BIO KEY INTERNATIONAL INC
Form SB-2/A
September 01, 2005

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As filed with the Securities and Exchange Commission on September 1, 2005

Registration No. 333-126492

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

AMENDMENT NO. 1
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	**3577**	**41-1741861**
(State of incorporation)	*(Primary Standard Industrial Classification Code Number)*	*(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)

Copy to:

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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. ý

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. o

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. o

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. o

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

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.

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 September 1, 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 "BKYI." The last reported sale price of our common stock on July 5, 2005 was $1.09 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.

September , 2005

TABLE OF CONTENTS

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.

If we are unable to successfully address the material weaknesses in our internal control over financial reporting, or if we fail to maintain an effective 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.

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. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results would be harmed. We have in the past discovered, and may in the future discover, areas of our disclosure and internal controls that need improvement. As a result after a review of our March 31, 2005 and June 30, 2005 quarterly operating results, we have identified certain deficiencies in some of our disclosure controls and procedures which we believe require remediation.

The Company's 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 weaknesses concerned deficiencies in the design and implementation of our internal control system and the fact that, due to two recent acquisitions, the Company was not staffed properly in its accounting and reporting department, and may not have had appropriate accounting and reporting software. For these reasons, the Company was not able to meet its schedule for preparing its audit and for filing its annual report on Form 10-KSB in a timely manner.

The Company is in the process of addressing these issues to ensure that the Company's internal control over financial reporting and disclosure controls and procedures are improved so as to provide reasonable assurance that information the Company is required to disclose in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. Specifically, during fiscal 2005, the Company has hired an Assistant Controller, a Manager of Finance, a Senior Staff Accountant and a Staff Accountant and has also retained the services of several financial consultants to assist the finance and accounting staff. The Company expects to continue to add to its finance and accounting staff during the second half of fiscal 2005. Also, the Company believes that its accounting and reporting software itself is appropriate for the business, but feels that additional training of the finance and accounting staff will enhance the software's utilization and improve the Company's internal control system. This training is currently being planned and is expected to be implemented during the quarter ending September 30, 2005.

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. Any failure to develop or maintain effective controls, or difficulties encountered in their implementation or in other effective improvement of our internal and disclosure controls could 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 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 propriety 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

This prospectus contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. 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 "BKYI." 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 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 July 5, 2005 was $1.09 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,