

BIO KEY INTERNATIONAL INC
Form SB-2/A
October 24, 2005

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As filed with the Securities and Exchange Commission on October 21, 2005

Registration No. 333-126492

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

AMENDMENT NO. 2
TO

FORM SB-2

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

BIO-key International, Inc.

(Exact name of registrant as specified in its charter)

Delaware
(State of incorporation)

3577
*(Primary Standard Industrial
Classification Code Number)*

41-1741861
*(I.R.S. Employer
Identification No.)*

3349 Highway 138, Building D, Suite B, Wall, NJ 07719, (732) 359-1100
(Address and telephone number of registrant's principal executive offices)

Michael W. DePasquale
Co-Chief Executive Officer
BIO-key International, Inc., 3349 Highway 138, Building D, Suite B, Wall, NJ 07719, (732) 359-1100
(Name, address and telephone number of agent for service)

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Approximate date of commencement of proposed sale to public: From time to time after this registration statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, as amended, or the Securities Act, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

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If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box.

Calculation of Registration Fee

Title of each class of securities to be registered	Number of units to be registered(1)	Proposed maximum aggregate offering price per unit(2)	Proposed maximum aggregate offering price(2)	Amount of registration fee(3)
Common Stock, \$.0001 par value per share, issuable upon conversion of secured convertible term notes	1,683,950 shares(4)	\$1.09	\$1,835,506	\$217
Common Stock, \$.0001 par value per share, issuable upon exercise of warrants	444,444 shares(5)	\$1.09	\$484,444	\$56
Common Stock, \$.0001 par value per share, issuable upon conversion of subordinated convertible term notes	2,921,679 shares(6)	\$1.09	\$3,184,631	\$375
Common Stock, \$.0001 par value per share, issuable upon exercise of warrants	961,399 shares(7)	\$1.09	\$1,047,925	\$124
Common stock, \$.0001 par value per share, issuable upon exercise of warrants	869,282 shares(8)	\$1.09	\$947,517	\$112

- (1) Pursuant to Rule 416 under the Securities Act, this registration statement also covers an indeterminate number of additional shares of the registrant's common stock as may be issuable upon any stock split, stock dividend or similar transaction.
- (2) Estimated pursuant to Rule 457(c) under the Securities Act solely for the purpose of calculating the registration fee, based upon the average of the high and low sale prices of the registrant's common stock as reported on the OTC Bulletin Board on July 5, 2005, a date within five days of the original filing date of this registration statement.
- (3) The registration fee has been previously paid by the registrant.
- (4) Shares of the registrant's common stock issuable upon conversion of secured convertible term notes issued pursuant to a securities purchase agreement dated as of June 8, 2005.
- (5) Shares of the registrant's common stock issuable upon the exercise of warrants issued pursuant to a securities purchase agreement dated as of June 8, 2005.
- (6) Shares of the registrant's common stock issuable upon conversion of subordinated convertible term notes issued pursuant to a securities purchase agreement dated as of May 31, 2005.
- (7) Shares of the registrant's common stock issuable upon the exercise of warrants issued pursuant to a securities purchase agreement dated as of May 31, 2005.
- (8) Shares of the registrant's common stock issuable upon the exercise of warrants issued to Jesup & Lamont Securities Corp. and certain of its employees.

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The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission acting pursuant to said Section 8(a), may determine.

The information in this prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

Subject to completion, dated October 21, 2005

PROSPECTUS

6,880,754 Shares

BIO-key International, Inc.

Common Stock

We are registering up to 6,880,754 shares of our common stock for offer or sale by the selling security holders named in this prospectus. Of the shares being registered, 4,605,629 shares are issuable upon conversion of convertible term notes issued to certain of the selling security holders and 2,275,125 shares are issuable upon exercise of warrants issued to certain of the selling security holders. The selling security holders may offer or sell all or a portion of their shares publicly or through private transactions at prevailing market prices or at negotiated prices. We will not receive any proceeds from the shares being registered for offer and sale by the selling security holders. We will, however, receive proceeds from the exercise price of certain warrants held by the selling security holders to the extent that such warrants are exercised.

**Investing in our common stock involves a high degree of risk.
See "Risk Factors" beginning on page 4.**

Our common stock is traded on the OTC Bulletin Board under the symbol "BKYL." The last reported sale price of our common stock on October 18, 2005 was \$0.66 per share.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

October 21, 2005

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You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information that is different. This prospectus may only be used where it is legal to sell these securities. The information in this prospectus may only be accurate on the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our common stock. Applicable rules of the Securities and Exchange Commission may require us to update this prospectus in the future.

PROSPECTUS SUMMARY

About BIO-key International, Inc.

BIO-key International, Inc. (the "Company," "BIO-key," "we," or "us") is in the business of delivering advanced identification solutions and information services to law enforcement departments, public safety agencies and other government and private sector customers. Our mobile wireless technology provides first responders with critical, reliable, real-time data and images from local, state, and national databases. More than 2,500 police, fire and emergency services departments in North America currently utilize our solutions, making us a leading supplier of mobile and wireless solutions for public safety.

Our scalable biometric finger identification technology identifies and authenticates users of wireless and enterprise data to improve security, convenience and privacy as well as reducing identity theft. Biometrics is the science of analyzing specific human characteristics which are unique to an individual in order to identify a specific individual from a broader population. Our technology scans a person's fingerprint and identifies that person within seconds without using a password, key card, personal identification number or any other identifying data. Fingerprint analysis is an accurate and reliable method to distinguish one individual from another and is generally viewed as less intrusive than many other biometric identification methods. We believe our technology and products will have a broad range of applications relating to protecting access to information and assets in both electronic and physical environments, including:

Delivering mission critical centralized enterprise information to field personnel graphically and wirelessly through standard off-the-shelf hardware devices;

Securing access to logical networks and applications;

Securing access to buildings and restricted areas; and

Prevention of identity and data theft.

Our technology provides a reliable and secure user identification/authentication system for public and private computer networks. WEB-key is designed to secure access to proprietary information residing on remote servers which is transmitted via the Internet. It is compatible with Oracle server software and new security features in Microsoft's Internet Explorer Versions 5.5 SP2 and 6.0. Network authentication is typically accomplished by using passwords. Since passwords can be lost, transferred, stolen or forgotten, we believe our WEB-key biometric solution is a more secure method for verifying the identity of remote users and eliminates the substantial administrative costs associated with tracking and reissuing new passwords.

On March 30, 2004, we acquired Public Safety Group, Inc. ("PSG"), a privately held leader in wireless solutions for law enforcement and public safety markets. The primary technology that we acquired from PSG is a software solution that provides police officers and other security personnel instantaneous access to criminal, civil and private database information in a wireless environment. PocketCop® is a handheld application that allows law enforcement officers to access state and federal databases over the wireless network for PalmOS, Windows CE and PocketPC. With the use of a portable wireless handheld device and PocketCop® application software, an authorized user can access suspect information such as wanted status, warrant status, vehicle registration and driver license status. With our acquisition of PSG, we believe there is a substantial market opportunity to integrate our VST and WEB-key biometric technologies with the PSG mobile solution.

On September 30, 2004, we acquired the Mobile Government Division ("Aether Mobil Government") of Aether Systems, Inc. ("Aether"). Pursuant to the Asset Purchase Agreement dated as of August 16, 2004 by and among the Company, Aether, Cerulean Technology, Inc. and SunPro, Inc., we paid Aether a purchase price of \$10,000,000 in cash, subject to post-closing adjustments to reflect changes in Aether Mobile Government's working capital and cash flows since June 30, 2004. In

connection with this acquisition, we also issued a subordinated secured promissory note to Aether in the face amount of \$6,884,588 (the "Aether Note"). The Aether Note evidences a contingent reimbursement obligation of the Company to Aether and a surety fee payable by the Company to Aether, in each case with respect to a letter of credit maintained by Aether for the Company's benefit in connection with the acquisition. Our obligations under the Aether Note are secured by a security interest granted to Aether in all or substantially all of our assets, subordinate to the security interests described in the "Convertible Debt Financing Transactions" section of this prospectus below.

Following our acquisition of Aether Mobile Government, we provide wireless data solutions for use by public safety organizations, primarily state and local police, fire and rescue and emergency medical services organizations, that enable such organizations to access law enforcement databases to validate identities and obtain suspect information. Our public safety solutions are integrated into fifty (50) different state databases, as well as local and federal databases, and its products deliver real-time information in seconds, without the need for human dispatchers or other resources.

Although biometric based solutions currently compete with more traditional security methods such as keys, cards, personal identification numbers and security personnel, biometric technology is becoming an acceptable approach to physical and logical security. Our current business plan is to:

License our core technology "VST" to original equipment manufacturers, systems integrators and application developers to develop and market products and applications which can then be sold to end users;

License WEB-key , our web-based biometric authentication solution;

Provide for "device independent" finger identification matching for virtually any application utilizing the latest advances in scanning technology;

License our wireless software solutions for law enforcement and public safety markets;

Leverage our FireRMS suite of products for the growing Emergency Medical Service data collection and reporting market; and

Integrate our core technology competencies to leverage new business opportunities and develop new markets for our innovative products.

We have evolved from a development stage company to a revenue generating company, but we have sustained substantial losses to date. We completed a private placement equity offering in March 2004 that resulted in approximately \$12,000,000 in gross proceeds to the Company and a private placement convertible debt offering in September 2004 that resulted in approximately \$10,000,000 in gross proceeds to the Company (most of which was used to finance the acquisition of Aether Mobile Government). We completed another private placement convertible debt offering in June 2005 that resulted in approximately \$4,500,000 in gross proceeds to the Company and management believes that we have sufficient funds to meet our working capital requirements at least through December 31, 2005. To the extent that we will require additional capital to support our operations, expand our marketing and sales efforts and to execute our business plan, we may need to obtain additional financing.

Our principal executive offices are located at 3349 Highway 138, Building D, Suite B, Wall, NJ 07719 and our telephone number is (732) 359-1100.

About the Offering

This prospectus covers the public resale of up to 6,880,754 shares of our common stock to be sold by the selling security holders identified herein. 1,683,950 shares of our common stock covered by this prospectus are issuable upon conversion of a secured convertible term note in the aggregate principal amount of \$2,000,000, together with accrued interest and fees due thereon, issued to Laurus Master Fund, Ltd. ("Laurus") pursuant to a Securities Purchase Agreement dated as of June 8, 2005 (the

"Senior Purchase Agreement") by and among the Company and such investor. 444,444 shares of our common stock covered by this prospectus are issuable upon exercise of warrants issued to Laurus. 2,481,610 shares of our common stock covered by this prospectus are issuable upon conversion of subordinated convertible term notes in the aggregate principal amount of \$3,244,723, together with accrued interest and fees due thereon, issued to The Shaar Fund Ltd., Longview Fund, L.P. and other institutional and accredited investors pursuant to a Securities Purchase Agreement dated as of May 31, 2005 (the "Subordinated Purchase Agreement") by and among the Company and such investors. 961,399 shares of our common stock covered by this prospectus are issuable upon exercise of warrants issued to the investors party to the Subordinated Purchase Agreement. The remaining 869,282 shares of our common stock covered by this prospectus are issuable upon the exercise of warrants issued by the Company to Jesup & Lamont Securities Corp. and certain of its employees, of which 620,667 shares are issuable upon exercise of warrants issued on February 2, 2005, which warrants represent a portion of fees earned by Jesup & Lamont Securities Corp. for acting as financial advisor and placement agent in connection with the private placement financing transaction that occurred on September 29, 2004, resulting in approximately \$10,000,000 in aggregate gross proceeds to the Company, and 248,615 shares are issuable upon exercise of warrants issued on June 8, 2005, which warrants represent a portion of the fees earned by Jesup & Lamont Securities Corp. for acting as financial advisor and placement agent in connection with the private placement financing transactions that occurred on May 31, 2005 and June 8, 2005, as described above.

RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the following information about certain of the risks of investing in our common stock, together with other information contained in this prospectus, before you decide to purchase our common stock.

Business and Financial Risks

Based on our lack of significant revenue since inception and recurring losses from operations, our auditors have included an explanatory paragraph in their opinion as to the substantial doubt about our ability to continue as a going concern.

Due to, among other factors, our history of losses and limited revenue, our independent auditors have included an explanatory paragraph in their opinion for the year ended December 31, 2004 as to the substantial doubt about our ability to continue as a going concern. Our financial statements have been prepared in accordance with accounting principals generally accepted in the United States, which contemplate that we will continue to operate as a going concern. Our financial statements do not contain any adjustments that might result if we are unable to continue as a going concern.

Since our formation, we have historically generated minimal revenue and have sustained substantial operating losses.

As of December 31, 2004, we had negative working capital of approximately \$3,016,000, and an accumulated deficit of approximately \$35,111,000. Since our inception, we have focused almost exclusively on developing our core technologies and, until the fourth quarter of 2004 have not generated any significant revenue. In order to increase revenue, we have developed a direct sales force and anticipate the need to retain additional sales, marketing and technical support personnel and may need to incur substantial expenses. We cannot assure you that we will be able to secure these necessary resources, that a significant market for our technologies will develop or that we will be able to achieve our targeted revenue.

We have identified material weaknesses in our internal control over financial reporting and have failed to maintain an effective system of disclosure controls and procedures. If we are unable to successfully address such material weaknesses, or if we continue to maintain an ineffective system of disclosure controls and procedures, we may not be able to accurately report our financial results or prevent fraud. As a result, current and potential stockholders could lose confidence in our financial reporting, which would likely harm our business and the trading price of our common stock.

After a review of our March 31, 2005 and June 30, 2005 quarterly operating results, conducted pursuant to Rule 13a-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), our Co-Chief Executive Officers and our Chief Financial Officer have determined that, as of each such date, our disclosure controls and procedures were not effective to provide reasonable assurance that information that we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified by in the Securities and Exchange Commission rules and forms. Our management reached this conclusion after identifying our system to capture disclosure items, our internal process of review for account reconciliations, our documentation of internal controls and our internal process for preparing our most recent annual report on Form 10-KSB as being inadequate to provide such assurance.

In addition, our independent auditors, Divine, Scherzer & Brody, Ltd., notified the Audit Committee of our Board of Directors on April 18, 2005 that they believed there were reportable conditions during 2004 and 2005 which constituted material weaknesses in our internal controls. These weakness concerned deficiencies in the design and implementation of our internal control system and the fact that, due to two recent acquisitions, we were not staffed properly in our accounting and

reporting department, and may not have had appropriate accounting and reporting software. For these reasons, we were not able to meet our schedule for preparing our audit and for filing our annual report on Form 10-KSB for the fiscal year ended December 31, 2004 in a timely manner.

Effective internal control over financial reporting and disclosure controls and procedures are necessary for us to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. We have in the past discovered, as described above, and may in the future discover, areas of our disclosure and internal controls that need improvement. We are in the process of addressing these issues to ensure that our internal control over financial reporting and disclosure controls and procedures are improved so as to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. If, however, we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed.

We cannot be certain that our efforts to improve the material weaknesses in our internal control over financial reporting and the ineffectiveness of our disclosure controls and procedures will be successful or that we will be able to maintain adequate controls over our financial processes and reporting in the future. We will need to commit substantial resources, including substantial time from our management team's accounting personnel and from external consultants, to implement and integrate into our organization improved disclosure controls and additional procedures generally and to improve systems to report financial information on a timely basis. Any failure or delay to develop or maintain effective controls, or difficulties encountered in their implementation or in other effective improvement of our internal and disclosure controls could materially harm our operating results or cause us to fail to meet our reporting obligations. If we are unable to adequately establish or improve our internal controls over financial reporting, our external auditors may not be able to issue an unqualified opinion on the effectiveness of our internal controls. Ineffective internal and disclosure controls could also cause investors to lose confidence in our reported financial information, which would likely have a significant negative effect on the trading price of our securities.

Our biometric technology has yet to gain widespread market acceptance and we do not know how large of a market will develop for our technology.

Biometric technology has received only limited market acceptance, particularly in the private sector. Our technology represents a novel security solution and we have not yet generated significant sales. Although recent security concerns relating to identification of individuals has increased interest in biometrics generally, it remains an undeveloped, evolving market. Biometric based solutions compete with more traditional security methods including keys, cards, personal identification numbers and security personnel. Acceptance of biometrics as an alternative to such traditional methods depends upon a number of factors including:

the reliability of biometric solutions

public perception regarding privacy concerns

costs involved in adopting and integrating biometric solutions

For these reasons, we are uncertain whether our biometric technology will gain widespread acceptance in any commercial markets or that demand will be sufficient to create a market large enough to produce significant revenue or earnings. Our future success depends, in part, upon business customers adopting biometrics generally, and our solution specifically.

Biometric technology is a new approach to Internet security which must be accepted in order for our Web-key solution to generate significant revenue.

Our Web-key authentication initiative represents a new approach to Internet security which has been adopted on a limited basis by companies which distribute goods, content or software applications over the Internet. The implementation of our WEB-Key solution requires the distribution and use of a finger scanning device and integration of database and server side software. Although we believe our solution provides a higher level of security for information transmitted over the Internet than existing traditional methods, unless business and consumer markets embrace the use of a scanning device and believe the benefits of increased accuracy outweigh implementation costs, our solution will not gain market acceptance.

Our software products may contain defects which will make it more difficult for us to establish and maintain customers.

Although we have completed the development of our core biometric technology, it has only been used by a limited number of business customers. Despite extensive testing during development, our software may contain undetected design faults and software errors, or "bugs" that are discovered only after it has been installed and used by a greater number of customers. Any such default or error in new or existing software or applications could cause delays in delivering our technology or require design modifications. These could adversely affect our competitive position and cause us to lose potential customers or opportunities. Since our technologies are intended to be utilized to secure physical and electronic access, the effect of any such bugs or delays will likely have a detrimental impact on us. In addition, given that biometric technology generally, and our biometric technology specifically, has yet to gain widespread acceptance in the market, any delays would likely have a more detrimental impact on our business than if we were a more established company.

While we have commenced a significant sales and marketing effort, we have only begun to develop a significant distribution channel and may not have the resources or ability to sustain these efforts or generate any meaningful sales.

In order to generate revenue, we are dependent upon independent original equipment manufacturers, system integrators and application developers, which we do not control. As a result, it may be more difficult to generate sales.

We market our technology through licensing arrangements with:

Original equipment manufacturers, system integrators and application developers which develop and market products and applications which can then be sold to end users

Companies which distribute goods, services or software applications over the Internet

As a technology licensing company, our success will depend upon the ability of these manufacturers and developers to effectively integrate our technology into products and services which they market and sell. We have no control over these licensees and can not assure you that they have the financial, marketing or technical resources to successfully develop and distribute products or applications acceptable to end users or generate any meaningful revenue for us. These third parties may also offer the products of our competitors to end users.

We derive nearly all of our revenue from government contracts, which are often non-standard, involve competitive bidding, may be subject to cancellation with or without penalty and may produce volatility in earnings and revenue.

Most of our business involves providing products and services under contracts with U.S. federal, state and local government agencies. Obtaining contracts from government agencies is challenging, and

government contracts often include provisions that are not standard in private commercial transactions. For example, government contracts may:

include provisions that allow the government agency to terminate the contract without penalty under some circumstances;

be subject to purchasing decisions of agencies that are subject to political influence;

contain onerous procurement procedures; and

be subject to cancellation if government funding becomes unavailable.

Securing government contracts can be a protracted process involving competitive bidding. In many cases, unsuccessful bidders may challenge contract awards, which can lead to increased costs, delays and possible loss of the contract for the winning bidder.

We face intense competition and may not have the financial and human resources necessary to keep up with rapid technological changes, which may result in our technology becoming obsolete.

The Internet, facility access control and information security markets are subject to rapid technological change and intense competition. We compete with both established biometric companies and a significant number of startup enterprises as well as providers of more traditional methods of access control. Most of our competitors have substantially greater financial and marketing resources than we do and may independently develop superior technologies, which may result in our technology becoming less competitive or obsolete. We may not be able to keep pace with this change. If we are unable to develop new applications or enhance our existing technology in a timely manner in response to technological changes, we will be unable to compete in our chosen markets. In addition, if one or more other biometric technologies such as voice, face, iris, hand geometry or blood vessel recognition is widely adopted, it would significantly reduce the potential market for our fingerprint identification technology.

We depend on our Chairman of the Board and Chief Executive Officer and need additional marketing and technical personnel to successfully market our technology. We cannot assure you that we will be able to retain or attract such persons.

