BIO KEY INTERNATIONAL INC
Form 10QSB/A
November 23, 2005

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB/A

ý **QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2005

o **TRANSITION REPORT UNDER SECTION 13 OR 15(D) OF THE EXCHANGE ACT**

For the Transition Period from to

Commission file number **1-13463**

BIO-KEY INTERNATIONAL, INC.

(Exact Name of Small Business Issuer as Specified in Its Charter)

DELAWARE	**41-1741861**
(State or Other Jurisdiction of Incorporation of Organization)	(IRS Employer Identification Number)

3349 HIGHWAY 138, BUILDING D, SUITE B, WALL, NJ 07719
(Address of Principal Executive Offices)

(732) 359-1100
(Issuer s Telephone Number)

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

Yes ý No o

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court.

Yes o No o

APPLICABLE ONLY TO CORPORATE ISSUERS

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes ý No

State the number of shares outstanding of each of the issuer s classes of common equity, as of the latest practicable date : There were 46,306,588 issued and outstanding shares of the registrant s common stock, par value $.0001 per share, as of November 15, 2005.

Transitional Small Business Disclosure Format (check one): Yes o No ý

BIO-KEY INTERNATIONAL, INC.

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EXPLANATORY NOTE

On November 21, 2005, BIO-Key International, Inc. (the Company) filed its Quarterly Report on Form 10-QSB for the period ended September 30, 2005 (the Original Report). The sole purpose of this Amendment No. 1 to Quarterly Report on Form 10-QSB/A is to correct certain typographical errors contained in the Original Report. Specifically, the Consolidated Balance Sheet contained in the Original Report incorrectly listed the Accumulated Deficit at December 31, 2004 as $(85,268,159) , which should have been $(35,268,159) , and the consolidated Statements of Cash Flows contained in the Original Report incorrectly listed (i) Net Loss for the nine months ended September 30, 2005 as $(8,515,134) , which should have been $(8,716,279) , (ii) Amortization as 1,303,455 , which should have been 1,504,600 , and (iii) Allowance for doubtful receivables as $(22,440) , which should have been $22,440 . The resulting corrections have also been made to Item 2 (Management Discussion and Analysis) contained herein. Except for the typographical errors corrected hereby, this Form 10-QSB/A does not amend, update or change any other information contained in the Original Report.

PART I
FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

BIO-key International, Inc. and Subsidiary
CONSOLIDATED BALANCE SHEETS

	September 30, 2005 (Unaudited)	December 31, 2004
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 1,497,188	$ 956,230
Marketable securities		1,000,000
Receivables		
Billed, less allowance for doubtful receivables of $134,292 and $422,393, respectively	2,980,298	1,698,144
Unbilled	122,662	310,523
Due from selling stockholders		60,793
Costs and earnings in excess of billings on uncompleted contracts	5,243,350	6,292,603
Inventory	3,465	29,599
Prepaid expenses and other	207,718	190,027
Total current assets	10,054,681	10,537,919
EQUIPMENT AND LEASEHOLD IMPROVEMENTS AT COST, less accumulated depreciation	609,375	644,101
OTHER ASSETS		
Costs and earnings in excess of billings on uncompleted contracts		657,000
Deposits	1,757,037	2,761,134
Intangible assets and deferred charges less accumulated amortization	4,752,050	4,577,784
Goodwill	11,120,395	12,067,248
	$ 28,293,538	$ 31,245,186
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Current maturities of long-term obligations	$ 2,236,901	$ 3,255,182
Advances from stockholders		12,753
Accounts payable	941,177	1,325,282
Billings in excess of costs and earnings on uncompleted contracts	61,402	760,807
Accrued liabilities	5,175,101	4,639,619
Deferred rent	430,558	393,676
Deferred revenue	3,883,787	3,166,356
Total current liabilities	12,728,926	13,553,675
LONG-TERM OBLIGATIONS, less discounts and current maturities	6,561,868	4,732,819
DEFERRED RENT	983,765	1,311,454
DEFERRED REVENUE	570,136	71,203
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
Preferred stock authorized, 5,000,000 shares of $.0001 par value (liquidation preference of $100 per share)		
Series A 7% Convertible; issued and outstanding 44,557 shares of $.0001 par value	4	
Series C 7% Convertible; issued and outstanding 62,182 shares of $.01 par value		622
Common stock authorized, 85,000,000 shares; issued and outstanding 46,306,588 shares of $.0001 par value and 40,680,691 shares of $0.01 par value, respectively	4,630	406,807
Additional contributed capital	51,560,705	46,436,765
Accumulated deficit	(44,116,496)	(35,268,159)
	7,448,843	11,576,035
	$ 28,293,538	$ 31,245,186

