ended December 31, 2004. In the nine months ended December 31, 2003, the provision for income taxes represents \$0.6 million income tax refund and \$0.1 million provision for state income taxes. The income tax refund of \$0.6 million at December 31, 2003 results from amending prior years' income tax returns to carry back net operating losses incurred in the past two years.

CUMULATIVE PREFERRED DIVIDENDS

Cumulative dividends on the outstanding Series A Preferred attributable to the nine months ended December 31, 2004 and December 31, 2003 were \$0.9 million and \$0.6 million, respectively.

LIQUIDITY AND CAPITAL RESOURCES

CASH FLOWS

During the nine months ended December 31, 2004, we financed our operations using cash on hand and proceeds from the sale of convertible debt. At December 31, 2004 and March 31, 2004, we had cash of \$1.1 million and \$2.1 million, respectively.

30

Operating activities used cash of \$4.1 million in the nine months ended December 31, 2004 and \$5.4 million in the nine months ended December 31, 2003. Cash used for operating activities in the nine months ended December 31, 2004 resulted from \$12.2 million net loss and \$2.0 million decrease in accounts payable and accrued expenses which were offset in part by \$4.0 million of non-cash depreciation and amortization, \$0.9 million on stock based compensation, \$3.3 million increase in deferred revenue, \$0.3 million decrease in other assets and \$1.1 million amortization of debt discount and conversion option.

Investing activities provided cash of \$0.1 million in the nine months ended December 31, 2004 and used cash of \$3.3 million in the nine months ended December 31, 2003. Cash provided by investing activities in the nine months ended December 31, 2004 resulted primarily from \$0.6 million proceeds from the acquisition of RTI, offset by \$0.4 million of capitalized software development costs. Cash used by investing activities in the nine months ended December 31, 2003 resulted primarily from \$3.0 million of capitalized software development costs and \$0.3 million purchase of furniture and equipment.

Financing activities provided cash of \$3.0 million and \$12.5 million in the nine months ended December 31, 2004 and 2003, respectively. Cash provided by financing activities in the nine months ended December 31, 2004 resulted primarily from the proceeds of a \$7.0 million note payable, offset by \$3.5

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million payment on convertible debentures. Cash provided by financing activities in the nine months ended December 31, 2003 resulted primarily from net proceeds of \$11.9 million from the sale of common stock and \$0.7 million from the issuance of convertible debentures.

Accounts receivable increased to \$6.1 million at December 31, 2004 from \$4.6 million at March 31, 2004. The increase is primarily due to the inclusion of RTI accounts receivable at March 31, 2004, offset by decrease in unbilled accounts receivable.

We believe that our cash and cash equivalent and funds generated from operations will provide adequate liquidity to meet our normal operating requirements for at least the next twelve months. Our future capital requirements depend on many factors, including our application development, sales and marketing activities. In addition, we have incurred losses for the last three fiscal years and we had a negative working capital at December 31, 2004. In the next twelve months, we anticipate raising additional capital through public or private equity or debt financings. In the long-term, we anticipate that cash from operations will be sufficient to provide liquidity for our normal operating requirements. As such, we do not know whether additional financing will be available when needed, or available on terms acceptable to us. We may raise capital through public or private equity or debt financings. If we are unable to raise the needed funds, we may be forced to curtail some or all of our activities and we may not be able to grow.

INDEBTEDNESS

NATIONAL AUSTRALIA BANK LIMITED

We decided in the third quarter of fiscal 2002 to sell certain assets of the Australian subsidiary to the former management of such subsidiary, and then cease Australian operations. The sale was 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 former management, and actively pursued the collection of receivables. If the sale proceeds plus collections on receivables were insufficient to discharge the indebtedness to National Australia Bank, we could have been called upon to pay the deficiency under our guarantee to the bank. We accrued \$187,000 as the maximum amount of our potential exposure as of March 31, 2004. 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 nine months ended December 31, 2004.

OMICRON/MIDSUMMER

On March 15, 2004, we sold Omicron Master Trust ("Omicron") and Midsummer Investment, Ltd. ("Midsummer") convertible debentures (the "March 2004 Debentures") for an aggregate price of \$3.0 million pursuant to a securities purchase agreement (the "March 2004 Debenture Purchase Agreement"). The March 2004 Debentures bear interest at a rate of 9% per annum, and provide for interest only payments on a quarterly basis, payable, at our option, in cash or shares of our common stock. The March 2004 Debentures mature on May 15, 2006. The March 2004 Debentures were initially convertible into shares of our common stock at a conversion price of \$1.32 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 statements or make any public disclosure that negatively revises or supplements any prior disclosure regarding a material transaction consummated

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prior to March 15, 2004 or trigger other customary anti-dilution protections.

31

We also issued Omicron and Midsummer two warrants each as follows: (i) Series A Warrants to purchase up to an aggregate of 1,043,479 shares of our common stock at an exercise price of \$1.15 per share 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 (ii) Series B Warrants to purchase up to an aggregate of 8,500,000 shares of our common stock with an exercise price of \$5 per share, 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. The Series B Warrants are immediately exercisable and expire on the earlier of the six-month anniversary of the effective date of the registration statement covering the shares underlying the warrant or 18 months from March 15, 2004.

In July 2004, with the proceeds from the sale of the Laurus Note, we paid Omicron \$1.75 million, the full amount due under its March 2004 Debenture, plus \$0.2 million in accrued interest, liquidated damages pursuant to the Omicron/Midsummer Registration Rights Agreement (described below) and prepayment penalties. In accordance with generally accepted accounting principles, the difference between the original conversion price of \$1.32 and our stock price on the date Omicron's March 2004 Debenture was issued 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.

In July 2004, we issued 600,000 shares of our common stock, which we valued at \$240,000, to Midsummer as payments for liquidated damages due under the Omicron/Midsummer Registration Rights Agreement (described below) and as partial consideration for Midsummer consenting to our issuance of the Laurus Note. We also amended Midsummer's March 2004 Debenture in exchange for its consent to the transaction with Laurus. Pursuant to Amendment No. 1 to the 9% Debenture Due May 15, 2006 Issued to Midsummer Investments, Ltd. And Waiver, the terms of Midsummer's March 2004 Debenture were amended as follows: (i) the prepayment penalty was eliminated, (ii) the conversion price was reduced to \$0.56 per share, (iii) interest payments are due on a monthly, rather than quarterly, basis, (iv) the commencement of monthly redemption payments was accelerated to September 1, 2004 and (v) the monthly redemption payments were revised such that payments of \$50,000 are due monthly commencing September 1, 2004 and increase to \$62,500 starting February 1, 2005. In connection with the issuance of the Laurus Note, the exercise price of the Series A Warrants held by both Omicron and Midsummer was reduced to \$0.56 per share. During the months of October, November and December 2004 132,433, 169,340 and 188,998 shares of common stock were issued, respectively, valued at \$50,000, \$58,905 and \$58,533, respectively, for payment of principal and interest. Computation of number of shares is in accordance with agreement and share price is based upon the 20 day average VWAP less 20% discount. Management considers this to be the fair value of the shares of common stock issued.

We entered into a registration rights agreement with Omicron and Midsummer dated March 15, 2004 (the "Omicron/Midsummer Registration Rights Agreement"), pursuant

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to which we were required to file a registration statement respecting the common stock issuable upon the conversion of the March 2004 Debentures and exercise of the warrants within 30 days after March 15, 2004, and to use best efforts to have the registration statement declared effective at the earliest date but in no event later than 90 days after March 15, 2004 (or 120 days in the event of full review). If we fail to file a registration statement within such 30 day period or have it declared effective within such 90 day period (or 120 day period in the event of a full review), we are obligated to pay liquidated damages to Omicron and Midsummer equal to 2% per month of each of their initial subscription amounts plus the value of any outstanding warrants. A registration statement on Form S-3 registering the shares issuable upon conversion of Midsummer's March 2004 Debenture and the shares issuable on exercise of both Omicron's and Midsummer's Series A Warrants was filed on August 25, 2004. A registration statement on Form S-3 registering the shares issuable upon exercise of Midsummer's and Omicron's Series B Warrants was filed on September 13, 2004. The registration statements were combined into one registration statement on Form S-3 pursuant to Amendment No. 1 to the Forms S-3 filed on December 2, 2004. Amendment No. 2 to the registration statement was filed on January 25, 2005, but it has not been declared effective as of February 10, 2005. Outstanding liquidated damages totaling \$201,000 were paid in July 2004. Additional liquidated damages were waived pursuant to Amendment No. 2 to Midsummer's March 2004 Debenture (as described below). We will accrue liquidated damages beginning February 1, 2005 until the registration statement is declared effective.

On November 30, 2004, we entered into Amendment No. 2 to Midsummer's March 2004 Debenture ("Amendment No. 2"). Pursuant to Amendment No. 2, the terms of Midsummer's March 2004 Debenture were amended as follows: (i) the conversion price for the March 2004 Debenture and the exercise price for the Series A Warrant were reduced to \$0.37 per share, (ii) all outstanding accrued and unpaid liquidated damages and all liquidated damages that may accrue through January

32

31, 2005 were waived, (iii) until the shares are registered, we may make monthly redemption and interest payments in shares of restricted stock valued at 80% of the value weighted average price for the 20 days prior to either the interest payment date or the date the shares are issued, whichever is lower and (iv) the date by which the registration statement covering the shares issuable upon conversion of Midsummer's March 2004 Debenture and the related warrants must be declared effective was extended to January 31, 2005. In addition, we issued Midsummer an additional warrant to purchase 200,000 shares of our common stock with an exercise price of \$0.41. We have assessed but not recorded any charge to expense in connection with the issuance of the additional warrant to Midsummer because the impact on the statement of operations is not material.

In accordance with generally accepted accounting principles, the difference between the original conversion price of \$1.32 and our stock price on the date of issuance of the Midsummer March 2004 Debenture amounted to \$110,000 and was being amortized over the term of the debt. Upon amending the debt, we recomputed the difference between the amended conversion price of \$0.56 and our stock price on 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 \$243,000 in the three and nine months ended December 31, 2004. No additional amounts were recorded for the second amendment of the Midsummer's March 2004 Debenture as maximum amounts were recorded in the first amendment.

For a period of 180 days following the date the registration statement covering the shares issuable upon conversion of the March 2004 Debentures and related

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warrants is declared effective (the "Omicron/Midsummer Registration Effective Date"), both Omicron and Midsummer have the right, in their sole discretion, to elect to purchase their pro rata portion of additional March 2004 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 would be identical to the terms set forth in the March 2004 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 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 180 days following the Omicron/Midsummer Registration Effective Date, if the daily volume weighted average price of our common stock for 15 consecutive trading days exceeds the then current conversion price by more than 200%, subject to adjustment, we may, on one occasion, in our sole determination, require Omicron and Midsummer to purchase each of their 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 March 2004 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 March 2004 Debenture and Series A Warrants.

For a period of 6 months from the Omicron/Midsummer Registration Effective Date, Omicron and Midsummer have a right of first refusal to participate in certain future financings by us involving the sale of our common stock or equivalent securities.