A loss of our current Chairman of the Board of Directors or Chief Executive Officer could severely and negatively impact our operations. We do not currently have an employment contract with Michael W. DePasquale, our Chief Executive Officer. We continue to retain additional employees with expertise in developing, marketing and selling software solutions. In order to successfully market our technology, we will need to retain additional engineering, technical support and marketing personnel. The market for such persons remains highly competitive and our limited financial resources will make it more difficult for us to recruit and retain qualified persons.

We cannot assure you that the limited intellectual property protection for our core technology provides a meaningful competitive advantage or barrier to entry against our competitors.

Our success and ability to compete is dependent in part upon proprietary rights to our technology. We rely primarily on a combination of patent, copyright and trademark laws, trade secrets and technical measures to protect our proprietary rights. We have filed a patent application relating to both the optic technology and biometrics solution components of our technology wherein several claims have been allowed. More recently, we filed a patent application with respect to our VST (Vector Segment Technology), the core algorithm of our biometric identification solution. We can not assure you that any patents will be issued, or that, if issued, that we will have the resources to protect any patent from infringement. Although we believe our technology does not currently infringe upon patents held by

others, we can not assure you that such infringements do not exist or will not exist in the future, particularly as the number of products and competitors in the biometric industry segment grows.

We may need to obtain additional financing to execute our business plan, which may not be available. If we are unable to raise additional capital or generate significant revenue, we may not be able to continue operations.

Since our inception, we have not generated any significant revenue (other than revenue from acquired businesses) and have experienced substantial losses, including approximately \$7,237,000 during 2004. In March 2004, we completed a private placement equity offering that resulted in approximately \$12,000,000 in gross proceeds to the Company and a private placement convertible debt offering in September 2004 that resulted in approximately \$10,000,000 in gross proceeds to the Company (most of which was used to finance the acquisition of Aether Mobile Government). We also completed a private placement convertible debt offering in June 2005 that resulted in approximately \$5,000,000 in gross proceeds to the Company. To the extent that we will require additional capital to support our operations, expand our marketing and sales efforts and to execute our business plan to substantially increase revenue, we may need to obtain additional financing through the issuance of debt or equity securities. Our long-term viability and growth will depend upon the successful commercialization of our technologies and our ability to obtain adequate financing. We have not and cannot assure you that we will ever be able to secure any such financing on terms acceptable to us. If we cannot obtain such financing or generate such revenues, we may not be able to execute our business plan or continue operations.

We may not be able to successfully integrate recent acquisitions into our operations.

The integration of PSG and AMG into our operations involves a number of risks, including:

difficulty integrating operations and personnel;

diversion of management attention;

potential disruption of ongoing business;

inability to retain key personnel;

inability to successfully incorporate the acquired products and services into our product and service offerings and to develop new products and services; and

impairment of relationships with employees, customers or vendors.

Failure to overcome these risks or any other problems encountered in connection with the acquisitions of PSG and AMG could slow our growth or lower the quality of our services, which could reduce customer demand. The result could be a material adverse effect on our financial position and results of operations.

We may not achieve profitability with respect to the law enforcement and public safety components of our business if we are unable to maintain, improve and develop the wireless data services we offer.

We believe that our future business prospects depend in part on our ability to maintain and improve our current services and to develop new ones on a timely basis. Our services will have to achieve market acceptance, maintain technological competitiveness and meet an expanding range of customer requirements. As a result of the complexities inherent in our service offerings, major new wireless data services and service enhancements require long development and testing periods. We may experience difficulties that could delay or prevent the successful development, introduction or marketing of new services and service enhancements. Additionally, our new services and service

enhancements may not achieve market acceptance. If we cannot effectively develop and improve services we may not be able to recover our fixed costs or otherwise become profitable.

Our law enforcement and public safety division depends upon wireless networks owned and controlled by others.

If we do not have continued access to sufficient capacity on reliable networks, we may be unable to deliver services and our sales could decrease. Our ability to grow and achieve profitability partly depends on our ability to buy sufficient capacity on the networks of wireless carriers such as Verizon Wireless, Bell South Corporation, Metrocall, Motient and Cingular and on the reliability and security of their systems. All of our services are delivered using airtime purchased from third parties. We depend on these companies to provide uninterrupted and bug free service and would not be able to satisfy our customers' needs if they failed to provide the required capacity or needed level of service. In addition, our expenses would increase and our profitability could be materially adversely affected if wireless carriers were to increase the prices of their services. Our existing agreements with the wireless carriers generally have one-year terms. Some of these wireless carriers are, or could become, our competitors and if they compete with us they may refuse to provide us with their services.

New laws and regulations that impact our law enforcement and public safety division could increase our costs or reduce our opportunities to earn revenue.

We are not currently subject to direct regulation by the Federal Communications Commission or any other governmental agency, other than regulations applicable to businesses in general. However, in the future, we may become subject to regulation by the FCC or another regulatory agency. In addition, the wireless carriers who supply us airtime and certain of our hardware suppliers are subject to regulation by the FCC and regulations that affect them could increase our costs or reduce our ability to continue selling and supporting our services.

If we fail to adequately manage our resources, it could have a severe negative impact on our financial results or stock price.

We could be subject to fluctuations in technology spending by existing and potential customers. Accordingly, we will have to actively manage expenses in a rapidly changing economic environment. This could require reducing costs during economic downturns and selectively growing in periods of economic expansion. If we do not properly manage our resources in response to these conditions, our results of operations could be negatively impacted.

We granted a blanket security interest in all of our assets to the holders of our secured debt. If we are unable to make our required monthly payments on such debt, or any other event of default occurs, it could have a material adverse effect on our business and operations, and the debt holders may foreclose on our assets.

As part of our recent secured convertible debt financing transactions, we granted to Laurus Master Fund, Ltd. and another holder of such secured debt a blanket security interest in all of our assets, including assets of our subsidiary. See the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section of this report. In the event we default in payment on such debt, or any other event of default occurs under the relevant financing documents, and the default is not cured, 120% of the outstanding principal amount of the secured notes, plus accrued interest and fees will accelerate and be due and payable in full. See the "Long Term Obligations" footnote to this prospectus for a list of such potential events of default.

The cash required to pay such accelerated amounts on the secured notes following an event of default would most likely come out of our working capital. As we rely on our working capital for our

day to day operations, such a default could have a material adverse effect on our business, operating results, or financial condition to such extent that we are forced to restructure, file for bankruptcy, sell assets or cease operations. In addition, upon an event of default, the holder of the secured debt could foreclose on our assets or exercise any other remedies available to them. If our assets were foreclosed upon, we were forced to file for bankruptcy or cease operations, stockholders may not receive any proceeds from disposition of our assets and may lose their entire investment in our stock.

Our obligations under our recently issued debt securities may adversely affect our ability to enter into potential significant transactions with other parties.

As a result of our recent debt financing transactions with Laurus Master Fund, Ltd., the Shaar Fund, Ltd. and other institutional and accredited investors, we have incurred significant repayment obligations, and have agreed to certain restrictive covenants. In particular, for so long as 25% of the aggregate principal amount of the convertible term notes remains outstanding, we will need the consent of the holders of such notes before we can take certain actions, including the following:

pay any dividends;

merge, effect a material reorganization, liquidate or dissolve;

materially change the scope of our business; or

create, incur or assume any debt (other than certain trade debt, equipment financings and debt for the purchase of assets in the ordinary course of business).

Accordingly, unless we obtain the noteholders' consent, we may not be able to enter into certain transactions. In addition, in connection with any potential significant transaction (such as a merger, sale of substantially all our assets, joint venture, or similar transaction), it is likely that we would have to pay off such debt obligations and have the applicable security interests released. Although we have the right at any time to prepay our debt obligations, we can only do so upon payment of amounts ranging from 110% to 120% of the then outstanding principal balances, plus all other amounts owing under the notes. Based on an aggregate outstanding principal balances of \$11.5 million at June 8, 2005, a complete prepayment would require a cash payment of approximately \$12.9 million. These provisions could have the practical effect of increasing the costs of any potential significant transaction, and restrict our ability to enter into any such transaction.

Our obligations to the holders of our outstanding preferred stock may further affect our ability to enter into potential significant transactions with other parties.

We will need to obtain the consent of the holders of a majority of the then outstanding shares of our convertible preferred stock before we can take certain actions, including the following:

a sale or other disposition of any material assets;

an acquisition of a material amount of assets;

engaging in a merger, reorganization or consolidation; or

incur or guaranty any indebtedness in excess of \$50,000.

Accordingly, unless we obtain such consent, we may not be able to enter into certain transactions.

Risks Related To Our Common Stock

We have issued a substantial number of securities that are convertible into shares of our common stock which will result in substantial dilution to the ownership interests of our existing shareholders.

As of June 8, 2005, approximately 37,765,011 shares of our common stock were reserved for issuance upon exercise or conversion of the following securities:

8,524,630 shares upon conversion of outstanding convertible term notes;

20,216,362 shares upon exercise of outstanding stock options and warrants;

2,182,964 shares upon exercise of options available for future grant under our existing option plans; and

6,841,055 shares upon conversion of our outstanding shares of convertible preferred stock and accrued dividends

The exercise or conversion of these securities will result in a significant increase in the number of outstanding shares and substantially dilute the ownership interests of our existing shareholders.

A substantial number of our convertible securities are convertible into shares of common stock at a conversion price of \$.75 per share. Most of these shares are eligible for public resale. The trading price of our common stock and our ability to raise additional financing may be adversely effected by the influx into the market of such a substantial number of shares.

Our outstanding convertible preferred stock and cumulative dividends in arrears are convertible into 6,841,055 shares of common stock as of June 8, 2005 at a per share conversion price of \$.75 which is substantially less than the current trading price of our shares. Although many of the shares issuable upon conversion of our convertible securities are eligible for public resale under Securities Exchange Commission Rule 144, we have agreed to file a registration statement to cover the public resale of all of these shares. This significant increase in the number of shares available for public sale may have a negative impact on the trading price of our shares and substantially dilute the ownership interests of our existing shareholders. In the event that our stock trades below \$.75 per share, in order to raise additional financing we would likely be required to issue additional shares of common stock or securities convertible into common stock at a purchase or conversion price, as applicable, of less than \$.75 per share. Any issuance of shares at a purchase price of less than \$.75 per share would reduce the conversion price of our Convertible Preferred Shares to such lower price. This would require us to issue additional shares upon conversion of our Series A Shares and further dilute the ownership interests of our existing shareholders. To the extent these factors are viewed negatively by the market, it may provide an incentive for persons to execute short sales of our common stock that could adversely affect the trading price of our common stock.

Applicable SEC Rules governing the trading of "penny stocks" limits the trading and liquidity of our common stock, which may affect the trading price of our common stock.

Our common stock currently trades on the OTC Bulletin Board. Since our common stock continues to trade below \$5.00 per share, our common stock is considered a "penny stock" and is subject to SEC rules and regulations, which impose limitations upon the manner in which our shares can be publicly traded. These regulations require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule explaining the penny stock market and the associated risks. Under these regulations, certain brokers who recommend such securities to persons other than established customers or certain accredited investors must make a special written suitability determination regarding such a purchaser and receive such purchaser's written agreement to a transaction prior to

sale. These regulations have the effect of limiting the trading activity of our common stock and reducing the liquidity of an investment in our common stock.

We do not intend to pay dividends in the foreseeable future.

We have never declared or paid a dividend on our common stock. In addition, the terms of our outstanding Convertible Preferred Shares preclude us from declaring or paying a dividend on our common stock unless a dividend is also declared or paid, as applicable, on our Convertible Preferred Shares. We intend to retain earnings, if any, for use in the operation and expansion of our business and, therefore, do not anticipate paying any dividends on our common stock in the foreseeable future.

The trading price of our common stock may be volatile.

The trading price of our shares has from time to time fluctuated widely and in the future may be subject to similar fluctuations. The trading price may be affected by a number of factors including the risk factors set forth in this prospectus as well as our operating results, financial condition, announcements of innovations or new products by us or our competitors, general conditions in the biometrics and access control industries, and other events or factors. Although we believe that approximately 15 registered broker dealers currently make a market in our common stock, we can not assure you that any of these firms will continue to serve as market makers or have the financial capability to stabilize or support our common stock. A reduction in the number of market makers or the financial capability of any of these market makers could also result in a decrease in the trading volume of and price of our shares. In recent years broad stock market indices, in general, and the securities of technology companies, in particular, have experienced substantial price fluctuations. Such broad market fluctuations may adversely affect the future-trading price of our common stock.

The selling security holders intend to sell their shares of common stock in the market, which sales may cause our stock price to decline.

The selling stockholders named in this prospectus intend to sell in the public market 6,880,754 shares of our common stock being registered in this offering. That means that up to 6,880,754 shares may be sold pursuant to this registration statement. Such sales may cause our stock price to decline. Our officers and directors and those shareholders who are significant shareholders as defined by the Securities and Exchange Commission will continue to be subject to the provisions of various insider trading and Rule 144 regulations.

FORWARD-LOOKING STATEMENTS

All statements other than statements of historical facts contained in this prospectus, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. The words "anticipate," "believe," "estimate," "will," "may," "future," "plan," "intend" and "expect" and similar expressions generally identify forward-looking statements. Although we believe that our plans, intentions and expectations reflected in the forward-looking statements are reasonable, we cannot be sure that they will be achieved. Actual results may differ materially due to a number of factors. Many of these factors are set forth in the "RISK FACTORS" section of this prospectus. Actual results may differ materially from the forward-looking statements contained in this prospectus. These factors are not intended to represent a complete list of the general or specific factors that may affect us. It should be recognized that other factors, including general economic factors and business strategies, may be significant, presently or in the future. Except as required by law, we undertake no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise.

USE OF PROCEEDS

The shares are being registered hereunder for resale by the selling security holders. We will not receive any proceeds from the sale of the shares by the selling security holders. We will receive the proceeds from the exercise price of certain warrants held by the selling security holders to the extent that such warrants are exercised. We expect to use the proceeds of any such sales for general working capital purposes.

MARKET FOR OUR COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Our common stock currently trades on the OTC Bulletin Board under the symbol "BKYL." The following table sets forth the range of high and low bid prices per share of our common stock for each of the calendar quarters identified below as reported by the OTC Bulletin Board. These quotations represent inter-dealer prices, without retail mark-up, markdown or commission, and may not represent actual transactions.

	High	Low
	_____	_____
2005:		
Quarter ended September 30, 2005	\$ 1.21	\$ 0.74
Quarter ended June 30, 2005	\$ 1.39	\$ 0.99
Quarter ended March 31, 2005	\$ 1.63	\$ 1.12
2004:		
Quarter ended December 31, 2004	\$ 1.61	\$ 0.74
Quarter ended September 30, 2004	\$ 1.43	\$ 0.60
Quarter ended June 30, 2004	\$ 3.00	\$ 1.26
Quarter ended March 31, 2004	\$ 1.85	\$ 1.03
2003:		
Quarter ended December 31, 2003	\$ 1.40	\$ 0.53
Quarter ended September 30, 2003	\$ 0.59	\$ 0.38
Quarter ended June 30, 2003	\$ 0.64	\$ 0.30
Quarter ended March 31, 2003	\$ 0.73	\$ 0.35

The last price of our common stock as reported on the OTC Bulletin Board on October 18, 2005 was \$0.66 per share.

 Holders

As of March 1, 2005 the number of stockholders of record of our common stock was 190. Based on broker inquiry conducted in connection with the distribution of proxy solicitation materials in connection with the Company's special meeting of shareholders in 2004, we believe that there are approximately 4,466 beneficial owners of its common stock.

 Dividends

We have not paid any cash dividends to date, and have no intention of paying any cash dividends on our common stock in the foreseeable future. The terms of our outstanding Series A preferred shares preclude us from declaring or paying a dividend on our common stock unless a dividend is also declared or paid, as applicable, on our Series A preferred shares. The declaration and payment of dividends is also subject to the discretion of our Board of Directors and certain limitations imposed under the Delaware General Corporation Law. The timing, amount and form of dividends, if any, will depend on, among other things, our results of operations, financial condition, cash requirements and other factors deemed relevant by our Board of Directors.

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATIONS**

This Management's Discussion and Analysis of Financial Condition and Results of Operations and other parts of this prospectus contain forward-looking statements that involve risks and uncertainties. All forward-looking statements included in this prospectus are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth in the section captioned "RISK FACTORS" and elsewhere in this prospectus. The following should be read in conjunction with our audited financial statements included elsewhere herein.

Overview

The following should be read in conjunction with the consolidated financial statements of the Company included elsewhere herein. We develop and market proprietary fingerprint identification biometric technology and software solutions. We also deliver advanced identification solutions and information services to law enforcement departments, public safety agencies and other government and private sector customers. Our mobile wireless technology provides first responders with critical, reliable, real-time data and images from local, state and national databases.

We pioneered the development of automated, finger identification technology that can be used without the aid of non-automated methods of identification such as a personal identification, password, token, smart card, ID card, credit card, passport, drivers license or other form of possession or knowledge based identification. This advanced BIO-key identification technology improves both the accuracy and speed of finger-based biometrics and is the only finger identification algorithm that has been certified by the International Computer Security Association (ICSA).

Since our inception in 1993, we have spent substantial time and effort in completing the development of what we believe is the most discriminating and effective finger biometric technology available. During the past two years, our focus has shifted to marketing and selling this technology and completing strategic acquisitions that can help us leverage our capability to deliver identification solutions. We have built a direct sale force of professionals with substantial experience in selling technology solutions to government and corporate customers. We expect to continue to add additional qualified personnel in 2005.

On March 30, 2004, we acquired all of the outstanding capital stock of Public Safety Group, Inc., a privately-held provider of wireless solutions for law enforcement and public safety markets based in Winter Park, Florida, in exchange for an aggregate of 2,422,108 shares of our common stock, \$500,000 in cash, and our assumption of \$600,000 in aggregate net liabilities of PSG. The acquisition was completed pursuant to the terms of an agreement and plan of merger by and among the Company, BIO-key Acquisition Corp., a wholly-owned subsidiary of the Company, PSG and all of the shareholders of PSG. As a result of this transaction, PSG became a wholly-owned subsidiary of the Company.

On March 31, 2004, we completed a private placement equity offering that resulted in approximately \$12,000,000 in gross proceeds to the Company.

On September 30, 2004, we completed our acquisition of the Mobile Government Division from Aether Systems Inc. Pursuant to the Asset Purchase Agreement dated as of August 16, 2004 by and among the Company, Aether, Cerulean Technology, Inc. and SunPro, Inc., the Company paid Aether a purchase price of \$10,000,000 in cash, subject to post-closing adjustments to reflect changes in Aether Mobile Government's working capital and cash flows since June 30, 2004. Post-closing working capital adjustments resulted in an additional payment by the Company of \$341,878 in December 2004. In

connection with this acquisition, the Company issued a subordinated secured promissory note to Aether in the face amount of \$6,884,588 (the "Aether Note"). The Aether Note evidences a contingent reimbursement obligation of the Company to Aether and a surety fee payable by the Company to Aether, in each case with respect to a letter of credit maintained by Aether for the Company's benefit in connection with the acquisition. The Company's obligations under the Aether Note are secured by a security interest granted to Aether in all or substantially all of the Company's assets, subordinate to the security interest described in the "Long-Term Obligations" footnote to this prospectus.

Aether Mobile Government provides wireless data solutions for use by public safety organizations, primarily state and local police, fire and rescue and emergency medical services organizations, that enable such organizations to access law enforcement databases to validate identities and obtain suspect information. Its public safety solutions are integrated into fifty (50) different state databases, as well as local and federal databases, and its products deliver real-time information in seconds, without the need for human dispatchers or other resources.

On September 29, 2004, we entered into a securities purchase agreement (the "September 2004 Senior Purchase Agreement") with certain institutional and accredited investors. Under this agreement, the Company issued secured convertible term notes (the "September 2004 Senior Convertible Notes") in the aggregate principal amount of \$5,050,000, convertible into common stock of the Company in certain circumstances at \$1.35 per share, and issued warrants (the "September 2004 Senior Warrants") to purchase an aggregate of 1,122,222 shares of our common stock at an exercise price of \$1.55 per share. The Company's obligations under these financing documents are secured by a security interest in all or substantially all of the Company's assets. Also on September 29, 2004, we entered into a separate securities purchase agreement (the "September 2004 Subordinated Purchase Agreement") with existing shareholders of the Company and other accredited investors. Under this agreement, the Company issued unsecured convertible term notes (the "September 2004 Subordinated Convertible Notes") in the aggregate principal amount of \$4,950,000, convertible into common stock of the Company in certain circumstances at \$1.35 per share, and issued warrants (the "September 2004 Subordinated Warrants") to purchase an aggregate of 1,099,997 shares of our common stock at an exercise price of \$1.55 per share. The proceeds from each of these transactions were used in part to finance a portion of the Company's acquisition of Aether Mobile Government and will be used in part for working capital purposes.