See accompanying notes to the consolidated financial statements.

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BIO-key International, Inc. and Subsidiary
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended September 30, 2005	Three months ended September 30, 2004	Nine months ended September 30, 2005	Nine months ended September 30, 2004
Revenues				
Services	$ 2,496,883	$ 77,639	$ 8,318,624	$ 278,415
License fees and other	705,718	231,179	2,448,901	861,402
	3,202,601	308,818	10,767,525	1,139,817
Costs and other expenses				
Cost of services	503,843	113,667	2,373,534	270,000
Cost of license fees and other	125,633	26,954	658,876	127,621
Selling, general and administrative	2,868,875	1,618,104	8,840,969	3,629,165
Research, development and engineering	1,799,845	452,545	5,545,386	1,067,120
	5,298,196	2,211,270	17,418,765	5,093,906
Operating loss	(2,095,595)	(1,902,452)	(6,651,240)	(3,954,089)
Other income (deductions)				
Interest income	6,908		35,958	
Interest expense	(844,038)	(692)	(2,055,649)	(138,164)
Gain (loss) on sale of marketable debt securities		33,125	(20,000)	33,125
Other	(24,816)	9,855	(25,348)	26,378
NET LOSS	$ (2,957,541)	$ (1,860,164)	$ (8,716,279)	$ (4,032,750)
Basic and diluted loss to common stockholders				
Net loss	$ (2,957,541)	(1,860,164)	(8,716,279)	(4,032,750)
Convertible preferred stock dividends and accretion	(1,500)	(4,044)	(188,800)	(157,194)
Loss applicable to common stockholders	$ (2,959,041)	$ (1,864,208)	$ (8,905,079)	$ (4,189,944)
Basic and diluted loss per common share				
Net loss	$ (.07)	$ (.05)	$ (.19)	$ (.12)
Convertible preferred stock dividend and accretion			(.01)	(.01)
Loss applicable per common share	$ (.07)	$ (.05)	$ (.20)	$ (.13)
Weighted average number of shares	45,476,802	38,624,196	45,129,000	33,408,056

See accompanying notes to the consolidated financial statements

BIO-key International, Inc. and Subsidiary
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended September 30, 2005	Nine Months Ended September 30, 2004
Cash flows from operating activities		
Net loss	$ (8,716,279)	$ (4,032,750)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	179,642	31,617
Amortization	1,504,600	216,658
Allowance for doubtful receivables	22,440	106,000
Loss (gain) on sale of marketable debt securities	20,000	(33,125)
Deferred rent	(290,807)	
Options and warrants issued for services and other	542,758	24,850
Change in assets and liabilities:		
Receivables	(804,799)	(260,951)
Costs in excess of billings	1,546,812	
Inventories	26,134	35,559
Prepaid expenses and other	(27,047)	125,343
Accounts payable	(418,332)	(719)
Accrued liabilities	683,989	242,105
Billings in excess of costs	24,173	
Deferred revenue	1,174,224	70,598
Net cash used in operating activities	(4,532,492)	(3,474,815)
Cash flows from investing activities		
Acquisition of PSG		(498,937)
Acquisition of AMG		(10,089,560)
Capital expenditures	(144,916)	(163,022)
Purchase of marketable debt securities		(5,887,500)
Proceeds from sale of marketable debt securities	980,000	4,920,625
Deposits	1,004,097	(2,769,140)
Proceeds from sale of trademark	50,000	
Other	(56,610)	(126,358)
Net cash provided by (used in) investing activities	1,832,571	(14,613,892)
Cash flows from financing activities		
Issuance of long-term obligations	4,920,251	9,482,680
Net advance from (to) stockholders	(12,753)	(49,259)
Repay long-term obligations	(1,894,148)	(400,000)
Financing fees	(374,614)	(80,000)
Issuance of bridge note	250,000	
Repayment of bridge note	(250,000)	
Repurchase of warrants		(125,000)
Sale of common stock		11,248,803
Exercise of warrants and options	558,787	1,950
Refund of financing fees	100,000	
Offering costs	(56,644)	(31,688)
Net cash provided by financing activities	3,240,879	20,047,486
NET INCREASE IN CASH AND CASH EQUIVALENTS	540,958	1,958,779
Cash and cash equivalents, beginning of period	956,230	1,012,790
Cash and cash equivalents, end of period	$ 1,497,188	$ 2,971,569