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 amortized the charge 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 debenture was repaid. Upon repayment of the Omicron Debenture, the remaining balance of \$363,000 was expensed.

The amount allocated to the warrants issued to Midsummer was originally \$300,000. Upon amending Midsummer's March 2004 Debenture, we recomputed the amount allocated to the 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 \$118,000 in the three and nine months ended December 31, 2004, respectively.

In connection with the sale and subsequent amendments of the convertible notes during the quarters ended September 30, 2004 and December 31, 2004, we adjusted the exercise price of outstanding warrants previously issued to certain investors to \$0.56 per share pursuant to the anti-dilution protection provisions. Accordingly, we recorded charges of \$366,000 and \$417,000 as interest expense in the quarters ended September 30, 2004 and December 31, 2004, respectively.

The outstanding balance of Midsummer Debenture, including accrued interest, is \$1.0 million at December 31, 2004.

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INTUIT

In connection with the RTI acquisition in June 2004, we issued a promissory note to Intuit for \$0.5 million ("Intuit Note"). The Intuit Note is due on June 1, 2006 and is payable in monthly installments of \$4,000 from June 1, 2004 through December 1, 2004, increasing to \$30,000 from January 1, 2005. The Intuit Note earns interest at a rate of 6.5% per annum. The balance of the Intuit Note including accrued interest is \$0.5 million at December 31, 2004.

RTI NOTEHOLDERS

In connection with the RTI acquisition in June 2004, we assumed RTI's obligations on notes payable totaling \$1.8 million and issued additional \$0.5 million in debt to the holders of these notes. These notes are secured by common stock of our subsidiary IP Retail Technology International, Inc., formerly known as IPI Merger Sub II, Inc. ("IP RTI"). The notes are due on May 31, 2005 and payable in monthly installments in aggregate of \$197,000 commencing May 31, 2004. These notes earn interest at a rate of 6.5% per annum. The balance of these notes, including accrued interest, is \$1.0 million at December 31, 2004.

TOMCZAK/BOONE

In connection with the RTI acquisition in June 2004, we issued promissory notes to RTI's two principals, Michael Tomczak and Jeffrey Boone, totaling \$2.6 million ("Officers Notes"). The Officers Notes are due on June 1, 2006 and payable in monthly installments in aggregate of \$20,000 from June 1, 2004 through May 1, 2005, increasing to \$200,000 from June 1, 2005. The Officers Notes earn interest at a rate of 6.5% per annum. The balance of the Officers Notes is \$2.5 million at December 31, 2004.

LAURUS

On July 12, 2004, we sold and issued a secured convertible term note (the "Laurus Note") to Laurus Master Fund, Ltd. ("Laurus") for gross proceeds of \$7.0 million pursuant to a Securities Purchase Agreement. In addition, we issued Laurus a warrant to purchase up to 3,750,000 shares of our common stock at a price of \$0.71 per share (the "Laurus Warrant").

The Laurus Note initially matured on September 1, 2004, however, the maturity date was automatically extended to July 12, 2007 (the "Maturity Date") upon our stockholders approving an increase to our authorized common stock from 100 to 250 million shares and our filing an amendment to our certificate of incorporation to effect such change on August 27, 2004. The Laurus Note accrues interest at a rate per annum (the "Interest Rate") equal to the "prime rate" published in The Wall Street Journal from time to time, plus two percent. Interest under the Note is payable monthly in arrears and interest payments commenced on August 1, 2004. The Interest Rate is calculated on the last day of each month and is subject to adjustment based on the then-current price of our common stock. The initial conversion price under the Note was \$0.56 per share, subject to adjustment upon our issuance of securities at a price 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. Our obligations under the Laurus Note are secured by all of our assets. In addition, all our wholly owned subsidiaries guaranteed our obligations under the Laurus Note and we pledged all of our interests in the outstanding stock of our subsidiaries as security for our obligations under the Laurus Note.

The Laurus Warrant is immediately exercisable and has a seven year term. We have the right to require exercise of the Laurus Warrant in whole or in part if: (1)

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all of our obligations under the Laurus Note have been irrevocably paid in full, (2) the common stock underlying the Laurus Warrant 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 Warrant is greater than three hundred percent (300%) of the then applicable exercise price.

In August 2004, Laurus agreed to defer the interest payments due under the Laurus Note on August 1, 2004 until the Maturity Date. In October 2004, Laurus agreed to amend the Laurus Note and defer the payments due from 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 due in July 2007. In connection with the amendment to the Laurus Note and the related amendment to the Laurus Registration Rights Agreement (as defined below): (1) the conversion price on \$2

34

million of the \$7 million Laurus Note was reduced to \$0.37, (2) we issued Laurus an additional warrant (the "October '04 Warrant") to purchase 250,000 shares of our common stock at a price of \$0.41 per share with the same terms as the Laurus Warrant, and (3) the Effectiveness Date (as defined below) under the Laurus Registration Rights Agreement was extended. We have assessed but not recorded any charge to expense in connection with the issuance of the October '04 Warrant because the impact on the statement of operations is not material.

Pursuant to the registration rights agreement between us and Laurus executed in connection with the sale of the Laurus Note (the "Laurus Registration Rights Agreement"), we were obligated to file a registration statement registering the shares of our common stock issuable upon conversion of the Laurus Note or exercise of the Laurus Warrant or the October '04 Warrant (the "Underlying Shares") within 60 days of July 12, 2004 and have the Registration Statement declared effective by the SEC no later than March 1, 2005. If (1) the Registration Statement is not filed or declared effective within the requisite periods, (2) the Registration Statement ceases to be effective for more than 30 days in any calendar year or any 10 consecutive calendar days, or (3) 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 filed a registration statement for the Underlying Shares on Form S-3 (the "Laurus Registration Statement") on September 13, 2004 and filed amendments to the Form S-3 on December 2, 2004 and January 25, 2005. The Laurus Registration Statement has not yet been declared effective.

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 \$23,000 in the three months and \$43,000 in the nine months ended December 31, 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 \$44,000 in the three months and \$81,000 in the nine months ended December 31,

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2004.

In connection with the amendment to the Laurus Note in October 2004, 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 amounted to \$1.0 million and is being amortized over the remaining term of the Laurus Note. We amortized \$62,000 in the three and nine months ended December 31, 2004.

In connection with the amendment to the Laurus Note in October 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 \$24,000 and is being amortized as interest expense over the life of the Laurus Note. We amortized \$2,000 in the three and nine months ended December 31, 2004.

The balance of the Laurus Note, including accrued interest, is \$7.0 million at December 31, 2004.

CONTRACTUAL OBLIGATIONS

The following table summarizes our contractual obligations, including purchase commitments at December 31, 2004, and the effect such obligations are expected to have on our liquidity and cash flow in future periods.

35

| Contractual Cash Obligations ----- | Total ----- | Payment due by period ----- | | |
|---------------------------------------|----------------|--------------------------------|--------------------|--------------------|
| | | Less than 1 year ----- | 1-3 years ----- | 3-5 years ----- |
| | | (in thousands) | | |
| Long-term debt obligations | \$ 13,319 | \$ 5,846 | \$ 7,473 | |
| Capital lease obligations | 149 | 146 | 3 | |
| Operating leases | 9,698 | 1,719 | 2,061 | 1,9 |
| Purchase obligations | 2,209 | 2,209 | -- | |
| | ----- | ----- | ----- | ----- |
| Total contractual cash obligations | \$ 25,375 | \$ 9,920 | \$ 9,537 | \$ 1,9 |
| | ===== | ===== | ===== | ===== |

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, based on historical experience, and various other assumptions that are believed to be

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reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect significant judgments and estimates used in the preparation of our consolidated financial statements:

- o REVENUE RECOGNITION. Our revenue recognition policy is significant because our revenue is a key component of our results of operations. In addition, our revenue recognition determines the timing of certain expenses such as commissions and royalties. We follow specific and detailed guidelines in measuring revenue; however, certain judgments affect the application of our revenue policy.

We license software under non-cancelable agreements and provide related services, including consulting and customer support. We recognize revenue in accordance with Statement of Position 97-2 (SOP 97-2), Software Revenue Recognition, as amended and interpreted by Statement of Position 98-9, Modification of SOP 97-2, Software Revenue Recognition, with respect to certain transactions, as well as Staff Accounting Bulletin ("SAB") 101, "Revenue Recognition," updated by SAB's 103 and 104, "Update of Codification of Staff Accounting Bulletins," and Technical Practice Aids issued from time to time by the American Institute of Certified Public Accountants.

Software license revenue, including third party license revenues or partner products, is generally recognized when a license agreement has been signed, the software product has been delivered, there are no uncertainties surrounding product acceptance, the fees are fixed and determinable, and collection is considered probable. If a software license contains an undelivered element, the fair value of the undelivered element is deferred and the revenue recognized once the element is delivered. We can establish vendor specific objective evidence ("VSOE") for all elements and not just undeliverable elements. The undeliverable elements are primarily training, consulting and maintenance services. VSOE of fair value for training and consulting services is based upon hourly rates charges when those services are sold separately. VSOE of fair value for maintenance is the price the customer will be required to pay when it is sold separately (that is the renewal rate). In addition, if a software license contains contingencies, such as specific customer acceptance criteria, right of return or a cancellation right, the software revenue is recognized upon the later of customer acceptance or the expiration of the acceptance period or cancellation right. Typically, payments for our software licenses are due in installments within twelve months from the date of delivery. Where software license agreements call for payment terms of twelve months or more from the date of delivery, revenue is recognized as payments become due and all other conditions for revenue recognition have been satisfied. Deferred revenue consists primarily of prepaid maintenance, support revenues, prepaid services revenue and deferred licenses.

Consulting services are separately priced, are generally available from a number of suppliers, and are not essential to the functionality of our software products. Consulting services, which include project management, system planning, design and implementation, customer configurations, and training are billed on both an hourly basis and under fixed price contracts. Consulting services revenue billed on an hourly basis is recognized as the work is performed. Under most fixed price contracts, consulting services revenue is recognized using the percentage of completion method of accounting by relating hours incurred to date to total estimated hours at completion. In limited instances where our fixed price contracts require the achievement of certain milestones, the milestones are agreed with the customer and revenues are recognized only when the milestones are delivered and accepted by the customer.

Customization of software is billed on both an hourly basis and under fixed price contracts. Customization services billed on an hourly basis is recognized as the work is performed. Under most fixed price contracts, customization services revenue is recognized using the percentage of completion method of accounting by relating hours incurred to date to total estimated hours at completion. In limited instances where our fixed price contracts require the achievement of certain milestones, the milestones are agreed with the customer and revenues are recognized only when the milestones are delivered and accepted by the customer.

Customer support services include post contract support and the rights to unspecified upgrades and enhancements. Maintenance revenues from ongoing customer support services are billed on a monthly basis and recorded as revenue in the applicable month, or on an annual basis with the revenue being deferred and recognized ratably over the maintenance period. If an arrangement includes multiple elements, the fees are allocated to the various elements based upon vendor-specific objective evidence of fair value.