On June 8, 2005, we entered into a securities purchase agreement (the "June 2005 Senior Purchase Agreement") with an institutional investor. Under the June 2005 Senior Purchase Agreement, the Company issued a secured convertible term note (the "June 2005 Senior Convertible Note") in the aggregate principal amount of \$2,000,000, convertible into common stock of the Company in certain circumstances at \$1.35 per share, and issued a warrant (the "June 2005 Senior Warrant") to purchase an aggregate of 444,444 shares of the common stock at a per share exercise price of \$1.55. The proceeds from this transaction are to be used for working capital purposes. The Company's obligations under the June 2005 Senior Purchase Agreement and the June 2005 Senior Convertible Note are secured by a security interest in all or substantially all of the Company's assets.

We entered into a securities purchase agreement, effective as of May 31, 2005 (the "May 2005 Subordinated Purchase Agreement") with existing shareholders of the Company and other accredited investors (collectively, the "May 2005 Subordinated Investors"). Under the May 2005 Subordinated Purchase Agreement, the Company issued secured convertible term notes (the "May 2005 Subordinated Convertible Notes") in the aggregate principal amount of \$3,244,723, convertible into common stock of the Company in certain circumstances at \$1.35 per share, and issued warrants (the "May 2005 Subordinated Warrants") to purchase an aggregate of 961,399 shares of the common stock at a per share exercise price of \$1.50. The proceeds from this transaction are to be used for working capital purposes. The May 2005 Subordinated Convertible Notes were issued at a purchase price equal to \$900 for each \$1,000 of principal amount of the Note.

Critical Accounting Policies

The Company believes the following represent its critical accounting policies:

Revenue recognition. Revenues from software licensing are recognized in accordance with Statement of Position (SOP) No. 97-2, Software Revenue Recognition, as amended by SOP No. 98-9. Accordingly, revenue from software licensing is recognized when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is probable.

The Company intends to enter into arrangements with end users for items which may include software license fees, usage fees and services or various combinations thereof. For each arrangement, revenues will be recognized when evidence of an agreement has been documented, the fees are fixed or determinable, collection of fees is probable, delivery of the product has occurred and no other significant obligations remain.

Multiple-Element Arrangements: For multiple-element arrangements, each element of the arrangement will be analyzed and the Company will allocate a portion of the total fee under the arrangement to the elements using vendor specific objective evidence of fair value of the element, regardless of any separate prices stated within the contract for each element. Vendor specific objective evidence is based on the price the customer is required to pay when the element is sold separately (i.e., software license fees charged when consulting or other services are not provided, hourly rates charged for consulting services when sold separately from a software license or usage fees). If vendor specific objective evidence of fair value does not exist for any undelivered elements, all revenue is deferred and recognized ratably over the service period if the undelivered element is services, or until sufficient objective evidence of fair value exists or all elements have been delivered.

License Revenues: Amounts allocated to license revenues are recognized at the time of delivery of the software and all other revenue recognition criteria discussed above have been met.

Revenue from licensing software which requires significant customization and modification is recognized using the percentage of completion method, based on the hours of effort incurred by the company in relation to the total estimated hours to complete. In instances where third party hardware, software or services form a significant portion of a customer's contract, the company recognizes revenue for the element of software customization by the percentage of completion method described above. Third party hardware, software, and services are recognized upon shipment or acceptance as appropriate. If the Company makes different judgments or utilizes different estimates of the total amount of work expected to be required to customize or modify the software, the timing and revenue recognition, from period to period, and the margins on the project in the reporting period, may differ materially from amounts reported. Revenues earned but not yet billed are shown as an asset in Costs and Earnings in Excess of Billings in the balance sheet. Billings in excess of cost and earnings are reflected as a liability in the balance sheet. Anticipated contract losses are recognized as soon as they become known and are estimable.

Service Revenues: Revenues from services are comprised of maintenance, consulting and implementation services. Maintenance revenues include providing for unspecified when-and-if available product updates and customer telephone support services and are recognized ratably over the term of the service period. Consulting services are generally sold on a time-and-materials basis and include a range of services including installation of software and assisting in the design of interfaces to allow the software to operate in customized environments. Services are generally separable from other elements under the arrangement since performance of the services are not essential to the functionality of any other element of the transaction and are described in the contract such that the total price of the arrangement would be expected to vary as the result of the inclusion or exclusion of the services. Revenues from services are generally recognized as the services are performed.

Usage Fees: Usage fees are charged on certain applications based on the customer's volume of use. Usage revenue is recognized based on the actual level of activity used by the customer or, in the case of fixed-fee arrangements, ratably over the arranged time period.

The Company provides customers, free of charge or at a minimal cost, testing kits which potential licensing customers may use to test compatibility/acceptance of the Company's technology with the customer's intended applications.

Accounts Receivable. Accounts receivable billed and unbilled are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history, and current economic conditions. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received.

Valuation of Long-Lived Tangible and Intangible Assets and Goodwill. Our long-lived tangible assets are equipment and leasehold improvements. As a result of our acquisitions, we have significant long-lived intangible assets and goodwill, which are susceptible to valuation adjustments as a result changes in various factors or conditions. The intangible assets are developed technology (software), copyrighted software, marketing agreements, customer relationships and trademarks which are amortized over their estimated useful lives on a straight line basis. Goodwill is not amortized.

We assess the potential impairment of intangible assets and equipment and leasehold improvements whenever changes in circumstances indicate the carrying value may not be recoverable. Some indicators of impairment include; significant underperformance relative to historical or projected future operating results, significant changes in the manner of or use of the acquired assets or the strategy for our overall business, significant negative industry or economic trends, significant decline in our stock price for a sustained period and a decline in our market capitalization below net book value.

Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ("SFAS 142") requires goodwill to be tested for impairment using a two-step process. The first step compares the fair value of the reporting unit with the unit's carrying amount, including goodwill. When the carrying amount of the reporting unit is greater than the unit's implied fair value, the unit's goodwill may be impaired, and the second step must be completed to measure the amount of impairment charge, if any. In this step, if the carrying amount is greater than the reporting unit's implied fair value, the carrying amount must be written down to its implied fair value. We operate in two reporting units; PSG and AMG. Goodwill is required to be tested for impairment at least annually, or more frequently when events and circumstances indicate that recorded goodwill might be impaired. We performed the goodwill assessment of PSG during the fourth quarter of 2004 and determined there was no impairment. As provided by SFAS No. 142, the Company has elected to perform the annual assessment of the carrying value of all goodwill as of August 1 each year. Factors we consider to be indicators of impairment include; significant underperformance relative to historical or projected future operating results, significant negative industry or economic trends, significant decline in our stock price for a sustained period and a decline in our market capitalization below net book value.

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123R (revised 2004), *Share-Based Payment* (SFAS 123R). This statement replaces SFAS No. 123 and supersedes *APB Opinion No. 25, Accounting for Stock Issued to Employees*. SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized in the financial statements based on their fair value. The pro forma disclosures previously permitted under SFAS 123 no longer will be an alternative to financial statement recognition. For the Company, SFAS 123R is effective for periods beginning after December 15, 2005.

We plan to adopt SFAS 123R on January 1, 2006 using the modified prospective application method described in the statement. Under the modified prospective application method, we will apply the standard to new awards and to awards modified, repurchased, or cancelled after the required effective date. Additionally, compensation cost for the unvested portion of awards outstanding as of the required effective date will be recognized as compensation expense as the requisite service is rendered after the required effective date. We are evaluating the impact of adopting SFAS 123R and expect that we will record substantial non-cash stock compensation expenses. The adoption of SFAS 123R is not expected to have a significant effect on cash flows but is expected to have a significant adverse effect on our results of operations. The future impact of the adoption of SFAS 123R cannot be predicted at this time because it will depend upon the levels of share-based payments granted in the future. However, had we adopted SFAS 123R in prior periods, the impact would have approximated the impact of SFAS 123 as described in the disclosure of pro forma net loss attributable to common stockholders included in the Stockholders' Equity footnote.

Results of Operations

The discussion below regarding our results of operations for the three and six months ended June 30, 2005 reflects the combined operations of our historic biometric technology licensing business and our new public safety division, comprised of the former PSG and the former Mobile Government. The corresponding periods in 2004 include the operations of our historic biometric business and three months of results for the new public safety division. In order to present the following discussion in a manner to provide a more meaningful comparison between the two periods, where possible, we have quantified the material changes in our results of operations which are attributable to the operations of each of our businesses. Because the acquisition of the Mobile Government division of Aether Systems was not completed until September 30, 2004, the results of operations for Mobile Government are not included in the three and six month periods ending June 30, 2004.

Three and Six Months Ended June 30, 2005 as Compared to June 30, 2004

Revenue

Services revenues, which include maintenance, technical support and other professional services, were approximately \$2,762,000 during the three months ended June 30, 2005 as compared to approximately \$158,000 during the corresponding period in 2004. The increase in 2005 services revenues is due to \$2,683,000 in revenue from Mobile Government, which was acquired in September, 2004. Services revenues from BIO-key and PSG were \$79,000 during the three months ended June 30, 2005 as compared with \$158,000 during the comparable period in 2004.

License fees and other revenue, which principally includes software license fees and hardware sales, were approximately \$903,000 during the three months ended June 30, 2005 as compared to approximately \$361,000 during the corresponding period in 2004. The increase in 2005 license and other revenues is due to \$776,000 in revenue from Mobile Government. License and other revenues from BIO-key and PSG on a combined basis were \$127,000 for the second quarter of 2005 as compared with \$361,000 during the comparable period in 2004.

For the six months ended June 30, 2005, services revenues were approximately \$5,822,000 compared to approximately \$201,000 during the corresponding period in 2004. The increase in 2005 services revenues is due to \$5,689,000 in revenue from the Mobile Government division. Service revenues from the BIO-key division and the Public Safety Group were \$132,000 during the six months ended June 30, 2005 compared to \$201,000 during the corresponding period in 2004.

License fees and other revenue, were approximately \$1,743,000 during the six months ended June 30, 2005 as compared to approximately \$630,000 during the corresponding period in 2004. The increase in 2005 license and other revenues is due to \$1,550,000 in revenue from Mobile Government.

License fees and other revenue from BIO-key and PSG were approximately \$193,000 during the six months ended June 30, 2005.

Costs and Other Expenses

Costs of services were approximately \$1,034,000 during the three months ended June 30, 2005 as compared to approximately \$156,000 during the prior year period. The increase in 2005 was due to \$874,000 in costs of services of Mobile Government.

Costs of license and other were approximately \$205,000 during the three months ended June 30, 2005 as compared to approximately \$95,000 during the corresponding period in 2004. The increase in 2005 was due to \$202,000 in costs of license and other of Mobile Government.

Costs of services were approximately \$1,870,000 during the six months ended June 30, 2005 as compared to approximately \$156,000 during the prior year period. The increase in 2005 was due to \$1,550,000 in costs of services of Mobile Government. Costs of services for BIO-key and PSG were \$320,000 for the six months ended June 30, 2005 as compared to approximately \$156,000 during the prior year period.

Costs of license and other were approximately \$533,000 during the six months ended June 30, 2005 as compared to approximately \$101,000 during the corresponding period in 2004. The increase in 2005 was due to \$510,000 in costs of license and other of Mobile Government. Costs of license and other for BIO-key and PSG were \$23,000 for the six months ended June 30, 2005.

Selling, general and administrative expenses. Selling, general and administrative expenses increased to approximately \$3,125,000 during the three months ended June 30, 2005 from approximately \$1,190,000 during the corresponding period in 2004. With the acquisition of Mobile Government, the Company significantly increased the number of employees in the selling, general and administrative area. Salary and benefit related expenses were approximately \$1,812,000 during the three months ended June 30, 2005 compared to \$585,000 for the comparable period in 2004. For the six months ended June 30, 2005, selling, general and administrative expenses increased by \$3,961,000 to approximately \$5,972,000. Salary and benefit related expenses were approximately \$3,817,000 during the six months ended June 30, 2005 compared to \$878,000 for the comparable period in 2004.

We expect selling, general and administrative expenses to decrease as a percentage of revenue during the remainder of 2005.

Research and Development. Research and development expenses increased to approximately \$1,670,000 during the three months ended June 30, 2005 from approximately \$352,000 in 2004. The increase was due to the addition of a significant number of employees as a result of the acquisition of Mobile Government. Salary, benefits and contractor expenses were approximately \$1,341,000 during the three months ended June 30, 2005 compared to \$252,000 for the comparable period in 2004. For the six months ended June 30, 2005, research and development expenses increased by \$3,131,000 to approximately \$3,746,000. Salary, benefits and contractor expenses were approximately \$2,734,000 during the six months ended June 30, 2005 compared to \$425,000 for the comparable period in 2004.

We expect research and development expenses to decrease as a percentage of revenue during the remainder of 2005.

Interest Expense. Interest expense was approximately \$576,000 during the three months ended June 30, 2005 as compared with approximately \$1,000 during the corresponding period of the prior year, when the Company had virtually no debt. For the six months ended June 30, 2005, interest expense was approximately \$1,081,000, as compared with approximately \$137,000 during the prior year period, which included debt during the first quarter only.

Net Operating Loss Carryforwards. As of December 31, 2004, we had federal and state net operating loss carryforwards of approximately \$32,501,000 and \$14,129,000, respectively. The carryforwards expire between 2011 and 2024. Such net operating loss carryforwards are subject to the limitations under Section 382 of the Internal Revenue Code due to changes in the equity ownership of the Company.

Year Ended December 31, 2004 as Compared to Year Ended December 31, 2003

Revenues

License fees and other, which principally includes software license fees and hardware sales, were approximately \$2,207,000 during 2004 as compared to approximately \$513,000 during 2003. Service, which includes maintenance, technical support and other professional services, was approximately \$3,351,000 during 2004 as compared to approximately \$11,000 in 2003. The revenue increases in each case are attributed to the additional revenue from acquired businesses in 2004, particularly the revenue generated from AMG in the fourth quarter.

During the fourth quarter of 2004, the Company conducted a review of its contracts with certain development stage companies and decided to reduce previously recorded revenue from those customers until payment is received. These adjustments totaled approximately \$300,000.

Costs and Other Expenses

Cost of license fees and other were approximately \$890,000 in 2004 as compared with approximately \$87,000 in 2003. These costs consist primarily of third party royalties and third party hardware incurred in conjunction with the AMG license revenue.

Cost of services was approximately \$1,174,000 in 2004 as compared to \$1,694 in 2003. These costs consist primarily of personnel expenses related to the cost of maintenance, customization, consulting and support.

Selling, general and administrative expenses. Selling, general and administrative expenses increased to approximately \$7,096,000 in 2004 from approximately \$2,118,000 in 2003. Approximately \$3,217,000 of this increase is due to expenses associated directly with acquired businesses and approximately \$1,761,000 is attributed to the Company's additional 2004 spending to enhance its sales and marketing capabilities.

Research and Development. Research and development expenses increased to approximately \$2,980,000 in 2004 from approximately \$1,037,000 in 2003. Approximately \$1,558,000 of this increase is due to expenses associated directly with acquired businesses and approximately \$385,000 is attributed to the Company's additional 2004 spending for research and development.

Interest Expense. Interest expense decreased by about \$443,000 to approximately \$667,000 in 2004. The decrease in 2004 interest expense resulted from the Company having a lower average balance of outstanding debt in 2004. During 2004, the Company had \$10 million in debt outstanding during the first and fourth quarters only. In 2003 the Company had approximately \$10 million in debt outstanding for the entire year. The 2004 interest expense includes \$120,000 primarily in non-cash amortization of warrants issued in connection with the Company's September 29, 2004 issuance of \$10 million of convertible notes.

Liquidity and Capital Resources

As of June 30, 2005, we had cash and cash equivalents of \$1,972,000 compared to \$1,956,000 as of December 31, 2004. During this period the Company raised approximately \$4,515,000 in net proceeds from private placements of convertible debt, received proceeds of approximately \$539,000 from warrant

option exercises, received approximately \$501,000 of performance bond deposits returns, repaid approximately \$1,405,000 of long-term obligations, and invested approximately \$120,000 in capital expenditures. During the six months ended June 30, 2005 the cash collection from customer receivables was approximately \$7,850,000 and operations related disbursements was approximately \$11,900,000.

Net cash used in operations during the six months ended June 30, 2005 was approximately \$3,752,000 compared to approximately \$2,307,000 during the six months ended June 30, 2004. The increase in negative operating cash flow in 2005 was due to the net loss of approximately \$5,628,000 as compared to the net loss of approximately \$2,173,000 during the comparable prior year period. The impact of the net loss on operating cash flow was offset in 2005 by non cash charges for depreciation of approximately \$116,000, amortization of intangible assets of approximately \$456,000, discounts on convertible debt related to warrants and beneficial conversion features of approximately \$312,000 and compensation expense associated with options and warrants issued for services of approximately \$530,000.

Working capital deficit at June 30, 2005 was approximately \$2,262,000 as compared to a deficit of approximately \$3,016,000 at December 31, 2004. The most significant reasons for this improvement was primarily due to reclassification of approximately \$292,000 of allowance for doubtful receivables from the Mobile Government acquisition to goodwill as discussed in the Notes to Consolidated Financial Statements included in this prospectus, approximately \$366,000 increase in unbilled receivables in accordance to our revenue recognition policy, an increase in our prepaid rent of \$300,000, offset by an increase in our sales commissions accrual and legal costs accrual of approximately \$153,000.

The resources necessary to provide working capital in the next twelve months for operations and to provide the resources for growth are a major concern for the Company. Current monthly operating expenses are approximately \$1,700,000 and monthly debt payments are approximately \$350,000. At this level, the Company would need to increase revenue to approximately \$2,000,000 per month in order to break even. This is significantly higher than the monthly revenue generated by the Company in the six months ending June 30, 2005. Accounts Receivable and Costs and Earnings in Excess of Billings, approximately totaling \$9,244,000 at June 20, 2005, are expected to be a significant source of cash for the Company. However, there can be no assurance that the Company can significantly increase its revenue or that timing of the payments from Accounts Receivable and Costs and Earnings in Excess of Billings will allow the Company to meet its monthly financial obligations.

To the extent that the Company is unable to increase its monthly revenue and continues to generate losses, we will need to obtain additional funding to (i) conduct the sales, marketing and technical support necessary to execute our plan to substantially grow operations, increase revenue and serve a significant customer base; and (ii) provide working capital. Due to several factors, including our history of losses and limited revenue, our independent auditors have included an explanatory paragraph in their opinion for the year ended December 31, 2004 as to the substantial doubt about our ability to continue as a going concern. Our long-term viability and growth will depend on the successful commercialization of our technologies and our ability to obtain adequate financing.

Net cash provided by investing activities for the six months ended June 30, 2005 was approximately \$1,389,000 compared to net cash used in investing activities of approximately \$6,541,000 for the corresponding period in 2004. The 2005 amount includes approximately \$980,000 in proceeds from the sales of marketable securities and as discussed above return of \$501,000 of performance bond deposits. During the prior year, the Company used approximately \$499,000 to acquire PSG and approximately \$5,888,000 to purchases marketable securities.

Net cash provided by financing activities during the six months ended June 30, 2005 was approximately \$3,380,000 compared to approximately \$11,673,000 in the corresponding period in 2004, at which time the Company raised approximately \$11,249,000 in net proceeds from a private placement of common stock. As discussed above, during the six months ended June 30, 2005, the Company raised

approximately \$4,515,000 in net proceeds from a private placement of convertible debt and received proceeds of approximately \$539,000 from warranted option exercises. Offsetting these proceeds were debt repayments of approximately \$1,405,000. The Company incurred a financing fee of \$347,000 associated with the June convertible debt financing. To the extent the Company continues to generate losses and negative cash flows from operations, the Company expects to seek additional outside financing.