See accompanying notes to the consolidated financial statements

BIO-key International, Inc. and Subsidiary

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2005 and 2004 (Unaudited) and December 31, 2004

1. BASIS OF PRESENTATION

The accompanying unaudited interim consolidated financial statements include the accounts of BIO-key International, Inc. and their wholly owned subsidiary (collectively, the Company) and are stated in conformity with accounting principles generally accepted in the United States, pursuant to the rules and regulations of the Securities and Exchange Commission. Pursuant to such rules and regulations, certain financial information and footnote disclosures normally included in the financial statements have been condensed or omitted. Significant intercompany accounts and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all necessary adjustments, consisting only of those of a recurring nature, and disclosures to present fairly the financial position and the results of its operations and cash flows for the periods presented. It is suggested that these interim consolidated financial statements are read in conjunction with the financial statements and the related notes thereto included in the Company s Annual Report on Form 10-KSB for the fiscal year ended December 31, 2004.

Certain amounts in the 2004 consolidated financial statements have been reclassified to conform to the 2005 presentation. These reclassifications had no effect on the previously reported net loss or stockholders equity.

2. LIQUIDITY AND CAPITAL RESOURCE MATTERS

Broad commercial acceptance of the Company s technology is critical to the Company s success and ability to generate revenues. The Company has only recently begun to generate significant revenues, has suffered recurring losses from operations and has a working capital deficit.

The Company is in need of additional capital. The Company is currently considering various alternatives related to raising additional capital including continued funding from an investment group and new funding from other sources. No assurance can be given that any form of additional financing will be available on terms acceptable to the Company, that adequate financing will be obtained to meet its needs, or that such financing would not be dilutive to existing shareholders.

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. The matters described in the preceding paragraphs raise substantial doubt about the Company s ability to continue as a going concern. Recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon the Company s ability to obtain additional financing, meet its financing requirements on a continuing basis, and succeed in its future operations. The accompanying financial statements do not include any adjustments that may result from the uncertainty regarding the Company s ability to continue as a going concern.

3. LOSS PER COMMON SHARE

Basic loss per share is calculated by dividing the net loss attributable to common stockholders by the number of weighted average common shares outstanding. Diluted earnings per share are calculated by dividing the net loss attributable to common stockholders by the weighted average common shares, and when dilutive, by including options, warrants and convertible securities outstanding using the treasury stock method. There was no difference between basic and diluted loss per share for all periods presented, because the impact of including options, warrants and convertible securities would be antidilutive.

4. EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Equipment and leasehold improvements at September 30, 2005 and December 31, 2004 consisted of the following:

	September 30, 2005	December 31, 2004
Equipment	$ 458,846	$ 348,298
Furniture and fixtures	175,650	162,593
Software	104,414	88,302
Leasehold improvements	170,955	165,756
	909,865	764,949
Less accumulated depreciation and amortization	300,490	120,848
	$ 609,375	$ 644,101

5. GOODWILL, OTHER INTANGIBLE ASSETS

The Company s goodwill resulted from the acquisition of Public Safety Group, Inc. and certain assets and assumed liabilities of the Mobile Government Division of Aether Systems, Inc. in 2004. 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 using a number of criteria, including the value of the overall enterprise. As of September 30, 2005, the Company believes no material impairment exists. Future impairment charges from existing operations or other acquisitions, if any, will be reflected as an operating expense in the statement of operations.