- o ACCOUNTS RECEIVABLE. We typically extend credit to our customers. Software licenses are generally due in installments within twelve months from the date of delivery. Billings for customer support and consulting services performed on a time and material basis are due upon receipt. From time to time software and consulting services are provided under fixed price contracts where the revenue is only recognized and the payments are only due upon customer acceptance and the achievement of certain milestones. Management estimates the probability of collection of the receivable balances and provides an allowance for doubtful accounts based upon an evaluation of our customers' ability to pay and general economic conditions.
- o VALUATION OF LONG-LIVED AND INTANGIBLE ASSETS AND GOODWILL. We do not amortize goodwill, but instead test goodwill for impairment on an annual basis or more frequently if certain events occur. Goodwill is to be measured for impairment by

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reporting units, which currently consist of our operating segments. At each impairment test for a business unit, we are required to compare the carrying value of the business unit to the fair value of the business unit. If the fair value exceeds the carrying value, goodwill will not be considered impaired. If the fair value is less than the carrying value, we will perform a second test comparing the implied fair value of reporting unit goodwill with the carrying amount of that goodwill. The difference, if any, between the carrying amount of that goodwill and the implied fair value will be recognized as an impairment loss, and the carrying amount of the associated goodwill will be reduced to its implied fair value. These tests require us to make estimates and assumptions concerning prices for similar assets and liabilities, if available, or estimates and assumptions for other appropriate valuation techniques.

For our intangible assets with finite lives, including our capitalized software and non-compete agreements, we assess impairment at least annually or whenever events and circumstances suggest the carrying value of an asset may not be recoverable based on the net future cash flows expected to be generated from the asset on an undiscounted basis. When we determine that the carrying value of intangibles with finite lives may not be recoverable, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model.

- o APPLICATION DEVELOPMENT. The costs to develop new software products and enhancements to existing software products are expensed as incurred until technological feasibility has been established. Technological Feasibility has occurred when all planning, designing, coding and testing have been completed according to design specifications. Once technological feasibility is established, any additional costs would be capitalized, in accordance with SFAS No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed."

37

- o STOCK-BASED COMPENSATION. We do not record compensation expense for options granted to our employees as all options granted under our stock option plans have an exercise price equal to the market value of the underlying common stock on the date of grant. In addition, we do not record compensation expense for shares issued under our employee stock purchase plan. As permitted under SFAS No. 123, "Accounting for Stock-Based Compensation" and SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," we account for costs of stock based compensation in accordance with the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and accordingly, discloses the pro forma effect on net income (loss) and related per share amounts using the fair-value method defined in SFAS No. 123, updated by SFAS No. 148.

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BUSINESS RISKS

INVESTORS SHOULD CAREFULLY CONSIDER THE FOLLOWING RISK FACTORS AND ALL OTHER INFORMATION CONTAINED IN OUR FORM 10-K/A FOR THE YEAR ENDED MARCH 31, 2004 AND FORM 10-Q/A FOR THE QUARTER ENDED JUNE 30, 2004. INVESTING IN OUR COMMON STOCK INVOLVES A HIGH DEGREE OF RISK. IN ADDITION TO THOSE DESCRIBED BELOW, RISKS AND UNCERTAINTIES THAT ARE NOT PRESENTLY KNOWN TO US OR THAT WE CURRENTLY BELIEVE ARE IMMATERIAL MAY ALSO IMPAIR OUR BUSINESS OPERATIONS. IF ANY OF THE FOLLOWING RISKS OCCUR, OUR BUSINESS COULD BE HARMED, THE PRICE OF OUR COMMON STOCK COULD DECLINE AND OUR INVESTORS MAY LOSE ALL OR PART OF THEIR INVESTMENT. SEE THE NOTE REGARDING FORWARD-LOOKING STATEMENTS INCLUDED AT THE BEGINNING OF ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS IN THIS FORM 10-Q.

WE INCURRED LOSSES FOR FISCAL YEARS 2004, 2003 AND 2002.

We incurred losses of \$8.9 million, \$2.7 million and \$14.7 million in the fiscal years ended March 31, 2004, 2003, and 2002 respectively. The losses in the past three years have generally been due to difficulties completing sales for new application software licenses, the resulting change in sales mix toward lower margin services, and debt service expenses. We will need to generate additional revenue to achieve profitability in future periods. If we are unable to achieve profitability, or maintain profitability if achieved, our business and stock price may be adversely effected and we may be unable to continue operations at current levels, if at all.

WE HAD NEGATIVE WORKING CAPITAL AT DECEMBER 31, 2004 AND IN THE PRIOR FISCAL YEAR, AND WE HAVE EXTENDED PAYMENT TERMS WITH A NUMBER OF OUR SUPPLIERS.

At December 31, 2004 and March 31, 2004, we had negative working capital of \$8.4 million and \$0.8 million, respectively. We have had difficulty meeting operating expenses, including interest payments on debt, lease payments and supplier obligations. We have at times deferred payroll for our executive officers, and borrowed from related parties to meet payroll obligations. We have extended payment terms with our trade creditors wherever possible.

As a result of extended payment arrangements with suppliers, we may be unable to secure products and services necessary to continue operations at current levels from these suppliers. In that event, we will have to obtain these products and services from other parties, which could result in adverse consequences to our business, operations and financial condition, and we may be unable to obtain these products from other parties on terms acceptable to us, if at all.

OUR REVENUES HAVE DECLINED IN RECENT FISCAL YEARS. WE EXPERIENCED A SUBSTANTIAL DECREASE IN APPLICATION SOFTWARE LICENSE SALES. OUR GROWTH AND PROFITABILITY IS DEPENDENT ON THE SALE OF HIGHER MARGIN LICENSES.

Our revenues decreased by 20% in the fiscal year ended March 31, 2004, compared to the fiscal year ended March 31, 2003. Our revenues decreased by 16% in the fiscal year ended March 31, 2003 compared to the fiscal year ended March 31, 2002. We experienced a substantial decrease in application license software sales in fiscal year 2004 and 2003, which typically carry a much higher margin than other revenue sources. We must improve new application license sales to become profitable. We have taken steps to refocus our sales strategy on core historic competencies, but our typically long sales cycles make it difficult to evaluate whether and when sales will improve. We cannot be sure that the decline in sales has not been due to factors which might continue to negatively affect sales.

OUR FINANCIAL CONDITION MAY INTERFERE WITH OUR ABILITY TO SELL NEW APPLICATION SOFTWARE LICENSES.

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Future sales growth may depend on our ability to improve our financial condition. Our past financial condition has made it difficult for us to complete sales of new application software licenses. Because our applications typically require lengthy implementation and extended servicing arrangements, potential customers require assurance that these services will be available for the expected life of the application. These potential customers may defer buying decisions until our financial condition improves, or may choose the products of our competitors whose financial conditions are, or are perceived to be, stronger. Customer deferrals or lost sales will adversely affect our business, financial conditions and results of operations.

38

OUR SALES CYCLES ARE LONG AND PROSPECTS ARE UNCERTAIN. THIS MAKES IT DIFFICULT FOR US TO PREDICT REVENUES AND BUDGET EXPENSES.

The length of sales cycles in our business makes it difficult to evaluate the effectiveness of our sales strategies. Our sales cycles historically have ranged from three to twelve months, which has caused significant fluctuations in revenues from period to period. Due to our difficulties in completing new application software sales in recent periods and our refocused sales strategy, it is difficult to predict revenues and properly budget expenses.

Our software applications are complex and perform or directly affect mission-critical functions across many different functional and geographic areas of the retail enterprise. In many cases, our customers must change established business practices when they install our software. Our sales staff must dedicate significant time consulting with a potential customer concerning the substantial technical and business concerns associated with implementing our products. The purchase of our products is often discretionary, so lengthy sales efforts may not result in a sale. Moreover, it is difficult to predict when a license sale will occur. All of these factors can adversely affect our business, financial condition and results of operations.

OUR OPERATING RESULTS AND REVENUE HAVE FLUCTUATED SIGNIFICANTLY IN THE PAST, AND THEY MAY CONTINUE TO DO SO IN THE FUTURE, WHICH COULD ADVERSELY AFFECT OUR STOCK PRICE.

Our quarterly operating results have fluctuated significantly in the past and may fluctuate in the future as a result of several factors, which are outside of our control, including the size and timing of orders, the general health of the retail industry, the length of our sales cycles and technological changes. If revenue declines in a quarter, our operating results will be adversely affected because many of our expenses are relatively fixed. In particular, sales and marketing, application development and general and administrative expenses do not change significantly with variations in revenue in a quarter. It is likely that in some future quarter our revenues or operating results will be below the expectations of public market analysts or investors. If that happens, our stock price will likely decline.

Further, due to these fluctuations, we do not believe period to period comparisons of our financial performance are necessarily meaningful nor should they be relied on as an indication of our future performance.

WE MAY EXPERIENCE SEASONAL DECLINES IN SALES, WHICH COULD CAUSE OUR OPERATING RESULTS TO FALL SHORT OF EXPECTATIONS IN SOME QUARTERS.

We may experience slower sales of our applications and services from October

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through December of each year as a result of retailers' focus on the holiday retail-shopping season. This can negatively affect revenues in our third fiscal quarter and in other quarters, depending on our sales cycles.

OUR DEBT COULD ADVERSELY AFFECT US.

As of December 31, 2004, our debt, including any accrued interest, is as follows:

- o \$1.0 million under the March 2004 Debenture held by Midsummer due in full in May 2006, with monthly redemptions that commenced in September 2004.
- o \$0.5 million in promissory note issued in June 2004 to Intuit Inc. due in full on June 1, 2006, payable in monthly installments.
- o \$1.4 million in promissory notes issued in June 2004 to RTI's noteholders due on May 1, 2005, payable in monthly installments.
- o \$2.5 million in promissory notes issued in June 2004 to Michael Tomczak and Jeffrey Boone due on June 1, 2006, payable in monthly installments.
- o \$7.0 million under the Laurus Note, which matures on July 12, 2007.

39

The substantial amount of our indebtedness impacts us in a number of ways:

- o We have to dedicate a portion of cash flow from operations to principal and interest payments on the debt, which reduces funds available for other purposes.
- o We may not have sufficient funds to pay principal and/or interest when they become due resulting in a default, which could lead to our debt holders exercising rights under their respective debt instruments, including, without limitation, declaring debt immediately due and payable or taking possession or control of the assets that secure the respective debt instruments.

These are just some factors pertaining to our debt that generally place us at a disadvantage to our less leveraged competitors. Any or all of these factors could cause our stock price to decline.

WE MAY NEED TO RAISE CAPITAL TO GROW OUR BUSINESS. OBTAINING THIS CAPITAL COULD IMPAIR THE VALUE OF YOUR INVESTMENT.

We may need to raise further capital to:

- o pay our debts outstanding as set forth above;
- o support unanticipated capital requirements;
- o take advantage of acquisition or expansion opportunities;

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- o continue our current development efforts;
- o develop new applications or services; or
- o address working capital needs.

Our future capital requirements depend on many factors including our application development and sales and marketing activities. We do not know whether additional financing will be available when needed, or available on terms acceptable to us. If we cannot raise needed funds for the above purposes on acceptable terms, we may be forced to curtail some or all of the above activities and we may not be able to grow our business or respond to competitive pressures or unanticipated developments.