On October 31, 2003, we entered into an amendment to the January 27, 2003 note purchase agreement with The Shaar Fund Ltd. ("Investor") to provide up to \$2,500,000 of additional financing pursuant to the terms of a secured promissory note (the "Secured Note"). Of this amount, \$600,000 was advanced at closing and \$1,900,000 was funded between December 3, 2003 and March 29, 2004. The Secured Note was due October 1, 2005, secured by substantially all of our assets including our intellectual property, accrued interest at the rate of 7% per annum payable on maturity, and may be prepaid without penalty. The principal amount and accrued interest was convertible at the option of the Investor into either shares of our common stock at a conversion price of \$.75 per share or shares of our Convertible Preferred Shares at a conversion price of \$100 per share. The Secured Note also provided that in the event we completed a private placement of our equity securities resulting in gross proceeds in excess of \$5,000,000 on or before June 30, 2004, some or all of the principal and accrued interest shall, at the option of the Investor, be either converted into such equity securities at a conversion price equal to the sale price of such securities or repaid in cash. Upon the closing of our private placement equity offering in 2003, the Investor elected to convert \$347,500 of the principal amount of the Secured Note into shares of our common stock and warrants to purchase shares of our common stock, each issued to the Investor in connection with such private placement.

Pursuant to a recapitalization transaction completed on March 3, 2004, all existing promissory notes payable to the Investor, other than the Secured Note, together with all accrued and unpaid interest due thereon (approximately \$6,500,000) were cancelled and converted into 65,000 Convertible Preferred Shares. Convertible Preferred Shares are convertible into common stock at a conversion price of \$.75 per share. In the event that the average closing bid price of our common stock is less than \$1.00 per share for thirty (30) consecutive days at any time after March 3, 2007, we will be required to redeem the Convertible Preferred Shares at a redemption price of \$100 per share plus all accrued and unpaid dividends due thereon. In connection with the recapitalization transaction, the Investor sold \$375,000 of the principal amount of the Secured Note to Thomas J. Colatosti, our Chairman of the Board of Directors.

On March 30, 2004, the Investor elected to convert \$1,827,463 of principal and accrued interest due under the Secured Note into 18,275 Convertible Preferred Shares. Also on March 30, 2004, the Investor elected to exchange all of the issued and outstanding shares of our series B preferred stock and accrued and unpaid dividends thereon and all accrued and unpaid interest on such dividends into 5,257 additional Convertible Preferred Shares. On April 29, 2004, Mr. Colatosti elected to convert \$375,000 of the principal amount of the Secured Note into 3,750 Convertible Preferred Shares. As a result of these conversions, as of the date of this report, we have no outstanding indebtedness other than as described in the Long Term Obligations footnote of this annual report and current liabilities.

Between April 7, 2004 and June 21, 2004, we issued an aggregate of 2,237,198 shares of common stock upon conversion of 16,600 shares of the Company's Series C 7% Convertible Preferred Stock and \$17,898 of dividends due thereon to the Shaar Fund.

On March 31, 2004, we entered into a securities purchase agreement with certain institutional and accredited investors pursuant to which we issued and sold an aggregate of 8,888,928 shares of our common stock and warrants (the "Warrants") to purchase an aggregate of 4,444,464 shares of our common stock. The investors paid an aggregate purchase price of \$1.35 for each share of common

stock and Warrant to purchase 0.5 of a share of common stock, resulting in gross proceeds to of approximately \$12,000,000.

On March 30, 2004, we completed the acquisition of PSG in exchange for an aggregate of 2,416,108 shares of our common stock, \$500,000 in cash, and our assumption of \$600,000 in net liabilities of PSG. Any liability or obligation of PSG in excess of such \$600,000 limitation shall remain the liability or obligation of the former shareholders of PSG. In connection with this acquisition, we also issued 6,000 shares of our common stock to Harward Investments, Inc. ("Harward") pursuant to an arrangement involving the discharge of certain outstanding debt obligations of PSG to Harward as of March 30, 2004

Additional earnout consideration, determined as a proportion of qualified revenues, as defined, attained by the acquired business during fiscal years 2004 and 2005, may be paid to the former shareholders of PSG. During 2004, the PSG earnout was \$43,635. During 2005, earnout consideration, if any, will be paid at the following rates: Ten percent (10%) of all 2005 Qualifying Revenue equal to or greater than \$7 million but less than \$10 million; and Twenty percent (20%) of all 2005 Qualifying Revenue equal to or greater than \$10 million. "Qualifying Revenue" means all license, services and maintenance fees recognized by the Company, which are generated by the Products, as defined (or any improvements thereto) in the public sector division of the Company, plus any revenues generated by the Products through other divisions or subsidiaries of the Company, as determined in accordance with generally accepted accounting principles. We will make payments of such additional consideration on the last day of the month following each month in which the acquired business achieves specified revenue milestones during fiscal years 2004 and 2005. Such payments will be made in cash, unless the aggregate amount of earnout consideration exceeds sixty percent (60%) of the aggregate consideration we paid in the merger transaction. Any such excess amounts will be paid in shares of our common stock priced as of two (2) days prior to the date on which any earnout payment becomes due.

On September 30, 2004, we completed our acquisition of Aether Mobil Government. Pursuant to the Asset Purchase Agreement dated as of August 16, 2004 by and among the Company, Aether, Cerulean Technology, Inc. and SunPro, Inc., the Company paid Aether a purchase price of \$10,000,000 in cash, subject to post-closing adjustments to reflect changes in Aether Mobile Government's working capital since June 30, 2004. In connection with this acquisition, the Company issued a Subordinated Secured Promissory Note to Aether in the face amount of \$6,884,588 (the "Aether Note"). The Aether Note evidences a contingent reimbursement obligation of the Company to Aether and a surety fee payable by the Company to Aether, in each case with respect to a letter of credit maintained by Aether for the Company's benefit in connection with the acquisition. The Company's obligations under the Aether Note are secured by a security interest granted to Aether in all or substantially all of the Company's assets, subordinate to the security interest described in the "Long-Term Obligations" footnote of this report below.

On September 29, 2004, we entered into the September 2004 Senior Purchase Agreement with Laurus Master Fund, Ltd. ("Laurus") and certain other institutional and accredited investors (together with Laurus, the "September 2004 Senior Investors"). Under the September 2004 Senior Purchase Agreement, the Company issued the September 2004 Senior Convertible Notes in the aggregate principal amount of \$5,050,000, convertible into common stock of the Company in certain circumstances at \$1.35 per share, and issued the September 2004 Senior Warrants to purchase an aggregate of 1,122,222 shares of our common stock at an exercise price of \$1.55 per share. The proceeds from this transaction were used to finance in part the Company's acquisition of Aether Mobile Government. The Company's obligations under the September 2004 Senior Purchase Agreement, the September 2004 Senior Convertible Notes and the September 2004 Senior Warrants are secured by a security interest in all or substantially all of the Company's assets.

Also on September 29, 2004, we entered into the September 2004 Subordinated Purchase Agreement with the Investor and other existing shareholders of the Company and accredited investors (collectively, the "September 2004 Subordinated Investors"). Under the September 2004 Subordinated Purchase Agreement, the Company issued the September 2004 Subordinated Convertible Notes in the aggregate principal amount of \$4,950,000, convertible into common stock of the Company in certain circumstances at \$1.35 per share, and issued the September 2004 Subordinated Warrants to purchase an aggregate of 1,099,997 shares of our common stock at an exercise price of \$1.55 per share. The proceeds from this transaction were used in part to finance a portion of the Company's acquisition of Aether Mobile Government and will be used in part for working capital purposes. Please see the Long Term Obligations footnote to the financial statements included in this prospectus for a more complete description of the transactions consummated in connection with the September 2004 Senior Purchase Agreement and the September 2004 Subordinated Purchase Agreement.

On June 8, 2005, we entered into a Securities Purchase Agreement (the "Senior Purchase Agreement") with an institutional investor. Under the Senior Purchase Agreement, the Company issued a Secured Convertible Term Note (the "Senior Convertible Note") in the aggregate principal amount of \$2,000,000, convertible into Common Stock of the Company in certain circumstances at \$1.35 per share, and issued a warrant (the "Senior Warrant") to purchase an aggregate of 444,444 shares of the Common Stock at a per share exercise price of \$1.55. The aggregate consideration received by the Company, net of all fees and expenses, for the Senior Convertible Note and the Senior Warrant was approximately \$1,841,000, which was paid by the Investor on June 8, 2005. The proceeds from this transaction are to be used for working capital purposes. The Company's obligations under the Senior Purchase Agreement and the Senior Convertible Notes are secured by a security interest in all or substantially all of the Company's assets.

We entered into a Securities Purchase Agreement, effective as of May 31, 2005, (the "Subordinated Purchase Agreement") with existing shareholders of the Company and other accredited investors (collectively, the "Subordinated Investors"). Under the Subordinated Purchase Agreement, the Company issued Convertible Term Notes (the "Subordinated Convertible Notes") in the aggregate principal amount of \$2,794,723, convertible into Common Stock of the Company in certain circumstances at \$1.35 per share, and issued warrants (the "Subordinated Warrants") to purchase an aggregate of 828,066 shares of the Common Stock at a per share exercise price of \$1.50. The aggregate consideration received by the Company, net of all fees and expenses, for the Subordinated Convertible Notes and Convertible Warrants was approximately \$2,411,000, which was paid by the Investor on June 8, 2005. The proceeds from this transaction are to be used for working capital purposes. The Subordinated Convertible Notes were issued at a purchase price equal to \$900 for each \$1,000 of principal amount of the Note.

Certain Subordinated Investors purchased additional Subordinated Convertible Notes in the aggregate principal amount of \$450,000 and received additional Subordinated Warrants to purchase an aggregate of 133,333 shares of Common Stock at a per share exercise price of \$1.50. The aggregate consideration received by the Company net of all fees and expenses for such Subordinated Convertible Notes and Subordinated Warrants was \$404,500, which was paid by the Subordinated Investors on July 8, 2005.

In connection with these purchase agreements, the Company's investment bankers received warrants to purchase an aggregate of 271,948 shares of the Common Stock at a per share exercise price of \$1.35.

We do not expect any material capital expenditures during the next twelve months.

Since January 7, 1993 (date of inception), our capital needs have been principally met through proceeds from the sale of equity and debt securities. If we continue to require additional financing, we expect to look to similar sources of additional capital.

No assurance can be given that any form of additional financing will be available on terms acceptable to us, that adequate financing will be obtained to meet our needs, or that such financing would not be dilutive to existing stockholders. If available financing is insufficient or unavailable or we fail to continue to generate meaningful revenue, we will be required to further reduce operating expenses, delay the expansion of operations, or be unable to pursue merger or acquisition candidates.

Additionally, the Company's ability to repay its outstanding debt obligations and accrued interest on a timely basis will be at risk. As of June 30, 2005 the Company was delinquent with respect to certain principal and interest obligations on certain subordinated notes issued in September 2004. Accordingly, the Company has reclassified approximately \$783,000 of principal from long-term to current as of June 30, 2005.

We do not currently maintain a line of credit or term loan with any commercial bank or other financial institution.

DESCRIPTION OF THE BUSINESS

Overview

BIO-key, founded in 1993, delivers advanced finger based biometric identification and security solutions and information services to law enforcement, fire service, and emergency medical service agencies as well as other government and private sector customers. BIO-key's mobile wireless technology provides first responders with critical, reliable, real-time data and images from local, state, and national databases. More than 2,500 police, fire, and emergency services departments in North America currently use BIO-key solutions, making the Company a leading supplier of mobile and wireless solutions for public safety.

Effective January 1, 2005, BIO-key International, Inc., a Minnesota corporation ("Old BIO-key"), reincorporated as the Company. The reincorporation was effected pursuant to an Agreement and Plan of Merger (the "Merger Agreement"), whereby Old BIO-key was merged with and into the Company, its wholly owned subsidiary, in order to reincorporate in the State of Delaware (the "Reincorporation"). As a result of the Reincorporation, the legal domicile of the Company is now Delaware.

Pursuant to the Merger Agreement, at the effective time of the Reincorporation: (i) each outstanding share of Common Stock of Old BIO-key, \$0.01 par value per share, was automatically converted into one share of Common Stock, \$0.0001 par value per share, of the Company; (ii) each outstanding share of Series C 7% Convertible Preferred Stock of Old BIO-key, \$0.01 par value per share, was automatically converted into one share of Series A 7% Convertible Preferred Stock, \$0.0001 par value per share, of the Company, with such Series A 7% Convertible Preferred Stock containing substantially identical terms and conditions as the Series C 7% Convertible Preferred Stock of Old BIO-key; (iii) each option to purchase shares of Old BIO-key's Common Stock granted by Old BIO-key under any warrant, stock option plan or similar plan of Old BIO-key outstanding immediately before the Reincorporation was, by virtue of the Merger Agreement and without any action on the part of the holder thereof, converted into and become an option to purchase, upon the same terms and conditions, the same number of shares of the Company's Common Stock at an exercise price per share equal to the exercise price per share thereunder immediately before the Reincorporation; and (iv) each warrant, option or stock option plan of Old BIO-key was assumed by, and continues to be, a warrant, option or plan of the Company. Accordingly, as a result of the Reincorporation, the shareholders of Old BIO-key became shareholders of the Company, and Old BIO-key has been merged out of existence by operation of law. Each certificate representing shares of capital stock of Old BIO-key outstanding immediately before the Reincorporation, is deemed from and after the Reincorporation for all corporate purposes to represent the same number of shares of capital stock of the Company.

Product Lines

BIO-key has four major product lines: biometrics, handheld mobile software/devices, mobile information software and records management software for fire service/EMS agencies. These lines are described below and a list of products in each line is noted.

Biometrics

BIO-key's finger identification algorithm: vector segment technology (VST) is the technology behind its full suite of biometric products that include:

Vector Segment Technology (VST) BIO-key's biometric algorithm for highly accurate device interoperable use. VST is available as a low level SDK for incorporation into many complex application systems. VST runs in Windows, Linux or Solaris systems.

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WEB-key BIO-key's biometric platform that offers an enhanced level of security by securing the user's authentication with trusted communications and simple use.

Biometric Service Provider The BioAPI (a standards based solution meeting worldwide needs, see www.bioapi.org for details) for compliant interface to applications using biometrics for verification and identification.

ID Director BIO-key's solution for Single Sign On integration with Netegrity and other solutions, utilizing the power and security of WEB-key.

The Company's biometric identification technology improves both the accuracy and speed of finger-based biometrics. The Company's proprietary biometric technology scans a fingerprint and identifies a person, typically within a few seconds or less, in databases of a million people or more, without using any other identifying data a key differentiator for BIO-key since other biometric solutions may also require traditional token/card identification. The company believes its fingerprint identification technology has a broad range of possible information security and access control applications, including:

Securing Internet sites and electronic transactions

Securing access to logical networks and applications

Securing access to buildings and restricted areas

Securing mobile devices such as cell phones and PDA's

Preventing identity theft with positive identification and false alias validation

Handheld Mobile Software/Devices

On March 30, 2004, BIO-key acquired Public Safety Group, Inc. (PSG), a privately held company that is a leader in wireless solutions for law enforcement and public safety markets. PSG's primary technology is PocketCop . In addition to PocketCop , BIO-key also offers PocketBlue handheld solution that provides mobile officers, such as detectives who are not typically in their vehicles, a hand-held, scaled down version of its mobile information software solution, PacketCluster .

Following are description of both products:

PocketCOP PocketCop is a software solution that provides police officers and other security personnel instantaneous access to important criminal, civil and private database information in a wireless environment. PocketCop is a handheld application that allows law enforcement officers to access state and federal databases over the wireless network for PalmOS, Windows CE, and PocketPC. Using a portable wireless handheld device and the PocketCop application software, an authorized user can access suspect information such as wanted status, warrant status, vehicle registration and driver license status. PocketCop technology has been deployed in numerous police departments in the United States, including the deployment for the Massachusetts State Police.

PocketBlue PocketBlue is driven by the growing demand to get mission-critical information to the officer in the field, and serves as a logical and essential extension to the core PacketCluster system. Law enforcement personnel with duty assignments outside of a vehicle require the same quick, secure, and confidential access to criminal history information as their in-vehicle counterparts. PocketBlue meets that need with a wireless handheld solution available on a variety of platforms. PocketBlue features include:

Full integration with PacketCluster Patrol mobile data

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Access to National Crime Information Center (NCIC), National Law Enforcement Telecommunications System (NLETS), Department of Motor Vehicles (DMV) for queries on persons, vehicles, boats, guns and articles

Rapid deployment for major events (such as sports and concerts) or incidents (such as sniper attacks and acts of terrorism) on a variety of RIM and PocketPC devices

Mobile Information Software for Police, Fire, and Emergency Medical Service ("EMS") Agencies

On September 30, 2004, BIO-key completed a transaction with Aether Systems, Inc. to purchase its Mobil Government Division ("Mobile Government" or "AMG"), a leading provider of wireless data solutions for use by public safety organizations, primarily state, local police, fire and rescue, and emergency medical services organizations. The PacketCluster mobile information software is integrated with 50 separate State/NCIC databases, as well as other state, local and federal databases. Its open architecture and its published Application Programming Interface (API) make it easy to interface with a wide range of information sources. PacketCluster products deliver real-time information in seconds, freeing dispatchers to handle more pressing emergencies. The PacketCluster suite of products includes:

PacketCluster® Patrol BIO-key's mobile information software for police agencies of all sizes. This client/server solution is open architected, providing optimal flexibility to add new users or features. PacketCluster® provides silent messaging to a user, groups of users, and dispatch and features a state interface to the NCIC. It has been selected by more than 1000 agencies in North America.

PacketCluster® Rescue BIO-key's mobile information solution for fire and EMS, runs off the same server as PacketCluster® Patrol. It provides much of Patrol's functionality without the State/NCIC interface not required by fire service and EMS. Rescue provides mission-critical data such as HAZMAT information and building plans while fire service officers are at a fire and need to know.

PacketWriter BIO-key's field reporting software provides officers with the tools to perform accident and incident reporting on computers in their vehicles. Users submit reports to supervisors remotely, and supervisors approve or reject the reports in the same way.

BIO-key also provides a number of optional features designed to augment the core products. These include:

ClusterLink, which enables contiguous agencies to connect via each others' server, for intercommunication between them.

Multiple Application Programming Interface (API), which allows an agency to have multiple ports to the server to accommodate disparate interfaces. These multiple API ports are in addition to the one port that is inherent in the server as well as the State/NCIC interface.

PacketCluster Incident Command, using FieldSoft's PDonScene, is used by both patrol and tactical teams such as a SWAT, to manage people and resources at the scene of an incident or at a central location such as an emergency operations center. It can also be used for general event management. Incident commanders can better focus on personnel, strategy, tactics, and hazards, potentially saving the lives of officers or citizens.

BIO-key Information Server BIO-key's solution for an agency's central messaging switch for application software service, State/NCIC interfaces, Computer Aided Dispatch (CAD) and Records Management Software (RMS) interfaces, data sharing and other applications.

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Records Management Software for Fire Service/EMS Agencies

In addition to law enforcement/fire service mobile data solutions, BIO-key offers its Sunpro fire service/EMS records management software, FireRMS , that helps large and small agencies manage operations, track incidents, and support fire prevention initiatives. FireRMS Mobile provides wireless query and messaging solutions that extend computer aided dispatch, fire records, and other in-house data sources to a mobile environment and provide mission-critical information to emergency response personnel where and when they need it.

FireRMS Records Management Software This NFIRS 5.0-compliant fire records system helps manage operations, track incidents and support fire prevention initiatives. It is designed to speed data entry and reduce completion time for front-line personnel.

CAD Interfaces CAD interfaces provide a connection between BIO-key records and all major CAD systems with the most comprehensive real time integration. Incident reports are opened as soon as CAD dispatches a call. Incidents are current and ready to complete when the crew returns to the station, streamlining and improving the accuracy of incident reporting.

RMS Interfaces RMS interfaces provide a mechanism to integrate patient care reports collected in the field with the NIBRS report. Patient data is populated in the appropriate fields, eliminating redundant data entry.

Other Interfaces BIO-key provides interfaces to other third party solutions including EMS billing, EMS county/state interfaces, professional staffing solutions, and others.

BIO-key also offers the following Fire/EMS Partner solutions:

EMS Field Data Collection Regist*r Express from MedDataSolutions enables EMS field data collection for efficient collection of patient data where it is generated.