Mobile Government	
Balance at December 31, 2004	$ 9,363,371
Adjustment to allowance for doubtful accounts	(310,541)
Billings in excess of costs and earnings on uncompleted contracts	(723,578)
Other working capital adjustments	87,266
Balance at September 30, 2005	8,416,518
Public Safety Group, Inc.	
Balance at December 31, 2004 and September 30, 2005	2,703,877
Total Goodwill	$ 11,120,395

Other intangible assets and deferred charges as of September 30, 2005 and December 31, 2004 consisted of the following:

	September30, 2005	December 31, 2004
Copyrighted software	$ 1,181,429	$ 1,181,429
Customer relationships	1,009,000	1,009,000

Trademarks		807,872		807,872
Developed technology		710,000		710,000
Marketing agreements		605,340		605,340
Patents and patents pending		274,604		217,994
Financing fees		1,435,643		523,347
		6,023,888		5,054,982
Less accumulated amortization		1,271,838		477,198
	$	4,752,050	$	4,577,784

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6. ACCRUED LIABILITIES

Accrued liabilities at September 30, 2005 and December 31, 2004 consisted of the following:

	September 30, 2005	December 31, 2004
Contract costs not yet invoiced by vendors	$ 3,720,938	$ 3,301,442
Compensation	611,261	634,894
Royalties	290,247	254,055
Interest	331,104	227,680
Other	221,551	221,548
	$ 5,175,101	$ 4,639,619

7. CONVERTIBLE 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 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. 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.

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 $^1/_{32}$ 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 specified 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, at the noteholder s option, become immediately due and Laurus shall be entitled to payment of a default interest rate of an additional 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;

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. The resale registration statement was initially filed with the Securities and Exchange Commission on July 8, 2005 for the shares underlying the Senior Convertible Note and Senior Warrant. Due to the fact that the registration was not declared effective by September 6, 2005, Laurus is 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 original principal amount of the Senior Convertible Note. Laurus has waived these liquidated damages.

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 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 such Subordinated Convertible Notes and Subordinated Warrants was approximately $2,411,000. 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.

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 through May 31, 2008, 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 annum 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;

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. We have filed a registration statement with the Securities and Exchange Commission on July 8, 2005 for the shares underlying the Subordinated Convertible Notes and Subordinated Warrants. Due to the fact that the registration statement was not declared effective by September 6, 2005, the Subordinated Investors are 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 original principal amount of the Subordinated Convertible Notes. Shaar has waived these liquidated damages and Longview has provided the Company with the option to settle these obligations at maturity. The Company had incurred and accrued damages associated with this failure payable to certain subordinated note holders, which is not material at this time.

Certain Subordinated Investors purchased additional Subordinated Convertible Notes under the Subordinated Purchase Agreement 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.

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

On April 28, 2005, The Shaar Fund Ltd. loaned $250,000 to the Company. The loan allowed for interest at 10% per annum and was paid in full in June 2005 in conjunction with the Company s recent financing activities.

On July 8, 2005, the Company made a payment of $39,061 to a holder of a senior convertible note issued by the Company on September 29,2004 to fully pay all principal and interest on the Note. In conjunction with this repayment, the holder surrendered a warrant to purchase 11,111 shares of the Company s $0.0001 par value common stock.

As of September 30, 2005, the Company had incorrectly calculated certain interest obligations on certain subordinated notes issued by the Company in September 2004. Accordingly, the Company has, subsequent to September 30, 2005, corrected the error and is now current with respect to its obligations under the September 2004 subordinated notes.

The Company entered into an Amendment and Waiver with Laurus, dated as of August 31, 2005, pursuant to which the Company was permitted to defer the payment of the monthly principal amounts due and payable for the months of September, October, November and December 2005 under both (a) 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), and (b) the Secured Convertible Term Note in the original principal amount of $2,000,000 issued by the Company to Laurus on June 8, 2005 (the June 2005 Note), such aggregate deferred principal amounts being equal to $625,000 and $187,500, respectively. 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 paid at the same time the final payments due with respect to that note upon maturity. The deferred principal amount under the June 2005 Note is now due on June 7, 2008, the maturity date of that note, and will be paid at the same time 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 as they are currently due.