We may raise capital through public or private equity offerings or debt financings. To the extent we raise additional capital by issuing equity securities or convertible debt securities, our stockholders may experience substantial dilution and the new securities may have greater rights, preferences or privileges than our existing common stock.

INTANGIBLE ASSETS MAY BE IMPAIRED MAKING IT MORE DIFFICULT TO OBTAIN FINANCING.

Goodwill, capitalized software, non-compete agreements and other intangible assets represent approximately 84% of our total assets as of December 31, 2004. We may have to impair or write-off these assets, which will cause a charge to earnings and could cause our stock price to decline. Any such impairment will also reduce our assets, as well as the ratio of our assets to our liabilities. These balance sheet effects could make it more difficult for us to obtain capital, and could make the terms of capital we do obtain more unfavorable to our existing stockholders.

FOREIGN CURRENCY FLUCTUATIONS MAY IMPAIR OUR COMPETITIVE POSITION AND AFFECT OUR OPERATING RESULTS.

Fluctuations in currency exchange rates affect the prices of our applications and services and our expenses, and foreign currency losses will negatively affect profitability or increase losses. Approximately 81%, 18 % and 1% of our revenues were in the Americas, Europe and Asia, respectively, in the three months ended December 31, 2004. Approximately 81%, 17% and 2% of our revenues were in the Americas, Europe and Asia, respectively, in the nine months ended December 31, 2003. Many of our expenses related to foreign sales, such as corporate level administrative overhead and development, are denominated in U.S. dollars. When accounts receivable and accounts payable arising from international sales and services are converted to U.S. dollars, the resulting gain or loss contributes to fluctuations in our operating results. We do not hedge against foreign currency exchange rate risks.

40

HISTORICALLY WE HAVE BEEN DEPENDENT ON A SMALL NUMBER OF CUSTOMERS FOR A SIGNIFICANT AMOUNT OF OUR BUSINESS.

Gabriel Brothers, Inc. accounted for 4% each of our consolidated revenues in the nine months ended December 31, 2004. Toys accounted for 12% in the nine months ended December 31, 2003.

IF WE LOSE THE SERVICES OF ANY MEMBER OF OUR SENIOR MANAGEMENT OR KEY TECHNICAL

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AND SALES PERSONNEL, OR IF WE ARE UNABLE TO RETAIN OR ATTRACT ADDITIONAL TECHNICAL PERSONNEL, OUR ABILITY TO CONDUCT AND EXPAND OUR BUSINESS WILL BE IMPAIRED.

We are heavily dependent on our President, Chief Operating Officer and Director, Michael Tomczak, and our Chief Technology Officer, Jeffrey Boone. We also believe our future success will depend largely upon our ability to attract and retain highly-skilled software programmers, managers, and sales and marketing personnel. Competition for personnel is intense, particularly in international markets. The software industry is characterized by a high level of employee mobility and aggressive recruiting of skilled personnel. We compete against numerous companies, including larger, more established companies, for our personnel. We may not be successful in attracting or retaining skilled sales, technical and managerial personnel. The loss of key employees or our inability to attract and retain other qualified employees could negatively affect our financial performance and cause our stock price to decline.

WE ARE DEPENDENT ON THE RETAIL INDUSTRY, AND IF ECONOMIC CONDITIONS IN THE RETAIL INDUSTRY FURTHER DECLINE, OUR REVENUES MAY ALSO DECLINE. RETAIL SALES HAVE BEEN AND MAY CONTINUE TO BE SLOW.

Our future growth is critically dependent on increased sales to the retail industry. We derive the substantial majority of our revenues from the licensing of software applications and the performance of related professional and consulting services to the retail industry. The retail industry as a whole is currently experiencing increased competition and weakening economic conditions that could negatively impact the industry and our customers' ability to pay for our products and services. In addition, the retail industry may be consolidating, and it is uncertain how consolidation will affect the industry. Such consolidation and weakening economic conditions have in the past, and may in the future, negatively impact our revenues, reduce the demand for our products and may negatively impact our business, operating results and financial condition. Specifically, uncertain economic conditions and the specter of terrorist activities have adversely impacted sales of our software applications, and we believe mid-tier specialty retailers may be reluctant during the current economic climate to make the substantial infrastructure investment that generally accompanies the implementation of our software applications, which may adversely impact our business.

THERE MAY BE AN INCREASE IN CUSTOMER BANKRUPTCIES DUE TO WEAK ECONOMIC CONDITIONS.

We have in the past and may in the future be impacted by customer bankruptcies. During weak economic conditions, such as those currently being experienced in many geographic regions around the world, there is an increased risk that certain of our customers will file bankruptcy. When our customers file bankruptcy, we may be required to forego collection of pre-petition amounts owed, and to repay amounts remitted to us during the 90-day preference period preceding the filing. Accounts receivable balances related to pre-petition amounts may in certain of these instances be large due to extended payment terms for software license fees, and significant billings for consulting and implementation services on large projects. The bankruptcy laws, as well as the specific circumstances of each bankruptcy, may severely limit our ability to collect pre-petition amounts, and may force us to disgorge payments made during the 90-day preference period. We also face risk from international customers who file for bankruptcy protection in foreign jurisdictions, in that the application of foreign bankruptcy laws may be less certain or harder to predict. Although we believe that we have sufficient reserves to cover anticipated customer bankruptcies, there can be no assurance that such reserves will be adequate, and if they are not adequate, our business, operating results and financial condition would be adversely affected.

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WE MAY NOT BE ABLE TO MAINTAIN OR IMPROVE OUR COMPETITIVE POSITION BECAUSE OF THE INTENSE COMPETITION IN THE RETAIL SOFTWARE INDUSTRY.

We conduct business in an industry characterized by intense competition. Most of our competitors are very large companies with an international presence. We must also compete with smaller companies which have been able to develop strong local or regional customer bases. Many of our competitors and potential competitors are more established, benefit from greater name recognition and have significantly greater resources than us. Our competitors may also have lower cost structures and better access to the capital markets than us. As a result, our competitors may be able to respond more quickly than we can to new or emerging technologies and changes in customer requirements. Our competitors may:

- o introduce new technologies that render our existing or future products obsolete, unmarketable or less competitive;

41

- o make strategic acquisitions or establish cooperative relationships among themselves or with other solution providers, which would increase the ability of their products to address the needs of our customers; and
- o establish or strengthen cooperative relationships with our current or future strategic partners, which would limit our ability to compete through these channels.

We could be forced to reduce prices and suffer reduced margins and market share due to increased competition from providers of offerings similar to, or competitive with, our applications, or from service providers that provide services similar to our services. Competition could also render our technology obsolete.

OUR MARKETS ARE SUBJECT TO RAPID TECHNOLOGICAL CHANGE, SO OUR SUCCESS DEPENDS HEAVILY ON OUR ABILITY TO DEVELOP AND INTRODUCE NEW APPLICATIONS AND RELATED SERVICES.

The retail software industry is characterized by rapid technological change, evolving standards and wide fluctuations in supply and demand. We must cost-effectively develop and introduce new applications and related services that keep pace with technological developments to compete. If we do not gain market acceptance for our existing or new offerings or if we fail to introduce progressive new offerings in a timely or cost-effective manner, our financial performance will suffer.

The success of application enhancements and new applications depends on a variety of factors, including technology selection and specification, timely and efficient completion of design, and effective sales and marketing efforts. In developing new applications and services, we may:

- o Fail to respond to technological changes in a timely or cost-effective manner;
- o Encounter applications, capabilities or technologies developed by others that render our applications and services obsolete or non-competitive or that shorten the life cycles of our existing applications and services;

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- o Experience difficulties that could delay or prevent the successful development, introduction and marketing of these new applications and services; or
- o Fail to achieve market acceptance of our applications and services.

The life cycles of our applications are difficult to estimate, particularly in the emerging electronic commerce market. As a result, new applications and enhancements, even if successful, may become obsolete before we recoup our investment.

OUR PROPRIETARY RIGHTS OFFER ONLY LIMITED PROTECTION AND OUR COMPETITORS MAY DEVELOP APPLICATIONS SUBSTANTIALLY SIMILAR TO OUR APPLICATIONS AND USE SIMILAR TECHNOLOGIES WHICH MAY RESULT IN THE LOSS OF CUSTOMERS. WE MAY HAVE TO BRING COSTLY LITIGATION TO PROTECT OUR PROPRIETARY RIGHTS.

Our success and competitive position is dependent in part upon our ability to develop and maintain the proprietary aspects of our intellectual property. Our intellectual property includes our trademarks, trade secrets, copyrights and other proprietary information. Our efforts to protect our intellectual property may not be successful. Effective copyright and trade secret protection may be unavailable or limited in some foreign countries. We hold only one patent. Consequently, others may develop, market and sell applications substantially equivalent to ours or utilize technologies similar to those used by us, so long as they do not directly copy our applications or otherwise infringe our intellectual property rights.

We may find it necessary to bring claims or initiate litigation against third parties for infringement of our proprietary rights or to protect our trade secrets. These actions would likely be costly and divert management resources. These actions could also result in counterclaims challenging the validity of our proprietary rights or alleging infringement on our part. The ultimate outcome of any litigation will be difficult to predict.

OUR APPLICATIONS MAY BE SUBJECT TO CLAIMS THEY INFRINGE ON THE PROPRIETARY RIGHTS OF THIRD PARTIES, WHICH MAY EXPOSE US TO LITIGATION.

We may become subject to litigation involving patents or proprietary rights of third parties. Patent and proprietary rights litigation entails substantial legal and other costs, and we do not know if we will have the necessary financial resources to defend or prosecute our rights in connection with any such litigation. Responding to and defending claims related to our intellectual property rights, even ones without merit, can be time consuming and expensive and can divert management's attention from other business matters. In addition,

42

these actions could cause application delivery delays or require us to enter into royalty or license agreements. Royalty or license agreements, if required, may not be available on terms acceptable to us, if they are available at all. Any or all of these outcomes could have a material adverse effect on our business, operating results and financial condition.

DEVELOPMENT AND MARKETING OF OUR OFFERINGS DEPENDS ON STRATEGIC RELATIONSHIPS WITH OTHER COMPANIES. OUR EXISTING STRATEGIC RELATIONSHIPS MAY NOT ENDURE AND MAY NOT DELIVER THE INTENDED BENEFITS, AND WE MAY NOT BE ABLE TO ENTER INTO FUTURE STRATEGIC RELATIONSHIPS.

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Since we do not possess all of the technical and marketing resources necessary to develop and market our offerings to target markets, our business strategy substantially depends on our strategic relationships. While some of these relationships are governed by contracts, most are non-exclusive and all may be terminated on short notice by either party. If these relationships terminate or fail to deliver the intended benefits, our development and marketing efforts will be impaired and our revenues may decline. We may not be able to enter into new strategic relationships, which could put us at a disadvantage to those of our competitors, who do successfully exploit strategic relationships.