Geographic Data Analysis FireView from the Omega Group allows Fire and EMS agencies to analyze their deployment strategies.

Personnel Staffing Telestaff from PDSI automates and manages complex Fire/RMS agency staffing needs and is integrated with FireRMS's Personnel and Roster modules.

Incident Command Module FDonScene by FieldSoft provides incident management, responder accountability, and tactical survey or preplan browser software solutions. FDonScene interfaces with PacketCluster Rescue to support incident management-en route or on scene.

Current Business Plan

BIO-key's current business plan is to:

License its core technology "VST" to original equipment manufacturers, systems integrators, and application developers who develop products and applications that utilize its biometric finger matching solutions.

License WEB-key , the Company's security centric web-based biometric authentication solution.

Provide for "device independent" finger identification matching for virtually any application by using the latest advances in scanning technology.

License its wireless software solutions for the public safety market directly to counties, cities and towns across North America as well as through systems integrators and resellers.

Leverage its FireRMS suite of products for the growing Emergency Medical Service data collection and reporting market.

Integrate its core technology competencies to leverage new business opportunities and develop new markets for its innovative products.

Current Market

Biometrics

BIO-key actively markets and sells its biometric technology to biometric system integrators and resellers who are focused on the security and logical access markets. A number of BIO-key's customers have begun to deploy its technology on a run-time basis, which is generating recurring revenues.

Public Safety

BIO-key's public safety offerings are sold directly to counties, cities, or towns across North America and to Computer Aided Dispatch/Records Management System application providers and system integrators who include BIO-key's mobile data and fire records management software as part of their overall deliverables for their customers. Most often, public safety offerings for small sized cities or towns are provided by BIO-key authorized resellers.

BIO-key is a leading supplier of mobile data solutions for police and fire service agencies using laptop computers as well as applications for handheld mobile delivery on different devices, including Blackberries, PDAs, Smartphones, and tablet notebook computers located in police vehicles. BIO-key handheld offerings are particularly suited for specialty units and investigators that work remotely and do not have access to a conventional office desktop computer or a laptop computer.

In the law enforcement market, BIO-key serves the full range of law enforcement agencies via its direct sales force, and addresses the needs of smaller agencies through its authorized resellers. By bringing both PSG and AMG products into BIO-key, the company offers a full range of device-independent functionality. BIO-key can serve both public carrier infrastructure and private radio infrastructure markets, and also offers mixed deployments of private radio and public carrier infrastructures. Law enforcement officials have real-time access to the data they need including wants and warrants and Department of Motor Vehicle information. BIO-key also offers report-writing products for field officers to use for data capture and reporting.

In the Fire Records Management market, mature products and vendors are moving up market for new opportunities, while new players are entering the market. One area of expected growth in the Fire Records Management market is Emergency Medical Service (EMS) data collection and reporting. Recent statistics released by the National Fire Department indicate that in 2004, 58% of all calls to fire service agencies were EMS-related. Leading drivers for a fire records management system include state reporting, the automatic export of data to billing systems, and efficient field data collection using mobile solutions.

Potential Market

Biometrics

Concerns relating to Homeland Security and the ever-increasing occurrences of identity theft in the commercial marketplace have amplified the need for positive identification of individuals, and increased interest in biometrics. BIO-key believes its biometric technology provides a most reliable, convenient, and cost effective method for confirming the identity of persons in local or remote locations relative to existing traditional methods.

Fingerprint based biometric solutions currently compete with more traditional security methods such as keys, cards, personal identification numbers and security personnel as well as other forms of biometric technologies including voice, face, iris and hand geometry. The proliferation of electronic

business-to-business and business-to-consumer transactions continues to grow rapidly. Such transactions are subject to fraud resulting from unauthorized individuals gaining access to confidential information.

Biometric technology is becoming an acceptable approach to physical and logical security. Acceptance of biometrics as an alternative to traditional security methods depends upon a number of factors including:

The reliability and ease of use of biometric solutions

Public perception regarding privacy concerns

Costs involved in adopting and integrating biometric solutions

Public Safety Agencies

Public safety is a large and important market. The ability to quickly and accurately collect data from a variety of database sources and formats and deliver this information to first responders represents a new paradigm for bringing real time intelligence to security officers deployed in the field. With BIO-key's acquisition of PSG and AMG, the Company believes there is a substantial market opportunity to integrate our VST and WEB-key biometric technologies with our leading public safety solutions for police, fire and EMS to protect access to the information.

BIO-key markets and sells its wireless data solutions primarily to local, county, state, university, and federal law enforcement and fire service/EMS agencies throughout the United States. BIO-key maintains an established, loyal public safety customer base and expects continued growth in this market, particularly in light of heightened security concerns.

During fiscal year 2005, the company is consolidating its PSG and AMG products under one complete BIO-key public safety product suite. In addition, BIO-key is expanding its biometric offerings to its public safety customer base, so they can take advantage of the BIO-key biometric solutions. This will enable customers to provide secure access to both logical (PCs, LANs and data access) and physical (building and access to secure areas such as evidence rooms and IT facilities) areas.

Competition

The markets for BIO-key products and technologies are developing; they are characterized by intense competition and rapid technological change. No assurance can be given that our competitors will not develop new or enhanced technologies that will offer superior price, performance, or features, or render BIO-key products or technologies obsolete.

Biometrics

In addition to companies that provide existing commonplace methods of restricting access to facilities and logical access points such as pass cards, PIN numbers, passwords, locks and keys, there are numerous companies involved in the development, manufacturing and marketing of fingerprint biometrics products to commercial, government, law enforcement, and prison markets. These companies include, but are not limited to, Cogent, NEC, Printrak International, IDENTIX, Sagem Morpho, and Bioscript.

The most recent automated fingerprint identification product sales in the market have been deployed for government and law enforcement applications, typically at more cost than BIO-key's products and licensing arrangements. Although most companies that target consumer application markets have completed development of their biometric products, such technologies have not been widely accepted in the commercial markets to date. Most companies competing for commercial opportunities are in the business of selling scanning devices and tie their algorithm to a specific device.

BIO-key has created a "device independent" algorithm that provides flexibility in choosing the correct device and optical or tactile sense to fit the application served.

BIO-key has found that commercial markets have been slow to widely purchase biometrics as a viable alternative to their current security methods. As a result, the primary competition for biometric technology consists of traditional security methods such as passwords, PINs, cards, and tokens.

With respect to competing biometrics technologies, each has its strength and weaknesses and none has emerged as a market leader:

Fingerprint identification is generally viewed as inexpensive and non-intrusive.

Iris scanning is viewed as accurate, but can be expensive and inconvenient to use.

Facial recognition has recently received substantial attention; however, it can have accuracy limitations and be highly dependent on ambient lighting conditions, angle of view and other factors.

The market for biometric technology is evolving. Computer breaches, identity theft, phishing and other events in the recent past are driving a large-scale shift to biometric deployments. In addition, companies such as IBM, Dell, Gateway, MPC, Samsung, and HP have all introduced computers with integrated finger scanning devices to complement the conventional username/password technique since it is highly susceptible to hackers and security breaches.

Public Safety

The public safety market comprises agencies at all government levels, with a range of users, from a few to many hundreds. BIO-key competitors in the mobile data market include Computer Aided Dispatch/Records Management companies such as Printrak, InfoCop, and Motorola. Each has comprehensive CAD and/or RMS offerings and has augmented those with their own mobile data and field reporting solutions. While these solutions may not be as functionally rich as the BIO-key suite of products, they are sometimes less expensive. They also provide a complete solution from one vendor.

Fire Service/EMS

The fire records management market includes a large number of RMS vendors including Firehouse, FDM, and ETI. These and other competing companies represent a wide range of organizations, from large integration companies, to small garage companies, and offer products similar in scope to BIO-key's FireRMS. The functionality and price of these products also encompass wide ranges of features and costs.

Marketing and Distribution

BIO-key's marketing and distribution efforts comprise the following major initiatives:

During the past year, BIO-key has strengthened its alliance with Oracle and has been recognized as a Certified Partner in the Oracle Partner Network. BIO-key supports the Oracle e-business suite of applications and provides the biometric enabler for the Oracle Single Sign on product. As an Oracle development partner, BIO-key provides the underlying database used for true user identification and on demand alias checking. As a development partner, BIO-key participates in Oracle Trade Shows such as Oracle Open World and Oracle Apps World.

BIO-key has strategic alliances with technology leaders including Oracle, Netegrity, Hewlett Packard, Dell, Verizon, Nextel, and others.

BIO-key is also promoting biometric technology and its offerings through industry trade shows, public speaking engagements, press activities, and partner marketing programs.

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BIO-key is directing licensing efforts to original equipment manufacturers, application developers, and system integrators.

BIO-key is building a reseller, integrator, and partner network as well as a direct sales team.

Following are the specific marketing/sales programs in place:

Direct Selling Efforts BIO-key's current selling efforts are conducted primarily through its expanded direct sales organization. Its public safety sales team is comprised of 13 direct sales representatives along with eastern and western regional Vice Presidents of Sales. BIO-key's biometrics sales team is comprised of three area sales directors; a business integration manager to support sales efforts with partners and resellers, OEM's and the indirect channel; and two senior sales representatives to support all indirect sales programs and campaigns for both the biometric and public safety markets.

Conferences and Trade Shows BIO-key attends and actively participates in various product-related conferences and trade shows in the technology and security industries to generate market awareness of biometric and wireless mobile data technology generally, and our offerings specifically. BIO-key's public safety software often is featured at our business partners' booths at these events, showcasing the interoperability of the two products.

Strategic Alliance ChoicePoint, who is a leader in civil identification and background checks, to thwart identity theft in the commercial marketplace, has selected BIO-key's technology to integrate into its identity verification products and services. One solution being deployed is a check cashing application in which individuals use fingerprint biometrics to truly verify that they are the individuals carrying the credentials and authorized to conduct the transaction.

Strategic Marketing Alliance BIO-key has established a strategic marketing alliance with Hewlett Packard to provide BIO-key handheld technology for the Massachusetts State Police.

Reseller Relationships BIO-key has established reseller relationships with companies that resell BIO-key public safety software.

Interoperability

The events of September 11, 2001 and the subsequent focus on Homeland Security have heightened the need to secure data dissemination throughout and between government agencies, as well as to automate the positive identification of personnel. BIO-key's finger identification technology coupled with the rich encryption functionality of its wireless data solutions form solutions to address these issues. Recently, BIO-key was awarded a contract to ensure the secure access, transmission, and retrieval of critical government and public sector information. BIO-key also is working with the National Sheriff's Association and the Pegasus Research Foundation to provide biometric authentication for secure sharing of critical data to sheriffs' offices and first responders across the country. BIO-key expects the initial roll out of 220 sheriffs' offices will continue to grow.

Licensing

BIO-key targets both Internet infrastructure companies and large portal providers as possible licensees for its WEB-key solution. On the Internet infrastructure side, BIO-key seeks to partner with Internet server manufacturers, providers of database and data warehouse engine software, horizontally positioned application engines, firewall solution providers, and peripheral equipment manufacturers. On the portal side, BIO-key is targeting financial service providers such as credit and debit card authorization and issuing institutions, Internet retailers, business-to-business application service providers (ASPs), and corporate intranets. In the past two years, BIO-key has undertaken a WEB-key

and VST direct selling effort, and entered into license agreements with OEMs and system integrators to develop applications for distribution to their respective customers.

BIO-key is also addressing the security needs of application providers in the following vertical markets:

Government Using BIO-key's technology, Northrup Grumman deployed an application within the Department of Defense to cross-credential visitors and contractors to certain military bases.

Education Educational Biometrics and Identimetrics have incorporated BIO-key technology to enable school children to pay for school lunch programs and checkout library books using their fingerprints. VST technology enables schools to enroll these children and reduces the administrative costs of managing passwords and collecting payments.

Commerce ChoicePoint has implemented a check cashing solution using BIO-key's VST technology to reduce fraud and identity theft.

Patient Records and Information Management HBOC, one of the largest healthcare patient records and information management companies, has integrated BIO-key technology into their portal and has deployed their solution in a pilot for the Baptist Hospital System.

Financial BIO-key is working with several companies focusing on financial applications such as point of sale systems and employee trusted identification cards, as well as customer facing applications over the Internet. BIO-key has also begun work with several financial institutions to incorporate its technology for secure access to money transfers for institutional customers.

Intellectual Property Rights

We believe that our intellectual property is important to our biometric, mobile solutions and information management segments:

Patents Our biometrics segment uses patent pending technology and trade secrets developed or acquired by us. We have a number of U.S. and foreign patent applications in process related to this intellectual property.

Trademarks We have registered our trademarks "PacketCluster", "PacketCluster Patrol", "PacketWriter", "PacketBlue", "SunPro" and the design mark for "Cerulean" with the U.S. Patent and Trademark Office. We have also applied for trademarks for "BIO-key", "SACman", "SACcat", "SACremote", "True User Identification", "WEB-key", "PocketCop" and "Cerulean".

Copyrights and trade secrets We take measures to ensure copyright and license protection for our software releases prior to distribution. When possible, the software is licensed in an attempt to ensure that only licensed and activated software functions to its full potential. We also take measures to protect the confidentiality of our trade secrets.

Research and Development

During fiscal years ended December 31, 2003 and 2004, BIO-key spent approximately \$1,037,000 and \$2,980,000, respectively, on research and development for its biometric solutions. BIO-key's limited customer base during that time did not directly bear these costs, which were principally funded through outside sources of equity and debt financing.

Although BIO-key believes that its identification technology is one of the most advanced and discriminating fingerprint technologies available today, the markets in which BIO-key compete are characterized by rapid technological change and evolving standards. In order to maintain its position in the market, BIO-key will continue to upgrade and refine its existing technologies.

During 2005, BIO-key's research and development effort will be focused on the continued evolution of its client-server-based authentication solution (WEB-key), furthering the VST algorithm, and standards based efforts like the BioAPI. The company has achieved its goal of enabling the identification of individuals with a single finger scan to a population of one million prints on a standard Oracle platform in less than five seconds. The BIO-key information server will be refined, and more sophisticated server functionality and interoperability will be added.

In 2005, BIO-key is introducing additional mobile applications for the FireRMS Building Inspections module to eliminate redundant data entry for occupancy inspection, providing timely updates to critical information and immediate notification of code violations to the Occupancy Management module.

Government Regulations

BIO-key is not currently subject to direct regulation by any government agency, other than regulations generally applicable to businesses or related to specific project requirements. In the event of any international sales, the company would be subject to various domestic and foreign laws regulating such exports and export activities.

Environmental Regulations

As of the date of this report, BIO-key has not incurred any material expenses relating to our compliance with federal, state, or local environmental laws and does not expect to incur any material expenses in the foreseeable future.

Employees and Consultants

BIO-key currently employs one hundred fifteen (115) individuals on a full-time basis: sixty-eight (68) in engineering, research and development; thirteen (13) in finance and administration; and thirty-four (34) in sales and marketing. BIO-key also uses the services of three (3) consultants who provide engineering and technical services, and one (1) consultant who provides financial consulting services.

DESCRIPTION OF PROPERTY

We do not own any real estate. We conduct operations from leased premises in Marlborough, Massachusetts (38,000 square feet), Eagan, Minnesota (6,800 square feet), Wall, New Jersey (2,180 square feet) and Winter Park, Florida (900 square feet). We believe that our current facilities are adequate for the foreseeable future.

LEGAL PROCEEDINGS

Except as disclosed below, we are not a party to any material pending legal proceeding nor are we aware of any proceeding contemplated by any governmental authority involving the Company. Prior to our acquisition of PSG in March, 2004, PSG had been named as a defendant in a civil action initiated in the Superior Court Department in Hampden County, Commonwealth of Massachusetts by The Vince Group, Inc. ("TVG"). The case has since been removed to the United States District Court for the District of Massachusetts at the request of the parties. The complaint claims that PSG is obligated to pay a percentage of certain of its revenues to TVG in consideration for a strategic business introduction allegedly made by an agent of TVG. PSG has denied the allegations and filed an answer in the litigation, and as of the date of this prospectus, the outcome of the litigation is pending. The claim is for an unspecified amount including actual damages, interest, and attorney's fees. Management believes that the claim is without merit and will be settled out of court for an amount that will not have a material adverse affect on our business, financial condition or operating results. In addition, the merger agreement pursuant to which we acquired PSG provides that any liability or payment obligation arising from this litigation will be solely the responsibility of the former shareholders of PSG.

MANAGEMENT

Directors and Executive Officers

The following sets forth certain information regarding each of the directors and executive officers of the Company.

NAME	AGE	POSITIONS HELD
Thomas J. Colatosti	57	Co-Chief Executive Officer; Chairman of the Board of Directors
Michael W. DePasquale	50	Co-Chief Executive Officer; Director
Richard E. Gaddy	60	Director
Jeffrey J. May	45	Director
Charles P. Romeo(a)	63	Director
John Schoenherr	52	Director
Francis J. Cusick	50	Chief Financial Officer
Randy Fodero	46	Senior Vice President of Sales and Marketing
Kenneth S. Souza	50	Senior Vice President and Chief Technology Officer

(a)

From April 2004 to February 2005, Mr. Romeo was employed by the Company.

The following is a brief summary of the business experience of each of the above-named individuals:

THOMAS J. COLATOSTI has served as a Director of the Company since September 2002 and as Chairman of the Board since January 3, 2003. He has served as Co-Chief Executive Officer since July 2005. Mr. Colatosti also currently serves as the Chief Executive Officer of American Security Ventures, a Lexington, Massachusetts based consulting firm he founded which specializes in providing strategic management consulting services to emerging and developing companies in the homeland security industry. From 1997 through June 2002, Mr. Colatosti served as the Chief Executive Officer of Viisage Technology, Inc., a publicly traded biometric technology company focusing on biometric face-recognition technology and delivering highly secure identification documents and systems. Between 1995 and 1997, Mr. Colatosti served as President and Chief Executive Officer of CIS Corporation, a higher education industry leader that designed and implemented integrated and flexible systems solutions to manage entire university administrative operations. Prior to CIS, Mr. Colatosti had a 20-year career with Digital Equipment Corporation. His most recent responsibility was Vice President and General Manager, Northeast Area, where he was responsible for a business unit with annual revenues of more than \$1.2 billion and 3,000 people. Mr. Colatosti is an active industry security spokesperson testifying before Congressional Committees and advising the White House and other Federal security agencies on homeland security issues. Mr. Colatosti earned a Bachelor of Science degree in Management and Finance as well as a Masters degree in Business Administration from Suffolk University.

MICHAEL W. DEPASQUALE has served as the Chief Executive Officer and a Director of the Company since January 3, 2003. He has served as Co-Chief Executive Officer since July 2005. Mr. DePasquale brings more than 20 years of executive management, sales and marketing experience to the Company. Prior to joining the Company, Mr. DePasquale served as the President and Chief Executive Officer of Prism eSolutions, Inc., a Pennsylvania based provider of professional consulting services and online solutions for ISO-9001/14000 certification for customers in manufacturing, healthcare and government markets, since February 2001. From December 1999 through December 2000, Mr. DePasquale served as Group Vice President for WRC Media, a New York based distributor of supplemental education products and software. From January 1996 until December 1999,

Mr. DePasquale served as Senior Vice President of Jostens Learning Corp., a California based provider of multi media curriculum. Prior to Jostens, Mr. DePasquale held sales and marketing management positions with McGraw-Hill and Digital Equipment Corporation. Mr. DePasquale earned a Bachelor of Science degree from the New Jersey Institute of Technology.

JEFFREY J. MAY has served as a Director of the Company since October 29, 2001. Since 1997, Mr. May has served as the President of Gideons Point Capital, a Tonka Bay Minnesota based financial consulting firm and angel investor focusing on assisting and investing in start-up technology companies. In 1983, Mr. May co-founded Advantek, Inc., a manufacturer of equipment and materials which facilitate the automatic handling of semi-conductors and other electrical components which was sold in 1993. Mr. May continued to serve as a director and Vice-President of Operations of Advantek until 1997, at which time it had over 600 employees and sales in excess of \$100 million. Mr. May earned a Bachelor of Science degree in Electrical Engineering from the University of Minnesota in 1983.

RICHARD E. GADDY has served as a Director of the Company since October 12, 2004. Mr. Gaddy has been a Vice President of Unisys Corporation for over five years and he currently serves as Vice President, Public Sector South. Mr. Gaddy is a 33-year veteran of the computer and information technology industry. His career with Unisys includes a number of sales and business management positions.