Pursuant to this Amendment and Waiver, the Company issued an aggregate of 612,166 shares of its Common Stock as consideration for this principal payment deferral. The Company entered into a Registration Rights Agreement dated as of August 31,2005 (the Registration Rights Agreement) pursuant to which the Company has agreed to file a registration statement with the Securities and Exchange Commission (the SEC) covering the resale of these shares of Common Stock on or before August 31, 2006.

The Company also entered into Amendment and Waivers, dated as of August 31, 2005, pursuant to which certain Subordinated Investors 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 the Convertible Term Notes in the aggregate original principal amount of $2,800,000 issued by the Company to the Subordinated Investors on September 29, 2004(the Subordinated Notes), such aggregate deferred principal amount being equal to $350,004. The deferred principal amount under each Subordinated Note is now due on September 29, 2007, the maturity date of each such note, and will be paid at the same time the final payments due with respect to each such note upon maturity. The Company will remain obligated to pay all monthly interest amounts under these notes as they are currently due.

Pursuant to these Amendment and Waivers, the Company issued an aggregate of 263,705 shares of its Common Stock to the Subordinated Investors as consideration for this principal payment deferral. The Company entered into the Registration Rights Agreement with each of the Subordinated Investors, pursuant to which the Company has agreed to file a registration statement with the SEC covering the resale of these shares of Common Stock on or before August 31, 2006.

Certain holders of convertible term notes issued by the Company on September 29, 2004 and May 31, 2005 did not permit the Company to defer such principal payments, but instead waived certain provisions of those notes, specifically regarding anti-dilution adjustments of the Fixed Conversion Price that would otherwise have been triggered as a result of the issuance of the above described shares in connection with the debt deferral. In consideration of these waivers, the warrants held by these note holders were modified to reflect an exercise price of $1.35.

8. STOCKHOLDERS EQUITY

Common Stock

During the nine months ended September 30, 2005, Investors converted convertible term notes in the aggregate principal amount of $2,063,920 and $62,276 of accrued interest thereon into 1,575,135 shares of the Company s common stock.

Additional Contributed Capital

In connection with an arbitration settlement, additional contributed capital increased by $100,000 as a result of a refund of offering costs received from the Company s investment bankers.

Series A Convertible Preferred Stock

During the nine months ended September 30, 2005, Investors converted a total of 17,625 shares of the Company s Series A Preferred Stock and $121,819 of accrued dividends thereon into 2,512,426 shares of the Company s $0.0001 par value common stock.

As of September 30, 2005, there are approximately $401,000 of cumulative dividends in arrears on the Series A preferred stock.

Options and Warrants

The following summarizes option and warrant activity since December 31, 2004:

	1996 Plan	1999 Plan	2004 Plan	Non-Plan	Warrants	Total
Balance, December 31, 2004	231,380	1,176,669	1,960,000	4,158,000	12,144,112	19,670,161
Granted			205,000			205,000
Exchanged	18,018	(17,544)				474
Exercised	(96,668)	(97,000)			(525,000)	(718,668)
Expired or cancelled	(2,730)			(470,000)	(67,500)	(540,230)
Balance, March 31, 2005	150,000	1,062,125	2,165,000	3,688,000	11,551,612	18,616,737
Granted			558,500		1,521,125	2,079,625
Exercised				(20,000)		(20,000)
Expired or cancelled				(390,000)	(50,000)	(440,000)
Balance, June 30, 2005	150,000	1,062,125	2,723,500	3,278,000	13,022,737	20,236,362
Granted			104,500		176,666	281,166
Exercised				(40,000)		(40,000)
Expired or cancelled			(138,250)	(60,000)	(11,111)	(209,361)
Balance, September 30, 2005	150,000	1,062,125	2,689,750	3,178,000	13,188,292	20,268,167
Available for future grants, September 30, 2005	159,332	647,132	1,310,250			2,116,714

In January 2005, the Company agreed to exchange an employee s 1999 Plan stock option of 17,544 shares for a 1996 Plan stock option of 18,018 shares. This employee along with another employee exercised options for 20,288 shares of the Company s common stock at a cost of $7,914.