OUR PRIMARY COMPUTER AND TELECOMMUNICATIONS SYSTEMS ARE IN A LIMITED NUMBER OF GEOGRAPHIC LOCATIONS, WHICH MAKES THEM MORE VULNERABLE TO DAMAGE OR INTERRUPTION. THIS DAMAGE OR INTERRUPTION COULD HARM OUR BUSINESS.

Substantially all of our primary computer and telecommunications systems are located in two geographic areas. These systems are vulnerable to damage or interruption from fire, earthquake, water damage, sabotage, flood, power loss, technical or telecommunications failure or break-ins. Our business interruption insurance may not adequately compensate us for our lost business and will not compensate us for any liability we incur due to our inability to provide services to our customers. Although we have implemented network security measures, our systems are vulnerable to computer viruses, physical or electronic break-ins and similar disruptions. These disruptions could lead to interruptions, delays, loss of data or the inability to service our customers. Any of these occurrences could impair our ability to serve our customers and harm our business.

IF PRODUCT LIABILITY LAWSUITS ARE SUCCESSFULLY BROUGHT AGAINST US, WE MAY INCUR SUBSTANTIAL LIABILITIES AND MAY BE REQUIRED TO LIMIT COMMERCIALIZATION OF OUR APPLICATIONS.

Our business exposes us to product liability risks. Any product liability or other claims brought against us, if successful and of sufficient magnitude, could negatively affect our financial performance and cause our stock price to decline.

Our applications are highly complex and sophisticated and they may occasionally contain design defects or software errors that could be difficult to detect and correct. In addition, implementation of our applications may involve customer-specific customization by us or third parties, and may involve integration with systems developed by third parties. These aspects of our business create additional opportunities for errors and defects in our applications and services. Problems in the initial release may be discovered only after the application has been implemented and used over time with different computer systems and in a variety of other applications and environments. Our applications have in the past contained errors that were discovered after they were sold. Our customers have also occasionally experienced difficulties integrating our applications with other hardware or software in their enterprise.

We are not currently aware of any defects in our applications that might give rise to future lawsuits. However, errors or integration problems may be discovered in the future. Such defects, errors or difficulties could result in loss of sales, delays in or elimination of market acceptance, damage to our brand or to our reputation, returns, increased costs and diversion of development resources, redesigns and increased warranty and servicing costs. In addition, third-party products, upon which our applications are dependent, may contain defects which could reduce or undermine entirely the performance of our applications.

Our customers typically use our applications to perform mission-critical

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functions. As a result, the defects and problems discussed above could result in significant financial or other damage to our customers. Although our sales agreements with our customers typically contain provisions designed to limit our exposure to potential product liability claims, we do not know if these limitations of liability are enforceable or would otherwise protect us from liability for damages to a customer resulting from a defect in one of our applications or the performance of our services. Our product liability insurance may not cover all claims brought against us.

THE SAGE GROUP HAS THE RIGHT TO ACQUIRE A SIGNIFICANT PERCENTAGE OF OUR COMMON STOCK, WHICH IF ACQUIRED BY THE SAGE GROUP, MAY ENABLE THE SAGE GROUP TO EXERCISE EFFECTIVE CONTROL OF US.

43

The Sage Group beneficially owns approximately 34.3 % of our outstanding common stock, including shares the Sage Group has the right to acquire upon conversion of its Series A Preferred and exercise of its outstanding options. Although the Series A Preferred is non-voting as to most matters and is redeemable by us, if the Sage Group converts its Series A Preferred to common stock, it may have effective control over all matters affecting us, including:

- o The election of all of our directors;
- o The allocation of business opportunities that may be suitable for the Sage Group and us;
- o Any determinations with respect to mergers or other business combinations involving us;
- o The acquisition or disposition of assets or businesses by us;
- o Debt and equity financing, including future issuance of our common stock or other securities;
- o Amendments to our charter documents;
- o The payment of dividends on our common stock; and
- o Determinations with respect to our tax returns.

THE SAGE GROUP'S POTENTIAL INFLUENCE ON OUR COMPANY COULD MAKE IT DIFFICULT FOR ANOTHER COMPANY TO ACQUIRE US, WHICH COULD DEPRESS OUR STOCK PRICE.

The Sage Group beneficially owns a significant percentage of our common stock. Sage Group's potential effective voting control could discourage others from initiating any potential merger, takeover or other change of control transaction that may otherwise be beneficial to our business or our stockholders. As a result, the Sage Group's potential effective control could reduce the price that investors may be willing to pay in the future for shares of our stock, or could prevent any party from attempting to acquire us at any price.

OUR STOCK PRICE HAS BEEN HIGHLY VOLATILE.

The market price of our common stock has been, and is likely to continue to be, volatile. When we or our competitors announce new customer orders or services, change pricing policies, experience quarterly fluctuations in operating results, announce strategic relationships or acquisitions, change earnings estimates,

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experience government regulatory actions or suffer from generally adverse economic conditions, our stock price could be affected. Some of the volatility in our stock price may be unrelated to our performance. Recently, companies similar to ours have experienced extreme price fluctuations, often for reasons unrelated to their performance.

WE HAVE NEVER PAID A DIVIDEND ON OUR COMMON STOCK NOR DO WE INTEND TO PAY DIVIDENDS ON OUR COMMON STOCK IN THE FORESEEABLE FUTURE.

We have not previously paid any cash or other dividend on our common stock. We anticipate that we will use our earnings and cash flow for repayment of indebtedness, to support our operations, and for future growth, and we do not have any plans to pay dividends in the foreseeable future. Holders of our Series A Preferred are entitled to dividends in preference and priority to common stockholders. Future equity financing(s) may further restrict our ability to pay dividends.

THE TERMS OF OUR PREFERRED STOCK MAY REDUCE THE VALUE OF YOUR COMMON STOCK.

We are authorized to issue up to 5,000,000 shares of preferred stock in one or more series. We issued 141,000 shares of Series A Preferred in May 2002. Our board of directors may determine the terms of subsequent series of preferred stock without further action by our stockholders. If we issue additional preferred stock, it could affect your rights or reduce the value of your common stock. In particular, specific rights granted to future holders of preferred stock could be used to restrict our ability to merge with or sell our assets to a third party. These terms may include voting rights, preferences as to dividends and liquidation, conversion and redemption rights, and sinking fund provisions. We are actively seeking capital, and some of the arrangements we are considering may involve the issuance of preferred stock.

44

FAILURE TO COMPLY WITH THE AMERICAN STOCK EXCHANGE'S LISTING STANDARDS COULD RESULT IN OUR DELISTING FROM THAT EXCHANGE AND LIMIT THE ABILITY OF OUR STOCKHOLDERS TO SELL ANY OF OUR COMMON STOCK.

Our stock is currently traded on the American Stock Exchange. The Exchange has published certain guidelines it uses in determining whether a security warrants continued listing. Pursuant to these guidelines the Exchange will consider suspending trading in a listed security or delisting a security when, in the opinion of the Exchange: (i) the financial condition and/or operating results of the issuer appear to be unsatisfactory; (ii) the aggregate market value of the security has become so reduced as to make further dealings on the Exchange inadvisable; (iii) the issuer has sold or otherwise disposed of its principal operating assets, or has ceased to be an operating company; (iv) the issuer has failed to comply with its listing agreements with the Exchange; or (v) any other event shall occur or any condition shall exist which makes further dealings on the Exchange unwarranted. As a result of our financial condition or other factors, the American Stock Exchange could in the future determine that our stock does not merit continued listing. If our stock were delisted from the American Stock Exchange, the ability of our stockholders to sell our common stock could become limited, and we would lose the advantage of some state and federal securities regulations imposing lower regulatory burdens on exchange-traded issuers.

OUR RESTATED FINANCIAL STATEMENTS COULD ADVERSELY EFFECT OUR STOCK PRICE OR SUBJECT US TO LAWSUITS BY OUR STOCKHOLDERS.

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On October 29, 2004, we filed an 8-K reporting that certain of our financial statements required restatement and should no longer be relied upon. On November 16, 2004, we filed an amended Form 10-K and amended Forms 10-Q restating our financial statements for the fiscal year ended March 31, 2004, 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. The restatement of these financial statements could cause investors to lose confidence in our financial reporting, which could adversely effect our stock price. Additionally, we may be subject to lawsuits by stockholders, who relied on the financial statements that were subsequently restated.

SHARES ISSUABLE UPON THE EXERCISE OF OPTIONS, WARRANTS, DEBENTURES AND CONVERTIBLE NOTES OR UNDER ANTI-DILUTION PROVISIONS IN CERTAIN AGREEMENTS COULD DILUTE YOUR STOCK HOLDINGS AND ADVERSELY AFFECT OUR STOCK PRICE.

We have issued options and warrants to acquire common stock to our employees and certain other persons at various prices, some of which are or may in the future have exercise prices at below the market price of our stock. We currently have outstanding options and warrants for 34,839,174 shares. Of these options and warrants, as of December 31, 2004, 27,261,050 have exercise prices above the recent market price of \$0.40 per share, and 7,578,124 have exercise prices at or below that recent market price. If exercised, these options and warrants will cause immediate and possibly substantial dilution to our stockholders.

Our existing stock option plan currently has approximately 6,525,500 shares available for issuance as of December 31, 2004. Future options issued under the plan may have further dilutive effects.

Sales of shares issued pursuant to exercisable options, warrants, convertible notes or anti-dilution provisions could lead to subsequent sales of the shares in the public market, and could depress the market price of our stock by creating an excess in supply of shares for sale. Issuance of these shares and sale of these shares in the public market could also impair our ability to raise capital by selling equity securities.

WE MAY BE UNABLE TO SUCCESSFULLY INTEGRATE OUR OPERATIONS WITH PAGE DIGITAL OR RTI OR REALIZE ALL OF THE ANTICIPATED BENEFITS OF THESE ACQUISITIONS.

On January 30, 2004, we acquired Page Digital and on June 1, 2004, we acquired RTI. These acquisitions involve integrating two companies that previously operated independently. These integrations may be complex, costly and time-consuming processes. The difficulties of combining these companies' operations include, among other things:

- o Coordinating geographically disparate organizations, systems and facilities;
- o Strain on management resources due to integration demands;
- o Integrating personnel with diverse business backgrounds;
- o Consolidating corporate and administrative functions;

- o Coordinating product development;

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- o Coordinating sales and marketing functions;
- o Retaining key employees; and
- o Preserving relationships with key customers.

BUSINESS RISKS FACED BY PAGE DIGITAL COULD DISADVANTAGE OUR BUSINESS.