CHARLES P. ROMEO has served as a director of the Company since February 28, 2005 and from January 29, 2003 to April 19, 2004. From April 2004 until February 2005, he served as Vice President of Sales, Public Safety Division of the Company. From September 2002 until April 2004 Mr. Romeo has served as the President and Chief Executive Officer of FreedomBridge Technologies, Inc., a Rhode Island based consulting firm to technology companies in the homeland security industry specializing in implementing direct and channel selling programs, strategic alliances and partnerships in the law enforcement market. Prior to founding FreedomBridge, Mr. Romeo had a 33 year sales and marketing management career with Digital Equipment Corporation, Compaq Computer Corporation and Hewlett Packard. During his career, Mr. Romeo served as Vice President of Service Sales for a \$500 million business unit, and Director of Public Sector Sales, a \$275 million division of Hewlett Packard. Mr. Romeo authored *The Sales Manager's Troubleshooter*, Prentice Hall 1998, which was named as one of the "top 10 must reads" by Sales and Marketing Magazine. Mr. Romeo earned a Bachelor of Science degree in Mathematics and Economics from the University of Massachusetts and an Executive MBA from Babson College.

JOHN SCHOENHERR has served as a Director of the Company since December 30, 2004. Mr. Schoenherr serves as Vice President of Corporate Performance Management for Oracle Corporation, and has served as an Oracle Vice President for over five years. Mr. Schoenherr has over 25 years of experience in the area of business intelligence. His career includes a number of product development and management positions.

FRANCIS J. CUSICK has served as the Chief Financial Officer of the Company since February 28, 2005. Mr. Cusick joined the Company as the Corporate Controller in September 2004. Prior to joining the Company, Mr. Cusick served as an independent business consultant to public and private companies in a variety of strategic and financial executive roles from March 2002 until September 2005. From January 2001 through February 2002, Mr. Cusick was Chief Financial Officer, Vice President of Finance and Treasurer for SANgate Systems, a multi-national provider of storage hardware and software. Between November 1999 and December 2000, Mr. Cusick served as Corporate Controller for Equipe Communications Corporation and was responsible for all accounting and finance functions. Prior to Equipe, Mr. Cusick held senior financial management positions at Parametric Technology Corp., Cascade Communications Corp. and Synneretics Inc.

RANDY FODERO has served as the Vice President of Sales and Marketing since July 18, 2003 and as a member of the Company's sales organization since March 2003. Mr. Fodero brings more than 20 years of successful executive and sales management experience to the Company. Prior to joining the Company, Mr. Fodero served as director of Global Accounts from Veritas Software from February 2002 until January 2003. Between 1999 and February 2002, Mr. Fodero served in executive sales capacities with both companies in the enterprise software industry, including Agile Software. From 1998 to 1999, Mr. Fodero served as Regional Vice President of Sales for Memco Software, a leading provider of information security software to Fortune 1000 companies, where he was instrumental in increasing sales and enhancing shareholder value in connection with the sale of Memco to Platinum Technology. From 1990 through 1998, Mr. Fodero served as Vice President of Sales of AT&T CommVault Systems, where he grew sales from startup to over \$36 million and participated in a management buyout.

KENNETH S. SOUZA has served as Senior Vice President and Chief Technology Officer of the Company since October 4, 2004. Prior to joining the Company, Mr. Souza was Vice President of Industry Solutions for EMC Corporation. Prior to joining EMC, he was Vice President for e-Commerce Enterprise Systems Solutions for Compaq Computer Corporation. His 25-year technology and market career includes serving in a number of executive positions with Digital Equipment Corporation including Vice President Worldwide Solutions Services and Training, and Director of Workstations Marketing. In the early 1980's, Mr. Souza held technical sales management positions with Hewlett Packard and Burroughs. Mr. Souza also held executive positions with a venture funded MRP software company.

Directors' Terms of Office

Mr. May was initially elected to serve as a director in 2001, and was re-elected in 2004. Mr. Colatosti was initially elected to serve as a director in 2002, and was re-elected in 2004. Mr. DePasquale was initially elected as a director in 2003, and was re-elected in 2004. Mr. Gaddy and Mr. Schoenherr were each initially elected as a director in 2004. Mr. Romeo was initially elected as a director in 2005. Each such director was elected to serve until the Company's next annual meeting or until his successor is duly elected and qualified in accordance with the By-laws of the Company.

EXECUTIVE COMPENSATION

The following table sets forth a summary of the compensation paid to or accrued by our chief executive officer and all of our other executive officers as of December 31, 2004 (the "named executive officers") for each of the fiscal years ended December 31, 2002, 2003 and 2004:

SUMMARY COMPENSATION TABLE

	Annual Compensation					Long Term Compensation		
	Fiscal Year	Salary (\$)	Bonus (\$)	Other Annual Compensation (\$)	Restricted Stock Award	Awards Securities Underlying Options/SARs	Payouts	
							LTIP Payouts	All Other
Michael W. DePasquale (1) Chief Executive Officer	2004	210,000	35,000					
	2003	148,943	25,000			1,080,000		
Randy Fodero (2) Senior Vice President Sales and Marketing	2004	150,000		47,674				
	2003	111,837	10,000			600,000		
Kenneth S. Souza (3) Senior Vice President and Chief Technology Officer	2004	50,000	19,000			300,000		
	2003							

- (1) Mr. DePasquale became employed as our Chief Executive Officer on January 3, 2003.
- (2) Mr. Fodero became an executive officer of the Company on July 18, 2003.
- (3) Mr. Souza became an executive officer of the Company on October 4, 2004.

OPTION GRANTS IN YEAR ENDED DECEMBER 31, 2004

The following table sets forth all options granted during the year ended December 31, 2004 to each of the named executive officers.

Name	Number of Securities Underlying Options Granted	Percent of Total Options Granted to Employees in Fiscal Year	Exercise Price \$/Share	Expiration Date
Kenneth S. Souza	300,000	11.2%	\$ 1.05	09/15/2011

Options vested in three (3) annual installments commencing September 15, 2005.

**AGGREGATED OPTION EXERCISES IN THE YEAR ENDED
DECEMBER 31, 2004 AND FISCAL YEAR-END OPTION VALUE**

The following table sets forth for each named executive officer, information regarding stock options exercised by such officer during the year ended December 31, 2004, together with the number and value of stock options held at December 31, 2004, each on an aggregated basis.

Name	Number Of Shares Acquired On Exercise	Value Realized	Number Of Unexercised Options At Fiscal Year-End Exercisable/ Unexercisable(#)	Value Of Unexercised In-The-Money Options At Fiscal Year-End Exercisable/ Unexercisable\$(1)
Michael W. DePasquale			757,500/322,500	597,875/83,850
Randy Fodero			190,909/409,091	227,182/207,818
Kenneth S. Souza			0/300,000	0/159,000

- (1) The last sales price of the Company's Common Stock as reported on the OTC Bulletin Board on December 31, 2004 was \$1.58.

Directors Compensation

Directors who are also officers of the Company receive no additional compensation for serving on the Board of Directors, other than reimbursement of reasonable expenses incurred in attending meetings. The Company's 1996 stock incentive plan provides for the grant of options to purchase 50,000 shares of common stock to each non-employee director upon first being elected or appointed to the Board of Directors. The Company's current policy is to issue options to purchase 50,000 shares of common stock to each non-employee director on an annual basis.

Employment Agreements

MICHAEL W. DEPASQUALE. On January 3, 2003, the Company entered into a two-year employment agreement with Michael W. DePasquale to serve as the Chief Executive Officer of the Company at an annual base salary of \$150,000 subject to adjustment by the Board of Directors. The employment agreement also provides for an annual bonus of options to purchase up to 500,000 shares of Company common stock payable at the discretion of the Board of Directors. The base salary was adjusted to \$216,000 for 2004. The quarterly performance bonus benchmarks for 2004 were also adjusted to provide for payment of the \$37,500 quarterly bonus upon achieving gross revenue of: \$500,000, \$750,000, \$1,000,000 and \$1,250,000 during the first, second, third and fourth calendar quarters of 2004, respectively. Additional performance bonuses of \$50,000 upon achieving annual gross revenue of at least \$4,000,000 and \$50,000 upon the Company reporting operating profit during 2004 were also included for 2004.

The employment agreement contains standard and customary confidentiality, non-solicitation and "work made for hire" provisions as well as a covenant not to compete which prohibits Mr. DePasquale from doing business with any current or prospective customer of the Company or engaging in a business competitive with that of the Company during the term of his employment and for the one year period thereafter. The agreement may be terminated by the Company at any time with or without cause. In the event of termination without cause, Mr. DePasquale shall continue to be paid his then current base salary for the greater of six months from the date of such termination or the number of months remaining until the end of the term of the employment agreement.

KENNETH S. SOUZA. In connection with his appointment as Senior Vice President and Chief Technology Officer of the Company on October 4, 2004, we entered into a one (1) year employment agreement with Kenneth S. Souza. The employment agreement provides for an annual base salary of \$200,000 and a performance bonus in the amount of up to \$76,000 payable upon achievement of certain performance criteria. Unless notice of non-renewal is provided to Mr. Souza at least two months prior to the end of the term, the employment agreement automatically renews for successive one year terms. In the event that Mr. Souza is terminated without cause, Mr. Souza will receive severance payment equal to his base salary for the greater of 6 months and that number of months remaining until the end of the term. The employment agreement contains standard and customary confidentiality, non-compete and work made for hire provisions.

Upon execution of the employment agreement, we issued to Mr. Souza a stock option to purchase 300,000 shares of our common stock at an exercise price of \$1.11 per share, the last sale price of our common stock as reported on the OTC Bulletin Board on the date of grant. The option has a term of seven (7) years and vests in three equal annual installments commencing on October 4, 2005. Upon completion of one (1) year of service, Mr. Souza shall be eligible to receive a stock option to purchase up to an additional 300,000 shares of Company stock based upon his performance as determined by the Company in its sole discretion.

Change in Control Provisions

The Company's 1996 Stock Option Plan (as amended to date, the "1996 Plan"), 1999 Stock Option Plan and 2004 Stock Incentive Plan (the "1999 Plan" and together with the 1996 Plan and 2004 Plan, the "Plans") provide for the acceleration of the vesting of unvested options upon a "Change in Control" of the Company. A Change in Control is defined in the Plans to include (i) a sale or transfer of substantially all of the Company's assets; (ii) the dissolution or liquidation of the Company; (iii) a merger or consolidation to which the Company is a party and after which the prior shareholders of the Company hold less than 50% of the combined voting power of the surviving corporation's outstanding securities; (iv) the incumbent directors cease to constitute at least a majority of the Board of Directors; or (v) a change in control of the Company which would otherwise be reportable under Section 13 or 15(d) of the Exchange Act.

In the event of a "Change In Control" each Plan provides for the immediate vesting of all options issued thereunder. The 1999 Plan provides for the Company to deliver written notice to each optionee under the 1999 Plan fifteen (15) days prior to the occurrence of a Change In Control during which all options issued under the 1999 Plan may be exercised. Thereafter, all options issued under the 1999 Plan which are neither assumed or substituted in connection with such transaction, automatically expire unless otherwise determined by the Board. The 1996 Plan provides for all options to remain exercisable for the remainder of their respective terms and permits the Company to make a cash payment to any or all optionees equal to the difference between the exercise price of any or all such options and the fair market value of the Company's common stock immediately prior to the Change In Control. The 2004 Plan enables the Board to provide that all outstanding options be assumed, or equivalent options be substituted by the acquiring or succeeding corporation upon the occurrence of a "Reorganization Event" as defined. If such Reorganization Event also constitutes a Change in Control, then such assumed or substituted options shall be immediately exercisable in full. If the acquiring or succeeding corporation does not agree to assume, or substitute for such options, then the Board, upon written notice to the Participants, may provide that all unexercised options become exercisable in full as of a specified time prior to the Reorganization Event and terminate prior to the consummation of the Reorganization Event. Alternatively, if under the terms and conditions of the Reorganization Event, holders of common stock will receive a cash payment for their shares, then the Board may provide that all Participants receive a cash payment equal to the difference between the Acquisition Price and the Option Price multiplied by the number of options held by such Participants.

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Employment Arrangements

The Company has entered into the employment agreements described above in the "EXECUTIVE COMPENSATION Employment Agreements" section of this prospectus.

Options Granted to Executive Officers and Directors

During 2002, the Company issued options to purchase 200,000 shares of common stock to Thomas J. Colatosti upon his appointment as a director of the Company. During 2003 and 2004, the Company issued options to purchase an aggregate of 2,180,000 and 400,000 shares, respectively of common stock to its officers and directors. The options were issued at exercise prices equal to the last sales price of the Company's common stock as reported on the OTC Bulletin Board on the date of grant, have terms of three (3) to seven (7) years, and vest over a one to three year period.

Consulting Arrangement with Thomas J. Colatosti

In connection with his appointment to the Board of Directors in September 2002, the Company entered into a consulting arrangement with Thomas J. Colatosti. Under the arrangement, the Company paid Mr. Colatosti \$4,000 per month through December 2003 and issued him options to purchase 150,000 shares of common stock at an exercise price of \$.33 per share, the closing price of the Company's common stock on the date of grant. In December 2003, a committee of independent directors renewed this arrangement through December 31, 2004. The committee also issued options to Mr. Colatosti to purchase 150,000 shares of common stock at an exercise price of \$1.32 per share, the closing price of the Company's common stock on the date of grant, for serving as Chairman. Effective November 1, 2004, Mr. Colatosti's monthly consulting fee was increased to \$14,500. Mr. Colatosti has substantial experience in the biometric industry and in addition to his role as the Chairman of the Board of Directors of the Company, provides extensive service to the Company in the areas of strategic planning and corporate finance.

In March 2004, Mr. Colatosti entered into a three year consulting arrangement with the Shaar Fund Ltd., a principal creditor of the Company. Under the terms of the arrangement, The Shaar Fund transferred \$375,000 principal amount of our secured convertible notes due October 1, 2005 to Mr. Colatosti. On April 28, 2004 the Company issued 3,750 shares of the Company's series C 7% convertible preferred stock to Mr. Colatosti in conversion of the \$375,000 secured convertible note.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth, as of May 31, 2005, information with respect to the securities holdings of all persons which the Company, pursuant to filings with the Securities and Exchange Commission, has reason to believe may be deemed the beneficial owners of more than five percent (5%) of the Company's outstanding common stock. The following table also sets forth, as of such date, the beneficial ownership of the Company's common stock by all officers and directors, individually and as a group. Unless otherwise indicated, the address of each person listed below is c/o BIO-key International, Inc., 3349 Highway 138, Building D, Suite B, Wall, NJ 07719.

Name and Address of Beneficial Owner	Number of Shares Beneficially Owned(1)	Percentage of Common Stock Outstanding
Thomas J. Colatosti	1,055,000(2)	2.4%
Michael W. DePasquale	1,100,000(3)	2.5%
Francis J. Cusick	0(4)	*
Jeffrey J. May	250,000(5)	*
Randy Fodero	365,948(6)	*
Richard E. Gaddy	0(7)	*
Charles P. Romeo	200,000(8)	*
John Schoenherr	0(9)	*
Kenneth S. Souza	0(10)	*
Kingdon Capital Management, LLC 152 West 57 th Street 50th Floor New York, NY 10019	2,621,112	5.9%*
All officers and directors as a group	2,970,948	6.6%

*

Less than one percent (1%) of the outstanding common stock.

(1)

The securities "beneficially owned" by an individual are determined in accordance with the definition of "beneficial ownership" set forth in the regulations promulgated under the Securities Exchange Act of 1934 and, accordingly, may include securities owned by or for, among others, the spouse and/or minor children of an individual and any other relative who has the same home as such individual, as well as, other securities as to which the individual has or shares voting or investment power or which each person has the right to acquire within sixty (60) days through the exercise of options or otherwise. Beneficial ownership may be disclaimed as to certain of the securities. This table has been prepared based on 44,802,217 shares of common stock outstanding as of May 31, 2005.

(2)

Includes 550,000 shares issuable upon exercise of options and 500,000 shares issuable upon conversion of Series A preferred stock.

(3)

Includes 1,080,000 shares issuable upon exercise of options.

(4)

Does not include 200,000 shares issuable upon exercise of options subject to vesting.

(5)

Consists of shares issuable upon exercise of options.

(6)

Includes 345,448 shares issuable upon exercise of options. Also includes 20,500 shares owned by Mr. Fodero's minor children. Mr. Fodero disclaims beneficial ownership of those shares. Does not include 254,552 shares issuable upon exercise of options subject to vesting.

(7)

Does not include 50,000 shares issuable upon exercise of options subject to vesting.

(8)

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Consists of 200,000 shares issuable upon exercise of options. Does not include 200,000 shares issuable upon exercise of options subject to vesting.

- (9) Does not include 50,000 shares issuable upon exercise of options subject to vesting.
- (10) Does not include 300,000 shares issuable upon exercise of options subject to vesting.

The following table sets forth, as of December 31, 2004, information with respect to our securities authorized for issuance under equity compensation plans.

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	231,380	\$ 0.6045	174,620
Equity compensation plans not approved by security holders	7,294,669	\$ 0.9506	2,669,588
Total	7,526,049	\$ 0.9399	2,844,208

The Company's 1999 Stock Option Plan (the "1999 Plan") was adopted by the Board of Directors of the Company on or about August 31, 1999. The material terms of the 1999 Plan are summarized below.

The 1999 Plan is currently administered by the Board of Directors of the Company (the "Plan Administrator"). The Plan Administrator is authorized to construe the 1999 Plan and any option issued under the 1999 Plan, select the persons to whom options may be granted, and determine the number of shares to be covered by any option, the exercise price, vesting schedule and other material terms of such option.

The 1999 Plan provides for the issuance of options to purchase up to 2,000,000 shares of common stock to officers, employees, directors and consultants of the Company at exercise prices not less than 85% of the last sale price of the Company's common stock as reported on the OTC Bulletin Board on the date of grant. Options have terms of not more than 10 years from the date of grant, are subject to vesting as determined by the Plan Administrator and are not transferable without the permission of the Company except by will or the laws of descent and distribution or pursuant to a domestic relations order. Options terminate three (3) months after termination of employment or other association with the Company or one (1) year after termination due to disability, death or retirement. In the event that termination of employment or association is for a cause, as that term is defined in the 1999 Plan, options terminate immediately upon such termination. The Plan Administrator has the discretion to extend options for up to three years from the date of termination or disassociation with the Company.

The 1999 Plan provides for the immediate vesting of all options in the event of a "Change In Control" of the Company. In the event of a Change In Control, the Company is required to deliver written notice to each optionee under the 1999 Plan fifteen (15) days prior to the occurrence of a Change in Control, during which time all options issued under 1999 Plan may be exercised. Thereafter, all options issued under the 1999 Plan which are neither assumed or substituted in connection with such transaction, automatically expire, unless otherwise determined by the Board. Under the 1999 Plan, a "Change In Control" is defined to include (i) a sale or transfer of substantially all of the Company's assets; (ii) the dissolution or liquidation of the Company; (iii) a merger or consolidation to which the Company is a party and after which the prior shareholders of the Company hold less than 50% of the combined voting power of the surviving corporation's outstanding securities; (iv) the incumbent directors cease to constitute at least a majority of the Board of Directors; or (v) a change in control of the Company which would otherwise be reportable under Section 13 or 15(d) of the Exchange Act.

As of December 31, 2004, there were outstanding options under the 1999 Plan to purchase 1,176,669 shares of common stock, and options to purchase an aggregate of 629,588 shares were available for future grants.

On October 12, 2004, the Board of Directors of the Company approved the 2004 Stock Option Plan (the 2004 Plan). The 2004 Plan has not yet been presented to stockholders for approval and thus incentive stock options are not available under this plan. Under the terms of this plan, 4,000,000 shares of common stock are reserved for issuance to employees, officers, directors, and consultants of the Company at exercise prices which may not be below 85% of fair market value. The term of stock options granted may not exceed ten years. Options issued under the 2004 Plan vest pursuant to the terms of stock option agreements with the recipients. In the event of a change in control, as defined, all options outstanding vest immediately. The 2004 Plan terminates in October 2014.

As of December 31, 2004, there were outstanding options under the 2004 Plan to purchase 1,960,000 shares of common stock, and options to purchase an aggregate of 2,040,000 shares were available for future grants.