In January 2005, warrants to purchase 10,000 shares of the Company s common stock were exercised on a cashless basis. This transaction resulted in the Company issuing an aggregate of 3,070 shares of the Company s common stock.

In January 2005, a former employee exercised an option for 97,000 shares of the Company s common stock in exchange for the cancellation of 60,195 shares of the Company s common stock previously owned by the former employee.

In January 2005, options to purchase 76,380 shares of the Company s common stock were exercised on a cashless basis. This transaction resulted in the Company issuing an aggregate of 27,302 shares of the Company s common stock.

During the three months ended March 31, 2005, warrants for 515,000 shares of the Company s common stock were exercised for $520,250.

On May 13, 2005 the Company issued a director, Charles Romeo a stock option to purchase 350,000 shares of the Company s common stock at an exercise price of $1.17 per share. The option has a term of seven (7) years and 200,000 shares vest immediately. Of the remaining shares, 75,000 vest on May 13, 2006 and 75,000 vest on May 13, 2007. The estimated fair value of this option was approximately $355,825.

On May 13, 2005, the Company issued a consultant a stock option to purchase 100,000 shares of common stock at an exercise price of $0.86 per share. This option has a term of seven (7) years and vests in two equal annual installments commencing May 13, 2006. The estimated fair value of this option was approximately $104,000.

Proforma Compensation Disclosure

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

The Company has not adopted a method under SFAS No. 148 to expense stock options but rather continues to apply the recognition and measurement provisions of APB Opinion No.25, Accounting for Stock issued to Employees, and related interpretations in accounting for those plans. No stock-based employee compensation expense for options is reflected in net income for the fiscal periods presented as all options granted under those plans had an exercise price equal to or lower than the market price of the underlying common stock at the date of grant.

If compensation expense for the stock options granted had been determined based on the fair value at the grant dates consistent with the method of SFAS No. 123, the Company s proforma net loss and proforma loss per share would have been as follows:

	Three Months Ended September 30, 2005	2004	Nine Months Ended September 30, 2005	2004
Net loss				
As reported	$ (2,957,541)	$ (1,860,164)	$ (8,716,279)	$ (4,032,750)
Proforma	(3,175,595)	(1,927,164)	(9,370,441)	(4,233,750)
Loss applicable to common Stockholders				
As reported	$ (2,959,041)	$ (1,864,208)	$ (8,905,079)	$ (4,189,944)
Proforma	(3,177,095)	(1,935,252)	(9,559,241)	(4,548,138)
Basic and diluted loss per common share				
As reported	$ (.07)	$ (.05)	$ (.20)	$ (.13)
Proforma	(.07)	(.05)	(.21)	(.14)

9. SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION

	Nine Months Ended September 30, 2005	2004
Cash paid for:		
Interest	$ 1,025,873	$ 2,547
Noncash Financing Activities:		
Conversion of convertible debentures and notes, bridge notes and accrued interest into common stock	2,126,196	2,864,293
Issuance of Convertible Preferred Shares in exchange for Series B preferred stock and cumulative dividends in arrears thereon		525,688
Issuance of Convertible Preferred Shares in exchange for debt		8,702,463

Issuance of common stock in exchange for options and warrants		99,222
Issuance of common stock in conjunction with PSG acquisition		3,608,940
Issuance of common stock in exchange for Series A and Series C preferred stock and cumulative dividends in arrears, thereon	121,822	30,461
Cashless exercise of options and warrants	164,075	
Goodwill allocation adjustment	946,852	
Warrants issued in conjunction with convertible debt financing	1,335,000	
Issuance of options in exchange for financing fees	27,367	
Issuance of common stock in exchange for financing fees related to payment deferral	788,284	
Issue of common stock and warrants in exchange for services		99,400
Issue of warrants in conjunction with debt offering		1,278,000
Trade receivables assumed by prior shareholders of AMG		54,552
Offering costs		131,211