Page Digital is a developer of multi-channel commerce software and faces several business risks that could disadvantage our business. These risks include many of the risks that we face, described above, as well as:

- o LONG AND VARIABLE SALES CYCLES MAKE IT DIFFICULT TO PREDICT OPERATING RESULTS - Historically, the period between initial contact with a prospective customer and the licensing of Page Digital's products has ranged from one to twelve months. Page Digital's average sales cycle is currently three months. The licensing of Page Digital's products is often an enterprise wide decision by customers that involves a significant commitment of resources by Page Digital and its prospective customer. Customers generally consider a wide range of issues before committing to purchase Page Digital's products, including product benefits, cost and time of implementation, ability to operate with existing and future computer systems, ability to accommodate increased transaction volume and product reliability. As a part of the sales process, Page Digital spends a significant amount of resources informing prospective customers about the use and benefits of Page Digital products, which may not result in a sale, therefore increasing operating expenses. As a result of this sales cycle, Page Digital's revenues are unpredictable and could vary significantly from quarter to quarter causing our operating results to vary significantly.
- o DEFECTS IN PRODUCTS COULD DIMINISH DEMAND FOR PRODUCTS AND RESULT IN LOSS OF REVENUES - From time to time errors or defects may be found in Page Digital's existing, new or enhanced products, resulting in delays in shipping, loss of revenues or injury to Page Digital's reputation. Page Digital's customers use its products for business critical applications. Any defects, errors or other performance problems could result in damage to Page Digital's customers' businesses. These customers could seek significant compensation from Page Digital for any losses. Further, errors or defects in Page Digital's products may be caused by defects in third-party software incorporated into Page Digital products. If so, Page Digital may not be able to fix these defects without the assistance of the software providers.
- o FAILURE TO FORMALIZE AND MAINTAIN RELATIONSHIPS WITH SYSTEMS INTEGRATORS COULD REDUCE REVENUES AND HARM PAGE DIGITAL'S ABILITY TO IMPLEMENT PRODUCTS - A significant portion of Page Digital's sales are influenced by the recommendations of systems integrators, consulting firms and other third parties who assist with the implementation and maintenance of Page Digital's products. These third parties are under no obligation to recommend or support Page Digital's products. Failing to maintain strong relationships with these third parties could result in a shift by these third parties toward favoring competing products, which could negatively affect Page Digital's software license and service revenues.

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- PAGE DIGITAL'S PRODUCT MARKETS ARE SUBJECT TO RAPID TECHNOLOGICAL CHANGE, SO PAGE DIGITAL'S SUCCESS DEPENDS HEAVILY ON ITS ABILITY TO DEVELOP AND INTRODUCE NEW APPLICATIONS AND RELATED SERVICES - The retail software industry is characterized by rapid technological change, evolving standards and wide fluctuations in supply and demand. Page Digital must cost-effectively develop and introduce new applications and related services that keep pace with technological developments to compete. If Page Digital fails to gain market acceptance for its existing or new offerings or if Page Digital fails to introduce progressive new offerings in a timely or cost-effective manner, our financial performance may suffer.
- FAILURE TO PROTECT PROPRIETARY RIGHTS OR INTELLECTUAL PROPERTY, OR INTELLECTUAL PROPERTY INFRINGEMENT CLAIMS AGAINST PAGE DIGITAL COULD RESULT IN PAGE DIGITAL LOSING VALUABLE ASSETS OR BECOMING SUBJECT TO COSTLY AND TIME-CONSUMING LITIGATION - Page Digital's success and ability to compete depend on its proprietary rights and intellectual property. Page Digital relies on trademark, trade secret and copyright laws to protect its proprietary rights and intellectual property. Page Digital also has one issued patent. Despite

46

Page Digital's efforts to protect intellectual property, a third party could obtain access to Page Digital's software source code or other proprietary information without authorization, or could independently duplicate Page Digital's software. Page Digital may need to litigate to enforce intellectual property rights. If Page Digital is unable to protect its intellectual property it may lose a valuable asset. Further, third parties could claim Page Digital has infringed their intellectual property rights. Any claims, regardless of merit, could be costly and time-consuming to defend.

- COMPETITION IN THE SOFTWARE MARKET IS INTENSE AND COULD REDUCE PAGE DIGITAL'S SALES OR PREVENT THEM FROM ACHIEVING PROFITABILITY - The market for Page Digital's products is intensely competitive and subject to rapid technological change. Competition is likely to result in price reductions, reduced gross margins and loss of Page Digital's market share, any one of which could reduce future revenues or earnings. Further, most of Page Digital's competitors are large companies with greater resources, broader customer relationships, greater name recognition and an international presence. As a result, Page Digital's competitors may be able to better respond to new and emerging technologies and customer demands.

BUSINESS RISKS FACED BY RTI COULD DISADVANTAGE OUR BUSINESS.

RTI is a provider of retail management store solutions to small through mid-tier retailers via an international network of retailers and faces several business risks that could disadvantage our business. These risks include many of the

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risks that we face, described above, as well as:

- RTI FACES INTENSE COMPETITION IN THE RETAIL POINT OF SALE INDUSTRY - RTI operates in an extremely competitive industry, which is subject to rapid technological and market changes. We anticipate that the competition will increase as more companies focus on providing technology solutions to small and mid-tier retailers. Many of our current and potential competitors, such as Microsoft, have more resources to devote to product development, marketing and distribution. While RTI believes that it has competitive strengths in its market, there can be no assurance that RTI will continue to compete successfully against larger more established competitors.
- RTI IS DEPENDENT ON THEIR VALUE-ADDED RESELLERS (VARs) - RTI does not have a direct sales force and relies on VARs to distribute and sell its products. RTI currently has approximately 67 VARs - 27 in North America, 7 in South America, 11 in Asia, 19 in Europe and the Middle East, 1 in Africa, and 1 each in Australia and New Zealand. Combined, RTI's four largest VARs account for approximately 35% of its revenues, although no one is over 15%. RTI's VARs are independently owned businesses and there can be no assurance that one or more will not go out of business or cease to sell RTI products. Until a replacement VAR could be recruited, and trained, or until an existing VAR could expand into the vacated territory, such a loss could result in a disruption in RTI's revenue and profitability. Furthermore, there can be no assurance that an adequate replacement could be located.
- A PROLONGED SLOWDOWN IN THE GLOBAL ECONOMY COULD ADVERSELY IMPACT RTI'S REVENUES - A slowdown in the global economy might lead to decreased capital spending, fewer new retail business start ups, and slower new store expansion at existing retail businesses. Such conditions, even on a regional basis could severely impact one or more of RTI's VARs and result to a disruption in RTI's revenues, and profitability.
- RTI'S PRODUCT MARKETS ARE SUBJECT TO RAPID TECHNOLOGICAL CHANGE, SO RTI'S SUCCESS DEPENDS HEAVILY ON ITS ABILITY TO DEVELOP AND INTRODUCE NEW APPLICATIONS AND RELATED SERVICES - We believe RTI's ability to succeed in its market is partially dependent on its ability to identify new product opportunities and rapidly, cost-effectively bring them to market. However, there is no guarantee that they will be able to gain market acceptance for any new products. In addition, there is no guarantee that one of RTI competitors will not be able to bring competing applications to market faster or market them more effectively. Failure to successfully develop new products, bring them to market and gain market acceptance could result in decreased market share and ultimately have a material adverse affect on RTI.
- RTI DOES NOT HOLD ANY PATENTS OR COPYRIGHTS, ANY TERMINATION OF OR ADVERSE CHANGE TO RTI'S LICENSE RIGHTS COULD HAVE A MATERIAL ADVERSE EFFECT ON ITS BUSINESS - RTI has a license to develop, modify, market, sell, and support its core technology from a third party. Any termination of, or disruption in this license could have a material adverse affect on RTI's business. Further, we believe that most of the technology used in the design and development of RTI's core products is widely available to others. Consequently, there can be no assurance

that others will not develop, and market applications that are similar to RTI's, or utilize technologies that are equivalent to RTI's. Likewise, while RTI believes that its products do not infringe on any third party's intellectual property, there can be no assurance that they will not become involved in litigation involving intellectual property rights. If such litigation did occur, it could have a material adverse affect on RTI's business.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of loss that may impact our consolidated financial position, results of operations or cash flows. We are exposed to market risks, which include changes in foreign currency exchange rate as measured against the U.S. dollar.

INTEREST RATE RISK

We do not have debt or borrowings with variable rate term.

FOREIGN CURRENCY EXCHANGE RATE RISK

We conduct business in various foreign currencies, primarily in Europe. Sales are typically denominated in the local foreign currency, which creates exposures to changes in exchange rates. These changes in the foreign currency exchange rates as measured against the U.S. dollar may positively or negatively affect our sales, gross margins and retained earnings. We attempt to minimize currency exposure risk through decentralized sales, development, marketing and support operations, in which substantially all costs are local-currency based. There can be no assurance that such an approach will be successful, especially in the event of a significant and sudden decline in the value of the foreign currency. We do not hedge against foreign currency risk. Approximately 20% and 33% of our total revenues were denominated in currencies other than the U.S. dollar for the three months ended December 31, 2004 and 2003, respectively. Approximately 18% and 20% of our total revenues were denominated in currencies other than the U.S. dollar for the nine months ended December 31, 2004 and 2003, respectively.

EQUITY PRICE RISK

We have no direct equity investments.

ITEM 4. CONTROLS AND PROCEDURES

After restating our financial statements for the fiscal year ended March 31, 2004, the second and third quarters of the fiscal year ended March 31, 2003, the first, second and third quarters for the fiscal year ended March 31, 2004 and the first quarter for the fiscal year ending March 31, 2005, and in connection with the end of the third quarter for the fiscal year ending March 31, 2005, management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 of the Exchange Act. In connection with such evaluation, management considered the amendments to financial statements and factors that played a role in the need to restate the financial statements.

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Management identified some weaknesses, including some weaknesses in internal communications. However, management did not regard the weaknesses either individually or in the aggregate as constituting material weaknesses in our internal controls and financial reporting. Management concluded that our disclosure controls and procedures were designed to provide reasonable assurance of meeting their objectives and were reasonably effective as of December 31, 2004. Despite management's conclusion that our disclosure controls and procedures are effective, we intend to continue to evaluate and improve our controls and procedures going forward. To this end, we have already implemented policies and are working to train our employees to improve internal communications and documentation practices. In addition, we hired a new Chief Financial Officer.

48

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Except as discussed in the footnotes to our interim financial statements (see Note 15), 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.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

During the quarter ended December 31, 2004, we issued:

- o Issued 132,433 shares of common stock, with a fair value of \$50,000, to Midsummer as monthly principal and interest payment of convertible debenture,
- o Issued 169,340 shares of common stock, with a fair value of \$58,905, to Midsummer as monthly principal and interest payment of convertible debenture,
- o Issued 188,998 shares of common stock, with a fair value of \$58,533, to Midsummer as monthly principal and interest payment of convertible debenture,
- o Granted incentive stock options to employees to purchase an aggregate of 49,000 shares of common stock at exercise prices ranging from \$0.39 to \$0.43,
- o Granted options to purchase an aggregate of 82,500 shares of common stock at exercise prices ranging from \$0.41 to \$0.42 to outside directors of the Board as directors' fees for the quarter ended December 31, 2004,
- o Employees, pursuant to the RTI acquisition, exercised options to purchase 18,369 shares of common stock at exercise price of \$0.02.

The foregoing securities were offered and sold without registration under the Securities Act of 1933 to investors who had access to all information which would have been in a registration statement, in reliance upon the exemption provided by Section 4(2) under such Act and Regulation D thereunder.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

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Not applicable.