In addition to options issued under the 1999 and 2004 Plans, the Company has issued options and warrants to employees, officers, directors and consultants to purchase an aggregate of 7,884,047 shares of common stock. The terms of these options are substantially similar to the provisions of the 1999 Plan and options issued thereunder.

DESCRIPTION OF SECURITIES

Common Stock

The Company is authorized to issue 85,000,000 shares of common stock, \$.0001 par value per share, of which 44,802,217 were outstanding as of June 8, 2005.

Holders of common stock have equal rights to receive dividends when, as and if declared by the Board of Directors, out of funds legally available therefor. Holders of common stock have one vote for each share held of record and do not have cumulative voting rights.

Holders of common stock are entitled, upon liquidation of the Company, to share ratably in the net assets available for distribution, subject to the rights, if any, of holders of any preferred stock then outstanding. Shares of common stock are not redeemable and have no preemptive or similar rights. All outstanding shares of common stock are fully paid and nonassessable.

Preferred Stock

Within the limits and restrictions provided in the Company's Certificate of Incorporation, the Board of Directors has the authority, without further action by the shareholders, to issue up to 5,000,000 shares of preferred stock, \$.0001 par value per share, in one or more series, and to fix, as to any such series, any dividend rate, redemption price, preference on liquidation or dissolution, sinking fund terms, conversion rights, voting rights, and any other preference or special rights and qualifications.

Series A Convertible Preferred Stock. In March 2004, we designated 100,000 shares of preferred stock as Series C Convertible Preferred Stock. In connection with the Company's reincorporation in Delaware, each share of Series C Convertible Preferred Stock was automatically converted into one share of Series A Convertible Preferred Stock (the "Series A Shares"), of which 48,682 were issued and outstanding at June 8, 2005. The following describes the material provisions of the Series A Shares which are more fully set forth in the Certificate of Designation on file with the Minnesota Secretary of State.

The Series A Shares accrue a cumulative annual dividend of 7% on the \$100 face amount of such shares payable June 15 and December 15 each year in shares of common stock. In the event of a liquidation, dissolution or winding up of the Company, the Series A shares have a liquidation preference of \$100 per share (plus all accrued and unpaid dividends thereon) prior to any payment or distribution to holders of our common stock. The Series A Shares are convertible into common stock at a conversion price of \$.75 per share. The conversion price is subject to proportional adjustment in the event of stock splits, stock dividends or reclassifications. Subject to certain exceptions, in the event we issue additional shares of common stock at a purchase price less than the conversion price of the Series A Shares, the conversion price shall be lowered to such lesser price. In the event that the average closing bid price of our common stock is less than \$1.00 per share for thirty (30) consecutive trading days at any time after March 3, 2007, we will be required to redeem the Series A Shares by payment of \$100 per share plus all accrued and unpaid dividends due thereon.

We are required to obtain the consent of the holders of a majority of the Series A Shares in order to, among other things, issue any shares of preferred stock that are equal to or have a preference over the Series A shares or issue any shares of preferred stock, rights, options, warrants, or any other securities convertible into common stock of the Company, other than those issued to employees of the Company in the ordinary course of their employment or to consultants or other persons providing services to the Company so long as such issuances do not exceed 500,000 shares of common stock. We are also required to obtain such consent in order to, among other things, complete a sale or other disposition of any material assets, complete an acquisition of a material amount of assets, engage in a merger, reorganization or consolidation, or incur or guaranty any indebtedness in excess of \$50,000.

Dividend Policy

The Company has never paid cash dividends on its common stock. The Board of Directors does not anticipate paying cash dividends in the foreseeable future as it intends to retain future earnings, if any, to finance the growth of the business. The payment of future dividends will depend on such factors as earnings levels, anticipated capital requirements, the operating and financial condition of the Company and other factors deemed relevant by the Board of Directors.

Anti-Takeover Provisions of the Company's Certificate of Incorporation

As described above, the Board of Directors is authorized without further stockholder action, to designate any number of series of preferred stock with such rights, preferences and designations as determined by the Board. Shares of preferred stock issued by the Board of Directors could be utilized, under certain circumstances, to make an attempt to gain control of the Company more difficult or time consuming. For example, shares of preferred stock could be issued with certain rights that might have the effect of diluting the percentage of common stock owned by a significant stockholder or issued to purchasers who might side with management in opposing a takeover bid that the Board of Directors determines is not in the best interest of the Company and its stockholders. The existence of the preferred stock may, therefore, be viewed as having possible anti-takeover effects.

Transfer Agent

The transfer agent for the Company's common stock is StockTrans, Inc., 44 West Lancaster Avenue, Ardmore, Pennsylvania 19003, (610) 649-7300.

CONVERTIBLE DEBT FINANCING TRANSACTIONS

Secured Debt Financing

On June 8, 2005, we entered into a Securities Purchase Agreement (the "Senior Purchase Agreement") with Laurus Master Fund, Ltd. ("Laurus"). Under the Senior Purchase Agreement, the Company issued a secured convertible term note (the "Senior Convertible Note") in the aggregate principal amount of \$2,000,000, convertible into common stock of the Company in certain circumstances at \$1.35 per share, and issued a warrant (the "Senior Warrant") to purchase an aggregate of 444,444 shares of our common stock at an exercise price of \$1.55 per share. As consideration for the Senior Convertible Note and Senior Warrant, the Company received approximately \$1,841,000, net of all fees and expenses, from Laurus, which amount was disbursed to the Company on June 9, 2005. The proceeds from this transaction will be used for the Company's general working capital purposes. The Company's obligations under the Senior Purchase Agreement, the Senior Convertible Note and the Senior Warrant are secured by a security interest in all or substantially all of the Company's assets.

Under the terms of the Senior Convertible Note, we are required to make monthly payments of accrued interest only beginning on July 1, 2005. In addition, the Senior Convertible Note provides for monthly payments of principal in equal $\frac{1}{32}$ increments thereof, plus accrued interest, commencing October 1, 2005. The Senior Convertible Note bears interest at an initial rate equal to the prime rate plus two percent (2%), subject to a six percent (6%) floor. The interest rate on the Senior Convertible Note is subject to reduction on a month-by-month basis if the following conditions are met: If (a) we register the common stock underlying the Senior Convertible Note and Senior Warrant on a registration statement declared effective by the Securities and Exchange Commission and (b) our common stock is trading at a 25% or greater premium to the note conversion price, then the interest rate will be adjusted downward by 2.0% for each incremental 25% increase over the note conversion price. Alternatively, if (x) we have not registered such common stock under an effective registration statement, but (y) our common stock is trading at a 25% or greater premium to the note conversion

price, then the interest rate will be adjusted downward by 1.0% for each incremental 25% increase over the note conversion price. In no event shall the interest rate be less than 0%.

For any cash payments we make on the Senior Convertible Note (e.g., any amounts due that are not converted into common stock), we are required to pay an amount equal to 102% of the principal amount due. In addition, we can prepay the note at any time upon payment of an amount equal to 110% of the then outstanding principal balance, plus accrued and unpaid interest.

Laurus has the option at any time to convert any or all of the outstanding principal and accrued and unpaid interest on the Senior Convertible Note into shares of our common stock at a conversion price of \$1.35 per share. In addition, for each monthly payment under the note, Laurus will be obligated to convert a portion of the monthly payment into common stock at the applicable conversion price, so long as:

the average closing price of our common stock (for the five trading days immediately preceding the payment date) is greater than \$1.48 per share (which represents 110% of the note conversion price, based on the initial conversion price of \$1.35),

such amount being converted does not exceed 25% of the aggregate dollar trading volume for such immediately preceding twenty-two trading days, and

the shares of common stock underlying the note are registered under an effective registration statement with the Securities and Exchange Commission.

The terms of the Senior Convertible Note and Senior Warrant prohibit conversion of the note or exercise of the warrant to the extent that conversion of the note and exercise of the warrant would result in any holder thereof, together with its affiliates, beneficially owning in excess of 4.99% of our outstanding shares of common stock. A holder may waive the 4.99% limitation upon 75 days' prior written notice to us. Also, this limitation does not preclude the holder from converting or exercising the note or warrant and selling shares underlying the note or warrant in stages over time where each stage does not cause the holder and its affiliates to beneficially own shares in excess of the limitation amount.

As security for our obligations to Laurus, we, along with our wholly-owned subsidiary Public Safety Group, Inc. ("PSG"), have granted to Laurus a blanket security interest in all of our assets, and we have entered into a stock pledge with Laurus for the capital stock in PSG. If an event of default occurs under the Senior Convertible Note or the other related investment agreements, 120% of the unpaid principal balance on the Senior Convertible Note, plus accrued interest and fees, shall become immediately due and Laurus shall be entitled to payment of a default interest rate of 1.5% per month on all amounts due under the Senior Convertible Note. Such events of default include the following:

a failure to pay interest and principal payments under the Senior Convertible Note within three days of when due;

a breach by us of any material covenant or term or condition of the Senior Convertible Note or in any of the investment agreements, if not cured within 30 days of such breach;

a breach by us of any material representation or warranty made in the Senior Convertible Note or in any of the investment agreements;

if we make an assignment for the benefit of our creditors, or a receiver or trustee is appointed for us, or any form of bankruptcy or insolvency proceeding is instituted by us, or any involuntary proceeding is instituted against us if not vacated within 60 days;

the filing of any money judgment or similar final process against us for more than \$50,000, which remains unvacated, unbonded or unstayed for a period of 30 days;

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if our common stock is suspended for five consecutive days or for five days during any ten consecutive days from a principal market or pursuant to a Securities and Exchange Commission stop order; and

a failure by us to timely deliver shares of common stock when due upon conversions of the Senior Convertible Note.

Upon an event of default, Laurus will be entitled to specified remedies, including remedies under the Uniform Commercial Code.

We have agreed to register with the Securities and Exchange Commission for resale the shares of common stock that are issuable upon conversion of the Senior Convertible Note and upon exercise of the Senior Warrant. Under the registration rights agreement, we are obligated to file a registration statement with the Securities and Exchange Commission on or before July 8, 2005, and to use reasonable commercial efforts to have the registration statement declared effective not later than September 6, 2005. The resale registration statement of which this prospectus is a part was initially filed with the Securities and Exchange Commission on July 8, 2005 for the shares underlying the Senior Convertible Note and Senior Warrant. If we fail to comply with our registration obligations, Laurus will be entitled to certain specified remedies, including monetary liquidated damages. In particular, for each 30 days (or such pro rated number of days) that we are out of compliance with our registration obligations, we will be subject to a liquidated damage assessment of 2% of the then outstanding principal amount of the Senior Convertible Note.

Laurus has agreed, pursuant to the Senior Purchase Agreement, that neither it nor any of its affiliates and investment partners will (and will not cause any other person or entity, directly or indirectly, to) engage in "short sales" of our common stock for as long as any Senior Convertible Note held by it remain outstanding. "Short sales" are contracts for the sale of shares of stock that the seller does not own, or certificates which are not within the seller's control, so as to be available for delivery at the time when, under applicable rules, delivery must be made.

The Company entered into an Amendment and Waiver with Laurus, effective as of August 31, 2005, pursuant to which Laurus allowed the Company to defer the payment of the monthly principal amounts due and payable for the months of September, October, November and December 2005 under both the Senior Convertible Note and the secured convertible term note in the original principal amount of \$5,000,000 issued by the Company to Laurus on September 29, 2004 (the "September 2004 Note"), such aggregate deferred principal amounts being equal to \$187,500 and \$625,000, respectively. The deferred principal amount under the Senior Convertible Note is now due on June 7, 2008, the maturity date of that note, and will be allocated and included with the final payments due with respect to that note upon maturity. The deferred principal amount under the September 2004 Note is now due on September 29, 2007, the maturity date of that note, and will be allocated and included with the final payments due with respect to that note upon maturity. The Company will remain obligated to pay all monthly interest amounts under these notes when due. Pursuant to this Amendment and Waiver, the Company issued an aggregate of 612,166 shares of its Common Stock to Laurus as consideration for this principal payment deferral.

Subordinated Debt Financing

We entered into a Securities Purchase Agreement, effective as of May 31, 2005 (the "Subordinated Purchase Agreement"), with The Shaar Fund, Ltd. ("Shaar"), Longview Fund, L.P. ("Longview") and other existing shareholders of the Company and accredited investors (collectively, the "Subordinated Investors"). Under the Subordinated Purchase Agreement, the Company issued unsecured convertible term notes (the "Subordinated Convertible Notes") in the aggregate principal amount of \$3,244,723, convertible into common stock of the Company in certain circumstances at \$1.35 per share, and issued warrants (the "Subordinated Warrants") to purchase an aggregate of 961,399 shares of our common

stock at an exercise price of \$1.50 per share. Each of the Subordinated Convertible Notes was issued at a purchase price equal to \$900 for \$1,000 of principal amount of the Note. As consideration for Subordinated Convertible Notes in the aggregate principal amount of \$2,794,723 and Subordinated Warrants to purchase 828,066 shares of common stock, the Company received approximately \$2,392,000, net of all fees and expenses, from the Subordinated Investors on June 8, 2005. As consideration for Subordinated Convertible Notes in the aggregate principal amount of \$450,000 and Subordinated Warrants to purchase 133,333 shares of common stock, the Company received approximately \$382,000, net of all fees and expenses, from the Subordinated Investors pursuant to a subsequent closing on July 8, 2005. The proceeds from this transaction will be used in part for working capital purposes.

Under the terms of the Subordinated Convertible Notes, we are required to make quarterly payments of accrued interest only beginning on September 1, 2005. In addition, the Subordinated Convertible Notes provide for quarterly payments of principal in equal increments thereof, plus accrued interest, commencing September 1, 2006, which payments may be made in shares of common stock at the option of each noteholder. The Subordinated Convertible Notes bear interest at nine percent (9%) per annum. Each Subordinated Convertible Note was issued at a purchase price equal to \$900 for each \$1,000 of principal amount of the Note.

We may prepay the Subordinated Convertible Notes at any time upon payment of an amount equal to 120% of the then outstanding principal balance, plus accrued and unpaid interest. Upon any such prepayment, the Senior Convertible Note must also be prepaid. The Subordinated Investors have the option at any time to convert any or all of the outstanding principal and accrued and unpaid interest on the Subordinated Convertible Notes into shares of our common stock at a conversion price of \$1.35 per share.

The terms of the Subordinated Convertible Notes and Subordinated Warrants prohibit conversion of the notes or exercise of the warrants to the extent that conversion of the notes and exercise of the warrants would result in any holder thereof, together with its affiliates, beneficially owning in excess of 4.99% of our outstanding shares of common stock. A holder may waive the 4.99% limitation upon 75 days' prior written notice to us. Also, this limitation does not preclude the holder from converting or exercising the note or warrant and selling shares underlying the note or warrant in stages over time where each stage does not cause the holder and its affiliates to beneficially own shares in excess of the limitation amount.

If an event of default occurs under the Subordinated Convertible Notes or the other related investment agreements, the unpaid principal balance on the Subordinated Convertible Notes, plus accrued interest, shall, at the noteholder's option, become immediately due and the Subordinated Investors shall be entitled to payment of additional default interest at the rate of 2.0% per month on all amounts due under the Subordinated Convertible Notes. Such events of default include the following:

failure to pay interest and principal payments under the Subordinated Convertible Notes within three days of when due;

a breach by us of any covenant, term or condition in any material respect of the Subordinated Convertible Notes or in any of the investment agreements, if not cured within 30 days of such breach;

any representation or warranty made in the Subordinated Convertible Notes or in any of the investment agreements being false or misleading in any material respect;

if we make an assignment for the benefit of our creditors, or a receiver or trustee is appointed for us, or any form of bankruptcy or insolvency proceeding is instituted by us, or any involuntary proceeding is instituted against us;

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the filing of any money judgment or similar final process against us for more than \$50,000, which remains unvacated, unbonded or unstayed for a period of 30 days;

if our common stock is suspended for five consecutive days or for five days during any ten consecutive days from a principal market or pursuant to a Securities and Exchange Commission stop order;

a failure by us to timely deliver shares of common stock when due upon conversions of the Subordinated Convertible Notes; and

a change in our controlling ownership.

Upon an event of default, the rights and remedies of the Subordinated Investors will be subordinate to those of the Senior Investors pursuant to a Subordination and Intercreditor Agreement dated as of September 30, 2004 (as amended, supplemented or otherwise modified from time to time) by and among Laurus, as Collateral Agent, Shaar, as Purchaser Agent, Aether Systems, Inc., PSG and the Company

We have agreed to register with the Securities and Exchange Commission for resale the shares of common stock that are issuable upon conversion of the Subordinated Convertible Notes and upon exercise of the Subordinated Warrants. Under the registration rights agreement, we are obligated to file a registration statement with the Securities and Exchange Commission on or before July 8, 2005, and to use reasonable commercial efforts to have the registration statement declared effective not later than September 6, 2005. The resale registration statement of which this prospectus is a part was initially filed with the Securities and Exchange Commission on July 8, 2005 for the shares underlying the Subordinated Convertible Notes and Subordinated Warrants. If we fail to comply with our registration obligations, the Subordinated Investors will be entitled to certain specified remedies, including monetary liquidated damages. In particular, for each 30 days (or such pro rated number of days) that we are out of compliance with our registration obligations, we will be subject to a liquidated damage assessment of 2% of the then outstanding principal amount of the Subordinated Convertible Notes.

Each Subordinated Investor has agreed, pursuant to the Subordinated Purchase Agreement, that neither it nor any of its affiliates and investment partners will (and will not cause any other person or entity, directly or indirectly, to) engage at any time following the effectiveness of the registration statement which includes this prospectus in "short sales" of our common stock for as long as any Subordinated Convertible Notes held by it remain outstanding.

SELLING SECURITY HOLDERS

We are registering for resale shares of our common stock issued to the selling security holders identified below. The selling security holders identified in the following table are offering for sale up to 6,880,754 shares of common stock, of which 4,605,629 shares are issuable upon conversion of convertible term notes and 2,275,125 shares are issuable upon exercise of warrants, each issued to the selling security holders in private placement transactions. The following table sets forth:

the name of each selling security holder;

the nature of any material relationship within the past three years between any selling security holder and the Company or any of our affiliates based on information currently available to us;

the number of shares of our common stock beneficially owned by each selling security holder prior to this offering;

the number of shares of our common stock offered hereunder by each selling security holder; and

the number and percent of shares of our common stock beneficially owned by each selling security holder after this offering is complete. This calculation assumes that all shares are sold pursuant to this offering and that no other shares of common stock are acquired or disposed of by the selling security holder prior to the termination of this offering.

We are unable to determine the exact number of shares that will actually be sold or when, or if, these sales will occur. Additionally, we are unable to determine the exact number of shares, if any, that will be issued to the selling security holders who hold our convertible term notes upon conversion of such notes.

Each of the selling security holders is offering for sale with this prospectus the number of shares listed below subject to the limitations described in the section of this prospectus entitled "Plan of Distribution". Beneficial ownership is determined in accordance with the rules and regulations of the Securities and Exchange Commission. Except as indicated in the footnotes to this table and subject to applicable community property laws, each of the selling security holders named in this table has sole voting power with respect to all shares of common stock listed as beneficially owned by such selling security holders.

The applicable percentages of beneficial ownership set forth below are based on an aggregate of 44,802,217 shares of our common stock issued and outstanding on June 8, 2005.

Name of Selling Security Holder	Number of Shares Beneficially Owned Prior to Offering	Shares Offered Pursuant to this Prospectus	Shares Beneficially Owned After Offering is Complete	
			Number	Percent
Laurus Master Fund, Ltd.(1)	2,128,394	2,128,394	0	0
The Shaar Fund Ltd.(2)	1,628,960	1,414,862	214,078	*
Longview Fund, LP(3)	1,776,388	1,776,388	0	0
Douglass Bermingham(4)	59,213	59,213	0	0
Mason Sexton IRA(5)	59,213	59,213	0	0
Longview Special Finance(6)	318,557	318,557	0	0
The CCJ Trust(7)	254,845	254,845	0	0
Jesup & Lamont Securities Corp.(8)	357,205	357,205	0	0
Douglass Bermingham(9)	385,213	385,213	0	0
Mason Sexton(10)	126,864	126,864	0	0
Total	7,094,852	6,880,754	214,078	*

*

Less than one percent (1%) of the outstanding common stock.