10. SUBSEQUENT EVENT

On November 11, 2005, the Company issued a consultant, Randy Fodero, a stock option to purchase 600,000 shares of the Company s common stock at an exercise price of $0.60 per share. The option has a term of seven (7) years and 200,000 shares vest immediately. Of the remaining shares, 200,000 vest on November 11, 2006 and 200,000 vest on November 11, 2007. The estimated fair value of this option was approximately $297,842. Mr. Fodero is the former Vice President of Sales for the Company and has been serving as a sales consultant since his resignation on July 22, 2005.

11. PRIOR PERIOD ADJUSTMENT

In connection with responding to an SEC comment letter, the Company identified accounting errors to the accounting for convertible debt issued in September 2004. The adjustments required to restate the accounting records to their proper balances at December 31, 2004 included: (i) An adjustment to increase Deferred offering costs by $400,505; (ii) An adjustment to increase the discount on convertible debt of $554,132; (iii) An adjustment to decrease retained earnings by $156,955 related to an understatement of interest expense; and (iv) an adjustment to increase Additional Paid in Capital by $1,111,592.

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS

CAUTIONARY STATEMENT FOR FORWARD-LOOKING STATEMENTS

The information contained in this Report on Form 10-QSB and in other public statements by the Company and Company officers include or may contain certain forward-looking statements. All statements other than statements of historical facts contained in this Report on Form 10-QSB, 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 expre 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 from the forward-looking statements contained herein due to a number of factors. Many of these factors are set forth in the Company s Annual Report on Form 10-KSB under the caption Risk Factors and other filings with the Securities and Exchange Commission. 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 might 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.

OVERVIEW

The following should be read in conjunction with the financial statements of the Company included elsewhere herein.

BIO-key International, Inc., a Delaware corporation (the Company, BIO-key, we, or us) 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.

BIO-key has four major product lines: biometrics, handheld mobile software/devices, mobile information software and records management software for fire service/EMS agencies.

We actively market and sell our 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.

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.

We are 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.

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.

CRITICAL ACCOUNTING POLICIES

There have been no material changes to our critical accounting policies and estimates since the end of our 2004 fiscal year. For detailed information on our critical accounting policies and estimates, see our financial statements and notes thereto included in this Report and in our Annual Report on Form 10-KSB for the fiscal year ended December 31, 2004.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123 (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 nine months ended September 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 six 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 nine month periods ending September 30, 2004.

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2005 AS COMPARED TO SEPTEMBER 30, 2004

Revenue

Services revenues, which include maintenance, technical support and other professional services, were approximately $2,497,000 during the three months ended September 30, 2005 as compared to approximately $78,000 during the corresponding period in 2004. The increase in 2005 services revenues is due to approximately $2,425,000 in revenue from Mobile Government, which was acquired in September 2004. Services revenues from BIO-key and PSG were $72,000 during the three months ended September 30, 2005.

License fees and other revenue, which principally includes software license fees and hardware sales, were approximately $706,000 during the three months ended September 30, 2005 as compared to approximately $231,000 during the corresponding period in 2004. The increase in 2005 license and other revenues is due to $665,000 in revenue from Mobile Government offset by a reduction in license and other revenues from BIO-key and PSG of approximately $200,000 for the third quarter of 2005.

For the nine months ended September 30, 2005, services revenues were approximately $8,319,000 compared to approximately $278,000 during the corresponding period in 2004. The increase in 2005 services revenues is due to $8,118,000 in revenue from the Mobile Government division. Service revenues from the BIO-key division and the Public Safety Group were $201,000 during the nine months ended September 30, 2005.

License fees and other revenue, were approximately $2,449,000 during the nine months ended September 30, 2005 as compared to approximately $861,000 during the corresponding period in 2004. The increase in 2005 license and other revenues is due to $2,252,000 in revenue from Mobile Government. License fees and other revenue from BIO-key and PSG were approximately $197,000 during the nine months ended September 30, 2005.