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

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

| Exhibit ----- | Description ----- |
|------------------|--|
| 2.1 | Purchase and Exchange Agreement dated as of January 1, 2002 between the Company and Softline Limited, incorporated by reference to exhibit 2.1 to the Company's 8-K filed May 16, 2002. Exhibits and schedules have been omitted pursuant to Item 601(b)(2) of Regulation S-K, but a copy will be furnished supplementally to the Securities and Exchange Commission upon request. |
| 2.2 | Deed of Appointment dated February 20, 2002 between the bank and the receivers of SVI Retail (Pty) Limited, incorporated by reference to exhibit 2.2 to the Company's 10-K for fiscal year ended March 31, 2002. |
| 2.3 | Business Sale Agreement dated May 3, 2002 among the receivers and managers of the assets of SVI Retail (Pty) Limited and QQQ Systems PTY Limited, incorporated by reference to exhibit 2.3 to the Company's 10-K for fiscal year ended March 31, 2002. |
| 2.4 | Securities Purchase Agreement dated March 31, 2003 by and among the Company, Midsummer Investment, Ltd., Omicron Master Trust, and Islandia, L.P., incorporated by reference to exhibit 2.1 to the Company's Form 8-K filed April 15, 2003. |
| 2.5 | Securities Purchase Agreement dated April 1, 2003 by and among the Company and MBSJ Investors, LLC, incorporated by reference to exhibit 2.2 to the Company's Form 8-K filed on April 15, 2003. |
| 2.6 | Agreement dated May 6, 2003 by and among the Company, Crestview Capital Fund I, L.P., Crestview Capital Fund II, L.P. and Crestview Capital Offshore Fund, Inc., incorporated by reference to exhibit 2.12 to the Company's Form S-1 filed on May 12, 2003. |
| 2.7 | Stock Purchase Agreement effective April 1, 2003 between SVI Solutions, Inc. and Arthur Klitofsky, incorporated by reference to exhibit 4.1 to the Company's Form 8-K filed on May 21, 2003. |
| 2.8 | Pledge Agreement effective April 1, 2003 between SVI Solutions, Inc. and Arthur Klitofsky, incorporated by reference to exhibit 4.2 to the Company's Form 8-K filed on May 21, 2003. |
| 2.9 | Securities Purchase Agreement dated June 27, 2003 by and among |

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the Company and the purchasers named therein, incorporated by reference to exhibit 2.1 to the Company's Form 8-K filed on July 2, 2003.

- 2.10 Securities Purchase Agreement dated November 7, 2003 by and among the Company and the purchasers named within, incorporated by reference to exhibit 2.1 to the Company's Form 8-K filed on November 12, 2003.
- 2.11 Agreement of Merger and Plan of Reorganization dated November 20, 2003 by and among the Company, Page Digital Incorporated and IPI Acquisition, Inc, incorporated by reference to exhibit 2.1 to the Company's Form 8-K filed on November 24, 2003.
- 2.12 Agreement of Merger and Plan of Reorganization dated March 12, 2004 by and among the Company, Retail Technologies International, Inc. and IPI Merger Sub, Inc., incorporated by reference to the Company's Form 8-K filed on March 17, 2004.
- 2.13 Amended and Restated Agreement of Merger and Plan of Reorganization dated June 1, 2004 by and between Island Pacific, Inc., Retail Technologies International, Inc., IPI Merger Sub, Inc., IPI Merger Sub II, Inc., Michael Tomczak and Jeffrey Boone, incorporated by reference to exhibit 2.1 to the Company's Form 8-K filed on June 14, 2004.
- 2.14 Agreement of Merger dated June 1, 2004 between IPI Merger Sub II, Inc. and Retail Technologies International, Inc., incorporated by reference to exhibit 2.2 to the Company's Form 8-K filed on June 14, 2004.
- 2.15 Securities Purchase Agreement dated March 15, 2004 by and among the Company, Omicron Master Trust and Midsummer Investments, Ltd, incorporated by reference to exhibit 4.1 to the Company's Form 8-K filed on March 17, 2004.
- 3.1 Amended and Restated Certificate of Incorporation, incorporated by reference to exhibit 3.1 to the Company's Form 8-K for filed July 15, 2003.
- 3.2 Certificate of Designation for Series A of Convertible Preferred Stock, incorporated by reference to exhibit 4.1 of the Company's Form 8-K filed May 16, 2002.
- 3.3 Certificate of Designation for Series B of Convertible Preferred Stock, incorporated by reference to exhibit 3.1 to the Company's Form 8-K filed on June 14, 2004.
- 3.4 Certificate of Amendment to the Certificate of Incorporation dated August 27, 2004, incorporated by reference to exhibit 3.1 to the Company's Form 8-K filed on August 30, 2004.
- 3.5 Restated Bylaws, incorporated by reference to exhibit 3.2 to the Company's Form 10-K for the fiscal year ended March 31, 2001.
- 4.1 Registration Rights Agreement dated as of March 31, 2003 by and

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among the Company, Midsummer Investment, Ltd., Omicron Master Trust and Islandia, L.P., incorporated by reference to exhibit 4.1 to the Company's Form 8-K filed April 15, 2003.

- 4.2 Registration Rights Agreement dated as of April 1, 2003 between the Company and MBSJ Investors LLC, incorporated by reference to exhibit 4.2 to the Company's Form 8-K filed April 15, 2003.
- 4.3 Registration Rights Agreement dated June 27, 2003 by and among the Company and the parties named therein, incorporated by reference to exhibit 4.1 to the Company's Form 8-K filed on July 2, 2003.
- 4.4 Registration Rights Agreement dated November 7, 2003 by and among the Company and the parties named therein, incorporated by reference to exhibit 4.1 to the Company's Form 8-K filed on November 12, 2003.
- 4.5 Settlement Agreement, Mutual Release and Covenant Not to Sue by and among the Company and Cord Camera Centers, Inc. dated September 30, 2003, incorporated by reference to exhibit 4.5 to the Company's Form S-1 filed on December 8, 2003.
- 4.6 Registration Rights Agreement dated March 15, 2004 by and among the Company, Omicron Master Trust and Midsummer Investments, Ltd., incorporated by reference to exhibit 4.2 to the Company's Form 8-K filed on March 17, 2004.
- 4.7 Security Agreement as of June 1, 2004 between Island Pacific, Inc., IPI Merger Sub II, Inc., Retail Technologies International, Inc., and Nathaniel F. Jessup, an individual, Kathleen M. Leacox, an individual, and Glenn Swenson, an individual, the Lumsden Real Estate Defined Benefit Plan, Mace and Shirley Lumsden as co-trustees of the Mace Lumsden and S.K. Lumsden Trust of January 19, 1995, and Merry Youle, an individual (individually, a "Secured Party), and collectively, the "Secured Parties"), incorporated by reference to exhibit 4.7 to the Company's Form 10-Q filed on August 12, 2004.
- 4.8 Registration Rights Agreement dated June 1, 2004 by and between Island Pacific, Inc., Michael Tomczak, Jeffrey Boone and Intuit, Inc., incorporated by reference to exhibit 4.1 to the Company's Form 8-K filed on June 14, 2004.
- 4.9 Form of Voting Agreement, incorporated by reference to exhibit 4.2 to the Company's Form 8-K filed on June 14, 2004.
- 4.10 Securities Purchase Agreement dated July 12, 2004 between Island Pacific, Inc. and Laurus Master Fund, Ltd., incorporated by reference to exhibit 4.1 to the Company's Form 8-K filed on July 21, 2004.
- 4.11 Secured Convertible Term Note issued by Island Pacific, Inc. in favor of Laurus Master Fund, Ltd., incorporated by reference to exhibit 4.2 to the Company's Form 8-K filed on July 21, 2004.

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- 4.12 Common Stock Purchase Warrant dated July 12, 2004 issued by Island Pacific, Inc., incorporated by reference to exhibit 4.2 to the Company's Form 8-K filed on July 21, 2004.
- 4.13 Registration Rights Agreement dated July 12, 2004 between Island Pacific, Inc. and Laurus Master Fund, Ltd., incorporated by reference to exhibit 4.4 of the Company's Form 8-k filed on July 21, 2004.
- 4.14 Amendment No. 1 to the 9% Convertible Debenture, Due May 15, 2006 Issued to Midsummer Investment, Ltd. and Waiver dated July 30, 2004 by and among the Company and Midsummer Investments, Ltd, incorporated by reference to exhibit 4.14 to the Company's 10-Q filed August 13, 2004.
- 4.15 Amendment No. 2 to the 9% Convertible Debenture, Due May 15, 2006 Issued to Midsummer Investment, Ltd. and Waiver dated November 30, 2004 by and among the Company and Midsummer Investments, Ltd, incorporated by reference to exhibit 4.10 to the Company's S-3 filed December 1, 2004.
- 4.16 Amended and Restated Secured Convertible Term Note dated October 29, 2004, issued by Island Pacific, Inc. in favor of Laurus Master Fund, Ltd., incorporated by reference to exhibit 4.1 to the Company's Form 8-K filed on November 2, 2004.
- 4.17 Common Stock Purchase Warrant issued to Laurus dated October 29, 2004 issued by Island Pacific, Inc., incorporated by reference to exhibit 4.2 of the Company's Form 8-k filed on November 2, 2004.
- 4.18 Common Stock Purchase Warrant dated November 30, 2004 issued by Island Pacific, Inc., incorporated by reference to exhibit 4.11 to the Company's Form S-3 filed on December 1, 2004.
- 4.19 Amended and Restated Registration Rights Agreement dated October 29, 2004 between Island Pacific, Inc. and Laurus Master Fund, Ltd., incorporated by reference to exhibit 4.3 of the Company's Form 8-K filed on November 2, 2004.
- 10.1 Letter Agreement between the Company and Union Bank of California, N.A. dated April 24, 2001, incorporated by reference to exhibit 10.18 to the Company's Form 10-K for the fiscal year ended March 31, 2001.
- 10.2 Letter Agreement between the Company and Union Bank of California, N.A. dated June 22, 2001, incorporated by reference to exhibit 10.19 to the Company's Form 10-K for the fiscal year ended March 31, 2001.
- 10.3 Amended and Restated Term Loan Agreement between the Company and Union Bank of California, N.A. dated as of June 29, 2001, incorporated by reference to exhibit 10.20 to the Company's Form 10-K for the fiscal year ended March 31, 2001.
- 10.4 First Amendment to Amended and Restated Term Loan Agreement between the Company and Union Bank of California, N.A. dated as of March 18, 2002, and First Amendment to Amended and Restated Pledge Agreement between the Company, Sabica Ventures, Inc., SVI Retail, Inc., SVI Training Products, Inc., and Union Bank of California, N.A. dated as of March 18, 2002, incorporated by reference to exhibit 10.4 to the Company's form 10-K for fiscal year ended March 31, 2002.

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10.5 Second Amendment to Amended and Restated Term Loan Agreement between the Company and Union Bank of California, N.A. dated as of May 21, 2001, incorporated by reference to exhibit 10.5 to the Company's form 10-K for fiscal year ended March 31, 2002.