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- (1) Includes 1,683,950 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 444,444 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of \$1.55. This selling security holder has identified Laurus Master Fund, Ltd. as having voting and dispositive power with respect to these securities. Laurus Capital Management, LLC, a Delaware limited liability company, is a control person of the securities held by Laurus Master Fund, Ltd. and David Grin and Eugene Grin are the sole members of Laurus Capital Management, LLC. This selling security holder has been the senior lender to the Company since September 2004.
- (2) Includes 1,060,870 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 353,992 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of \$1.50. This selling security holder has identified Hugo Van Neutegem as having voting and dispositive power with respect to these securities. This selling security holder has been the principal creditor and source of financing for the Company since June 1998.
- (3) Includes 1,331,944 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 444,444 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of \$1.50. This selling security holder has identified Peter T. Benz as having voting and dispositive power with respect to these securities.
- (4) Includes 44,398 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term notes held by this selling security holder and 14,815 shares issuable upon exercise of warrants held by this selling security holder at an exercise price of \$1.50. This selling security holder has identified itself as an affiliate of a registered broker-dealer. See "Plan of Distribution" section of this prospectus for required disclosure regarding such selling security holder's status as an affiliate of a registered broker-dealer.
- (5) Includes 44,398 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term notes held by this selling security holder and 14,815 shares issuable upon exercise of warrants held by this selling security holder at an exercise price of \$1.50. This selling security holder has identified itself as an affiliate of a registered broker-dealer. See "Plan of Distribution" section of this prospectus for required disclosure regarding such selling security holder's status as an affiliate of a registered broker-dealer.
- (6) Includes 244,483 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term notes held by this selling security holder and 74,074 shares issuable upon exercise of warrants held by this selling security holder at an exercise price of \$1.50. This selling security holder has identified Peter T. Benz as having voting and dispositive power with respect to these securities.
- (7) Includes 195,586 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term notes held by this selling security holder and 59,259 shares issuable upon exercise of warrants held by this selling security holder at an exercise price of \$1.50. This selling security holder has identified Charles C. Johnston as having voting and dispositive power with respect to these securities.
- (8) Includes 253,627 shares issuable upon exercise of a warrant held by this selling security holder at an exercise price of \$1.35. This selling security holder received such warrant on February 2, 2005 for acting as financial advisor and placement agent in connection with the private placement financing transaction involving certain institutional and accredited investors which occurred on September 29, 2004, resulting in approximately \$10,000,000 in aggregate gross proceeds to the

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Company. This selling security holder may exercise this warrant in whole or in part on or before September 29, 2010. Also includes 103,578 shares issuable upon exercise of a warrant held by this selling security holder at an exercise price of \$1.35. This selling security holder has identified itself as a registered broker-dealer, and it received such warrant on June 8, 2005 for acting as financial advisor and placement agent in connection with the private placement transactions involving certain institutional and accredited investors which were completed on June 8, 2005, resulting in approximately \$4,500,000 in aggregate gross proceeds to the Company. This selling security holder has identified Douglass Birmingham as having voting and dispositive power with respect to these securities.

(9)

Includes 283,528 shares issuable upon exercise of a warrant held by this selling security holder at an exercise price of \$1.35. This selling security holder received such warrant on February 2, 2005 for acting, through his affiliate, Jesup & Lamont Securities Corp., as financial advisor and placement agent in connection with the private placement financing transaction involving certain institutional and accredited investors which occurred on September 29, 2004, resulting in approximately \$10,000,000 in aggregate gross proceeds to the Company. This selling security holder may exercise this warrant in whole or in part on or before September 29, 2010. Also includes 101,685 shares issuable upon exercise of a warrant held by this selling security holder at an exercise price of \$1.35. This selling security holder received such warrant on June 8, 2005 for acting, through his affiliate Jesup & Lamont Securities Corp., as financial advisor and placement agent in connection with the private placement transactions involving certain institutional and accredited investors which were completed on June 8, 2005, resulting in approximately \$4,500,000 in aggregate gross proceeds to the Company. This selling security holder has identified himself as an affiliate of Jesup & Lamont Securities Corp., the registered broker-dealer that performed the placement agent services in return for these securities. See "Plan of Distribution" section of this prospectus for required disclosure regarding such selling security holder's status as an affiliate of a registered broker-dealer.

(10)

Includes 83,512 shares issuable upon exercise of a warrant held by this selling security holder at an exercise price of \$1.35. This selling security holder received such warrant on February 2, 2005 for acting, through his affiliate, Jesup & Lamont Securities Corp., as financial advisor and placement agent in connection with the private placement financing transaction involving certain institutional and accredited investors which occurred on September 29, 2004, resulting in approximately \$10,000,000 in aggregate gross proceeds to the Company. Also includes 43,352 shares issuable upon exercise of a warrant held by this selling security holder at an exercise price of \$1.35. This selling security holder received such warrant on June 8, 2005 for acting, through his affiliate Jesup & Lamont Securities Corp., as financial advisor and placement agent in connection with the private placement transactions involving certain institutional and accredited investors which were completed on June 8, 2005, resulting in approximately \$4,500,000 in aggregate gross proceeds to the Company. This selling security holder may exercise this warrant in whole or in part on or before September 29, 2010. This selling security holder has identified himself as an affiliate of Jesup & Lamont Securities Corp., registered broker-dealer that performed the placement agent services in return for these securities. See "Plan of Distribution" section of this prospectus for required disclosure regarding such selling security holder's status as an affiliate of a registered broker-dealer.

PLAN OF DISTRIBUTION

The selling security holders may, from time to time after the registration statement which includes this prospectus becomes effective, sell any or all of their shares of common stock on any stock exchange, market or trading facility on which the shares are traded or in private transactions. These sales may be at fixed or negotiated prices. The selling security holders may use any one or more of the following methods when selling shares:

ordinary brokerage transactions and transactions in which the broker-dealer solicits purchasers;

block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;

purchases by a broker-dealer as principal and resale by the broker-dealer for its account;

an exchange distribution in accordance with the rules of the applicable exchange;

privately negotiated transactions;

broker-dealers may agree with the selling security holders to sell a specified number of such shares at a stipulated price per share;

a combination of any such methods of sale; and

any other method permitted pursuant to applicable law.

The selling security holders may also sell shares under Rule 144 under the Securities Act, if available, rather than under this prospectus.

Laurus Master Fund, Ltd., The Shaar Fund Ltd. and the other selling security holders offering shares of our common stock under this prospectus upon conversion of our convertible term notes and accompanying warrants have each agreed, pursuant to the applicable securities purchase agreement with us, that neither it nor any of its affiliates and investment partners will (and will not cause any other person or entity, directly or indirectly, to) engage in "short sales" of our common stock for as long as such notes held by it remain outstanding. "Short sales" are contracts for the sale of shares of stock that the seller does not own, or certificates which are not within the seller's control, so as to be available for delivery at the time when, under applicable rules, delivery must be made.

Broker-dealers engaged by the selling security holders may arrange for other brokers-dealers to participate in sales. Broker-dealers may receive commissions or discounts from the selling security holders (or, if any broker-dealer acts as agent for the purchaser of shares, from the purchaser) in amounts to be negotiated. The selling security holders do not expect these commissions and discounts to exceed what is customary in the types of transactions involved. Any profits on the resale of shares of common stock by a broker-dealer acting as principal might be deemed to be underwriting discounts or commissions under the Securities Act. Discounts, concessions, commissions and similar selling expenses, if any, attributable to the sale of shares will be borne by a selling security holder. The selling security holders may agree to indemnify any agent, dealer or broker-dealer that participates in transactions involving sales of the shares if liabilities are imposed on that person under the Securities Act.

In order to comply with the securities laws of certain states, if applicable, the shares being offered hereby must be sold in such jurisdictions only through registered or licensed brokers or dealers. In addition, in certain states such shares may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirement is available and there has been compliance thereof.

The selling security holders may from time to time pledge or grant a security interest in some or all of the shares of common stock owned by them and, if they default in the performance of their secured obligations, the pledgees or secured parties may offer and sell the shares of common stock

from time to time under this prospectus after we have filed an amendment to this prospectus under Rule 424(b)(3) or other applicable provision of the Securities Act amending the list of selling security holders to include the pledgee, transferee or other successors in interest as selling security holders under this prospectus.

The selling security holders also may transfer the shares of common stock in other circumstances, in which case the transferees, pledgees or other successors in interest will be the selling beneficial owners for purposes of this prospectus and may sell the shares of common stock from time to time under this prospectus after we have filed an amendment to this prospectus under Rule 424(b)(3) or other applicable provision of the Securities Act amending the list of selling security holders to include the pledgee, transferee or other successors in interest as selling security holders under this prospectus.

The selling security holders and any broker-dealers or agents that are involved in selling the shares of common stock may be deemed to be "underwriters" within the meaning of the Securities Act in connection with such sales. In such event, any commissions received by such broker-dealers or agents and any profit on the resale of the shares of common stock purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act.

We are required to pay all fees and expenses incident to the registration of the shares of common stock. We have agreed to indemnify the selling security holders against certain losses, claims, damages and liabilities, including liabilities under the Securities Act. The selling security holders will be responsible, however, for all selling commissions applicable to the sale of shares pursuant to this prospectus.

Each selling security holder that is an affiliate of a registered broker-dealer has represented to us that it purchased our securities for its own account for investment only and that at the time of such purchase, such selling security holder had no agreements, plans or understandings, directly or indirectly, with any person to distribute such securities.

The selling security holders have advised us that they have not entered into any agreements, understandings or arrangements with any underwriters or broker-dealers regarding the sale of their shares of common stock, nor is there an underwriter or coordinating broker acting in connection with a proposed sale of shares of common stock by any selling security holder. If we are notified by any selling security holder that any material arrangement has been entered into with a broker-dealer for the sale of shares of common stock, if required, we will file a supplement to this prospectus. If the selling security holders use this prospectus for any sale of the shares of common stock, they will be subject to the prospectus delivery requirements of the Securities Act.

The anti-manipulation rules of Regulation M under the Exchange Act may apply to sales of our common stock and activities of the selling security holders. We have informed the selling security holders that, during such time as they may be engaged in a distribution of any of the shares we are registering by this registration statement, they are required to comply with Regulation M, and the selling security holders have agreed, and will cause each of their affiliates and investment partners, to comply with Regulation M in all respects during such time. In general, Regulation M precludes any selling security holder, any affiliated purchasers and any broker-dealer or other person who participates in a distribution from bidding for or purchasing, or attempting to induce any person to bid for or purchase, any security which is the subject of the distribution until the entire distribution is complete. Regulation M defines a "distribution" as an offering of securities that is distinguished from ordinary trading activities by the magnitude of the offering and the presence of special selling efforts and selling methods. Regulation M also defines a "distribution participant" as an underwriter, prospective underwriter, broker, dealer or other person who has agreed to participate or who is participating in a distribution.

Regulation M also prohibits any bids or purchases made in order to stabilize the price of a security in connection with the distribution of that security, except as specifically permitted by Rule 104 of Regulation M. These stabilizing transactions may cause the price of our common stock to be more than it would otherwise be in the absence of these transactions. We have informed the selling security holders that stabilizing transactions permitted by Regulation M allow bids to purchase our common stock if the stabilizing bids do not exceed a specified maximum, and the selling security holders have agreed, and will cause each of their affiliates and investment partners, to comply with Regulation M in all respects during such time as they may be engaged in a distribution of any of the shares we are registering by this registration statement. Regulation M specifically prohibits stabilizing that is the result of fraudulent, manipulative or deceptive practices. Selling security holders and distribution participants are required to consult with their own legal counsel to ensure compliance with Regulation M.

**DISCLOSURE OF COMMISSION POSITION OF INDEMNIFICATION
FOR SECURITIES ACT LIABILITIES**

The Company's Certificate of Incorporation limit the personal liability of the Company's officers and directors for monetary damages for breach of their fiduciary duty as directors, except for liability that cannot be eliminated under the Delaware General Corporation Law (the "DGCL"). The Company's Bylaws also provide for the Company to indemnify directors and officers to the fullest extent permitted by the DGCL.

The indemnification provisions described above would provide coverage for claims arising under the Securities Act and the Exchange Act. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the Company pursuant to the Company's Certificate of Incorporation, Bylaws, the DGCL, or otherwise, the Company has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

EXPERTS

Our financial statements as of December 31, 2004 and for each of the two years in the period ended December 31, 2004 included in this prospectus have been audited by Divine, Scherzer & Brody Ltd., independent certified public accountants, as stated in their report appearing herein, and have been so included in reliance upon the report of such firm given upon their authority as experts in accounting and auditing.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission under the Exchange Act. Such reports and other information may be inspected and copied at the Securities and Exchange Commission's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the Public Reference Room. The Securities and Exchange Commission also maintains an Internet site that contains reports, proxy statements and other information about issuers, like us, who file electronically with the Securities and Exchange Commission. The address of the Securities and Exchange Commission's web site is <http://www.sec.gov>.

This prospectus is part of a registration statement that we have filed with the Securities and Exchange Commission. The prospectus, which forms a part of such registration statement, and any accompanying prospectus supplement do not contain all of the information included in the registration statement. We have omitted a few parts of the registration statement according to the rules and regulations of the Securities and Exchange Commission. For further information, we refer you to the registration statement, including its exhibits and schedules. Statements contained in this prospectus and any accompanying prospectus supplement about the provisions or contents of any contract, agreement or any other document referred to are not necessarily complete. For each of these contracts, agreements or documents filed as an exhibit to the registration statement, we refer you to the actual exhibit for a more complete description of the matters involved. You should not assume that the information in this prospectus or any supplement is accurate as of any date other than the date on the front of those documents. We do not intend to distribute annual reports or audited financial statements to our shareholders. This information may be found in our filings with the Securities and Exchange Commission.

ITEM 7 FINANCIAL STATEMENTS

The following consolidated financial statements of BIO-key International, Inc. and Subsidiary are included herein at the indicated page numbers:

	Page No.
BIO-key International, Inc. and Subsidiary	
Fiscal Year Ended December 31, 2004	
Report of Independent Certified Public Accountants	F-2
Balance Sheet at December 31, 2004	F-3
Statements of Operations Years ended December 31, 2004 and 2003	F-5
Statement of Stockholders' Equity (Deficit) Years ended December 31, 2004 and 2003	F-6
Statements of Cash Flows Years ended December 31, 2004 and 2003	F-7
Notes to Consolidated Financial Statements December 31, 2004 and 2003	F-8
Six months Ended June 30, 2005	
Consolidated Balance Sheets as of June 30, 2005 (unaudited), and December 31, 2004	F-39
Consolidated Statements of Operations for the three and six months ended June 30, 2005 and 2004 (unaudited)	F-40
Consolidated Statements of Cash Flows for the six months ended June 30, 2005 and 2004 (unaudited)	F-41
Notes to Consolidated Financial Statements June 30, 2005 and 2004 (unaudited) and December 31, 2004	F-42

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Report of Independent Certified Public Accountants

Board of Directors and Stockholders
BIO-key International, Inc.

We have audited the accompanying consolidated balance sheets of BIO-key International, Inc. and Subsidiary as of December 31, 2004, and the related statements of operations, stockholders' equity (deficit) and cash flows for each of the two years in the two year period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BIO-key International, Inc. and Subsidiary as of December 31, 2004 and the results of its operations and its cash flows for each of the two years in the two year period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States, which contemplate continuation of the Company as a going concern. However, as discussed in Note A to the financial statements, the Company has only recently begun to generate significant revenues, has suffered recurring losses from operations and has a working capital deficit. These aforementioned issues, among others, raise substantial doubt about the Company's ability to continue as a going concern. The financial statements do not include any adjustments that might result from this uncertainty. Management's plans in regard to these matters are also discussed in Note A.

/s/ Divine, Scherzer & Brody, Ltd.

Minneapolis, Minnesota
April 7, 2005

BIO-key International, Inc. and Subsidiary

BALANCE SHEET

December 31, 2004

ASSETS

CURRENT ASSETS	
Cash and cash equivalents	\$ 956,230
Marketable debt securities	1,000,000
Receivables	
Billed, less allowance for doubtful receivables of \$422,393	1,698,144
Unbilled	310,523
Due from selling stockholders and other	60,793
Costs and earnings in excess of billings on uncompleted contracts	6,292,603
Inventory	29,599
Prepaid expenses	190,027
	<hr/>
Total current assets	10,537,919
EQUIPMENT AND LEASEHOLD IMPROVEMENTS AT COST, less accumulated depreciation	
	644,101
OTHER ASSETS	
Costs and earnings in excess of billings on uncompleted contracts	657,000
Deposits	2,761,134
Intangible assets less accumulated amortization	4,177,279
Goodwill	12,067,248
	<hr/>
	19,662,661
	<hr/>
	\$ 30,844,681
	<hr/>

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LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

CURRENT LIABILITIES	
Current maturities of long-term obligations	\$ 3,255,182
Advances from stockholders	12,753
Accounts payable	1,325,282
Billings in excess of costs and earnings on uncompleted contracts	760,807
Accrued liabilities	4,639,619
Deferred rent	393,676
Deferred revenue	3,166,356
	<hr/>
Total current liabilities	13,553,675
LONG-TERM OBLIGATIONS, less discounts and current maturities	5,286,951
DEFERRED RENT	1,311,454
DEFERRED REVENUE	71,203
COMMITMENTS AND CONTINGENCIES	
STOCKHOLDERS' EQUITY (DEFICIT)	
Preferred stock authorized, 5,000,000 shares of \$.01 par value (liquidation preference of \$100 per share)	
Series C 7% Convertible; issued and outstanding, 62,182 shares	622
Common stock authorized, 85,000,000 shares of \$.01 par value; issued and outstanding 40,680,691 shares	406,807
Additional contributed capital	45,325,173
Accumulated deficit	(35,111,204)
	<hr/>
	10,621,398
	<hr/>
	\$ 30,844,681
	<hr/>

The accompanying notes are an integral part of this statement.

BIO-key International, Inc. and Subsidiary

STATEMENTS OF OPERATIONS

	Years ended December 31,	
	2004	2003
Revenues		
Services	\$ 3,351,406	\$ 10,694
License fees and other	2,206,825	513,407
	<u>5,558,231</u>	<u>524,101</u>
Costs and other expenses		
Cost of services	1,174,324	1,694
Cost of license fees and other	889,896	87,387
Selling, general and administrative	7,096,088	2,118,122
Research, development and engineering	2,979,904	1,037,330
	<u>12,140,212</u>	<u>3,244,533</u>
Operating loss	<u>(6,581,981)</u>	<u>(2,720,432)</u>
Other income (deductions)		
Interest income	66,824	
Interest expense	(667,008)	(1,109,786)
Other expense	(55,300)	4,145
	<u>(655,484)</u>	<u>(1,105,641)</u>
NET LOSS	<u>\$ (7,237,465)</u>	<u>\$ (3,826,073)</u>
Basic and diluted loss to common stockholders		
Net loss	\$ (7,237,465)	\$ (3,826,073)
Convertible preferred stock dividends and accretion	(414,240)	(136,755)
	<u>(7,651,705)</u>	<u>(3,962,828)</u>
Basic and diluted loss per common share		
Net loss	\$ (.21)	\$ (.22)
Convertible preferred stock dividend and accretion	(.01)	(.01)
	<u>(.22)</u>	<u>(.23)</u>
Weighted average number of shares	<u>34,727,969</u>	<u>17,543,586</u>

The accompanying notes are an integral part of these statements.

BIO-key International, Inc. and Subsidiary**STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)****Years ended December 31, 2004 and 2003**

	Series B 9% Convertible Preferred Stock		Series C 7% Convertible Preferred Stock		Common Stock		Additional contributed capital	Accumulated Deficit	Total
	Shares	Amount	Shares	Amount	Shares	Amount			
Balance as of December 31, 2002	18,430	\$ 184			14,377,406	\$ 143,774	\$ 16,284,399	\$ (23,605,404)	\$ (7,177,047)
Conversion of series B preferred stock and cumulative dividends in arrears into common stock	(14,250)	(142)			4,239,206	42,392	202,525	(244,775)	
Conversion of note, debenture and accrued interest into common stock					2,097,953	20,980	1,552,486		1,573,466
Exercise of options into common stock					308,324	3,083	58,582		61,665
Options and warrants issued for services and other							156,000		156,000
Common stock issued in exchange for services and other					200,000	2,000	74,000		