52

10.6 Third Amendment to Amended and Restated Term Loan Agreement between the Company and Union Bank of California, N.A. dated as of July 15, 2002, incorporated by reference to exhibit 10.6 to the Company's form 10-K for fiscal year ended March 31, 2002.

10.7 Fourth Amendment to Amended and Restated Term Loan Agreement between the Company and Union Bank of California, N.A. dated as of November 15, 2002, incorporated by reference to exhibit 10.3 to the Company's 10-Q filed on February 14, 2003.

10.8 Warrant in favor of UNIONBANCAL EQUITIES, Inc. dated January 2, 2003, incorporated by reference to exhibit 10.4 to the Company's 10-Q filed on February 14, 2003.

10.9 Discounted Loan Payoff Agreement dated March 31, 2003 by and among Union Bank of California, N.A., SVI, SVI Retail, Inc., Sabica Ventures, Inc. and SVI Training Products, Inc., incorporated by reference to exhibit 10.3 to the Company's Form 8-k filed on April 15, 2003.

10.10 Unsecured Promissory Note dated March 31, 2003 in favor of Union Bank of California, incorporated by reference to exhibit 10.47 to the Company's Form S-1 filed on May 12, 2003.

10.11 Amended and Restated Subordinated Promissory Note of the Company in favor of Softline Limited dated June 30, 2001, incorporated by reference to exhibit 10.26 to the Company's Form 10-K for the fiscal year ended March 31, 2001.

10.12 Investor Rights Agreement between the Company and Softline Limited dated as of January 1, 2002, incorporated by reference to exhibit 4.2 of the Company's Form 8-K filed May 16, 2002.

10.13 Investors' Rights Agreement between the Company, Koyah Leverage Partners, L.P. and Koyah Partners, L.P., incorporated by reference to exhibit 10.3 to the Company's Form 8-K filed January 8, 2001.

10.14 Investors' Rights Agreement among SVI Holdings, Inc., Koyah Leverage Partners, L.P. and Koyah Partners, L.P. dated July 19, 2002, incorporated by reference to exhibit 10.25 to the Company's Form S-1 filed on May 12, 2003.

10.15 Form of Convertible Promissory Note, incorporated by reference to exhibit 10.31 to the Company's Form 10-K for the fiscal year ended March 31, 2001.

10.16 Amendment Agreement to between the Company, Koyah Leverage Partners, Koyah Partners, L.P., Raven Partners, L.P., Nigel Davey, and Brian Cathcart dated July 15, 2002, incorporated by

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reference to exhibit 10.11 to the Company's 10-K for fiscal year ended March 31, 2002.

- 10.17 First Amendment to Amendment Agreement between the Company, Koyah Leverage Partners, Koyah Partners, L.P., Raven Partners, L.P., Nigel Davey, and Brian Cathcart dated December 5, 2002, incorporated by reference to exhibit 10.6 to the Company's 10-Q filed on February 14, 2003.
- 10.18 Second Amendment to Amendment Agreement between the Company, Koyah Leverage Partners, Koyah Partners, L.P., and Raven Partners, L.P. dated March 14, 2003, incorporated by reference to exhibit 10.29 to the Company's Form S-1 filed on May 12, 2003.
- 10.19 Third Amendment to Amendment Agreement between the Company, Koyah Leverage Partners, Koyah Partners, L.P., and Raven Partners, L.P. dated March 28, 2003, incorporated by reference to exhibit 10.30 to the Company's Form S-1 filed on May 12, 2003.
- 10.20 Fourth Amendment to Amendment Agreement between the Company, Koyah Leverage Partners, Koyah Partners, L.P., and Raven Partners, L.P. dated April 3, 2003, incorporated by reference to exhibit 10.31 to the Company's Form S-1 filed on May 12, 2003.
- 53
- 10.21 Fifth Amendment to Amendment Agreement between the Company, Koyah Leverage Partners, Koyah Partners, L.P., and Raven Partners, L.P. dated June 27, 2003, incorporated by reference to exhibit 10.21 to the Company's Form 10-K filed on June 29, 2004.
- 10.22 Professional Services Agreement between SVI Retail, Inc. and Toys "R" Us dated July 10, 2001, incorporated by referenced to exhibit 10.2 to the Company's Form 10-Q for the quarter ended September 30, 2001. Portions of this exhibit (indicated by asterisks) have been omitted pursuant to a request for confidential treatment pursuant to Rule 24b-2 of the Securities Exchange Act of 1934.
- 10.23 Purchase Agreement between the Company and Toys "R" Us, Inc. dated May 29, 2002, incorporated by reference to exhibit 10.14 to the Company's form 10-K for fiscal year ended March 31, 2002.
- 10.24 Convertible Note in favor of Toys "R" Us, Inc. dated May 29, 2002, incorporated by reference to exhibit 10.15 to the Company's form 10-K for fiscal year ended March 31, 2002.
- 10.25 Warrant in favor of Toys "R" Us, Inc. dated May 29, 2002, incorporated by reference to exhibit 10.16 to the Company's form 10-K for fiscal year ended March 31, 2002.
- 10.26 Development Agreement between the Company and Toys "R" Us, Inc. dated May 29, 2002, incorporated by reference to exhibit 10.17 to the Company's form 10-K for fiscal year ended March 31, 2002.
- 10.27 Summary of lease terms for Carlsbad facility, incorporated by reference to exhibit 10.20 to the Company's form 10-K for fiscal year ended March 31, 2002.

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- 10.28 Termination Agreement between the Company and Toys "R" Us, Inc. dated November 13, 2003, incorporated by reference to exhibit 10.28 to the Company's Form 10-K filed on June 29, 2004.
- 10.29 Option Agreement between Softline Ltd. and Steven Beck, as trustee of a certain management group of Island Pacific, Inc., incorporated by reference to exhibit 10.29 to the Company's Form 10-K filed on June 29, 2004.
- 10.30 Employment Agreement dated January 30, 2004 by and between Island Pacific, Inc. and Larry Page, incorporated by reference to exhibit 10.30 to the Company's Form 10-K filed on June 29, 2004.
- 10.31 Employment Agreement dated January 30, 2004 by and between Island Pacific, Inc. and David Joseph, incorporated by reference to exhibit 10.31 to the Company's Form 10-K filed on June 29, 2004.
- 10.32 Employment Agreement dated June 1, 2004 by and between Island Pacific, Inc. and Michael Tomczak, incorporated by reference to exhibit 10.1 to the Company's form 8-K filed on June 14, 2004.
- 10.33 Employment Agreement dated June 1, 2004 by and between Island Pacific, Inc. and Jeffrey Boone, incorporated by reference to exhibit 10.2 to the Company's form 8-K on June 14, 2004.
- 10.34 Option Agreement dated September 3, 2003 by and between SVI Solutions, Inc. and Harvey Braun, incorporated by reference to exhibit 10.34 to the Company's Form 10-K filed on June 29, 2004.
- 10.35 Option Agreement dated September 3, 2003 by and between SVI Solutions, Inc. and Steven Beck, incorporated by reference to exhibit 10.35 to the Company's Form 10-K filed on June 29, 2004.
- 54
- 10.36 Retail Pro Software License Agreement by and between Retail Technologies International, Inc. and Intuit Inc. dated December 6, 2002, incorporated by reference to exhibit 10.36 to the Company's 10-Q filed on November 15, 2004.
- 10.37 Summary of loan transactions between the Company and World Wide Business Centres, incorporated by reference to exhibit 10.12 to the Company's form 10-K for fiscal year ended March 31, 2002.
- 10.38 Master Security Agreement between Island Pacific, Inc., Page Digital Incorporated, IPI Merger Sub II, Inc., Sabica Ventures, Inc. and Laurus Master Fund, Ltd. dated July 12, 2004, incorporated by reference to exhibit 10.1 to the Company's Form 8-K filed on July 21, 2004.
- 10.39 Subsidiary Guaranty executed by Page Digital Incorporated, IPI Merger Sub II, Inc. and Sabica Ventures, Inc., incorporated by reference to exhibit 10.2 to the Company's Form 8-K filed on July 21, 2004.
- 10.40 Stock Pledge Agreement dated July 12, 2004 between Island Pacific, Inc. and Laurus Master Fund, Ltd., incorporated by reference to exhibit 10.2 to the Company's Form 8-K filed on July

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21, 2004.

- 10.41 Separation Agreement and General Release of Claims between Island Pacific, Inc. and Steven Beck dated July 29, 2004, incorporated by reference to exhibit 10.42 to the Company's Form 10-Q filed on August 12, 2004.
- 10.42 Severance and Release Agreement between Island Pacific, Inc. and Harvey Braun dated October 28, 2004, incorporated by reference to the Company's Form 10-Q filed on November 15, 2004.
- 10.43 Separation Agreement between Island Pacific, Inc. and Ran Furman dated January 7, 2005, incorporated by reference to exhibit 10.1 to the Company's 8-K filed on January 14, 2005.
- 10.44 Amendment No. 2 to the Retail Pro Software License between Intuit Inc. and Retail Technologies International, Inc. dated January 5, 2005, incorporated by reference to exhibit 10.1 to the Company's Form 8-K filed on February 11, 2005.
- 14.1 Code of Ethics and Business Conduct, incorporated by reference to exhibit 10.36 to the Company's Form 10-K filed on June 29, 2004.
- 31.1 Certification of CEO required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of CFO required pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) REPORTS ON FORM 8-K

On October 7, 2004, we filed a Form 8-K dated September 30, 2004 disclosing as Item 5.02 the departure of Larry Page as our Executive Vice President of Special Projects.

On October 28, 2004, we filed a Form 8-K dated October 25, 2004 disclosing as Item 4.02 the restatements of financial statements for the fiscal years ended March 31, 2004 and March 31, 2003 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.

On November 2, 2004, we filed a Form 8-K dated October 29, 2004 disclosing as Item 3.03 the Amended and Restated Secured Convertible Term Note , an Amended and Restated Registration Rights Agreement and Common Stock Purchase Warrant Agreement with Laurus Master Fund, Ltd.

On November 24, we filed a Form 8-K/A dated June 1, 2004 disclosing as Item 7

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financials statements and exhibits related to the acquisition of Retail Technologies International, Inc.

On December 2, 2004, we filed a Form 8-K dated November 30, 2004 disclosing as Item 1.01 the Amended and Restated Secured Convertible Debenture, an Amended and Restated Registration Rights Agreement and Common Stock Purchase Warrant Agreement with Midsummer Investment Ltd.

On January 14, 2005, we filed a Form 8-K dated January 10, 2005 disclosing as Item 5.02 the departure of Ran Furman as our Chief Financial Officer and appointment of Corinne Bertrand to the position of Chief Financial Officer.

SIGNATURES

Pursuant to the requirement of the Securities Exchange Act of 1934, the registrant has duly cause this report to be signed on its behalf by the undersigned thereunto duly authorized.

Island Pacific, Inc.
Registrant

/S/ Corinne Bertrand

Date: February 14, 2005

Corinne Bertrand
Chief Financial Officer
(Principal Financial and Accounting Officer)

Signing on behalf of the registrant