Costs And Other Expenses

Costs of services were approximately $504,000 during the three months ended September 30, 2005 as compared to approximately $ 114,000 during the prior year period. The increase in 2005 was due to $441,000 in costs of services of Mobile Government.

Costs of license and other were approximately $126,000 during the three months ended September 30, 2005 as compared to approximately $27,000 during the corresponding period in 2004. The increase in 2005 was due to $112,000 in costs of license and other of Mobile Government.

Costs of services were approximately $2,374,000 during the nine months ended September 30, 2005 as compared to approximately $270,000 during the prior year period. The increase in 2005

was due to $1,991,000 in costs of services of Mobile Government. Costs of services for BIO-key and PSG were $383,000 for the nine months ended September 30, 2005.

Costs of license and other were approximately $659,000 during the nine months ended September 30, 2005 as compared to approximately $128,000 during the corresponding period in 2004. The increase in 2005 was due to $622,000 in costs of license and other of Mobile Government.

Selling, general and administrative expenses. Selling, general and administrative expenses increased to approximately $2,869,000 during the three months ended September 30, 2005 from approximately $1,618,000 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 $1,519,000 during the three months ended September 30, 2005 compared to $602,000 for the comparable period in 2004. For the nine months ended September 30, 2005, selling, general and administrative expenses increased by $5,212,000 to approximately $8,841,000. Salary and benefit related expenses were approximately $4,441,000 during the nine months ended September 30, 2005 compared to $1,370,000 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 $1,800,000 during the three months ended September 30, 2005 from approximately $453,000 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 $1,284,000 during the three months ended September 30, 2005 compared to $413,000 for the comparable period in 2004. For the nine months ended September 30, 2005, research and development expenses increased by $4,478,000 to approximately $5,545,000. Salary, benefits and contractor expenses were approximately $4,139,000 during the nine months ended September 30, 2005 compared to $975,000 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 $844,000 during the three months ended September 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 nine months ended September 30, 2005, interest expense was approximately $2,056,000, as compared with approximately $138,000 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.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operations during the nine months ended September 30, 2005 was approximately $4,532,000 compared to approximately $3,475,000 during the nine months ended September 30, 2004. The increase in negative operating cash flow in 2005 was due to the net loss of approximately $8,716,000 as compared to the net loss of approximately $4,033,000 during the comparable prior year period. The impact of the net loss on operating cash flow was somewhat mitigated in 2005 by non cash charges for amortization approximately $1,505,000 and compensation expense associated with options and warrants issued for services of approximately $543,000. Additionally, the operating cash flow was positively impacted by a reduction of $1,547,000 in costs in excess of billings on long-term projects as well as an increase in deferred revenue for $1,174,000.

Net cash provided by investing activities for the nine months ended September 30, 2005 was approximately $1,833,000 compared to net cash used in investing activities of approximately $14,614,000 for the corresponding period in 2004. The 2005 amount includes approximately $980,000 in proceeds from the sale of marketable securities and return of $1,004,000 of deposits. During the prior year, the Company used approximately $499,000 to acquire PSG, $10,090,000 to acquire AMG and approximately $5,888,000 to purchase marketable securities.

Net cash provided by financing activities during the nine months ended September 30, 2005 was approximately $3,241,000 compared to approximately $20,047,000 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. During the nine months ended September 30, 2005, the Company raised approximately $4,920,000 in net proceeds from a private placement of convertible debt and received proceeds of approximately $559,000 from warrant and option exercises. Offsetting these proceeds were debt repayments of approximately $1,894,000. To the extent the Company continues to generate losses and negative cash flows from operations, the Company expects to seek additional outside financing.

Working capital deficit at September 30, 2005 was approximately $2,674,000 as compared to a deficit of approximately $3,016,000 at December 31, 2004.

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.

The Company entered into an Amendment and Waiver with Laurus, dated as of August 31, 2005, pursuant to which the Company was permitted to defer the payment of the monthly principal amounts due and payable for the months of September, October, November and December 2005 under both (a) 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), and (b) the Secured Convertible Term Note in the original principal amount of $2,000,000 issued by the Company to Laurus on June 8, 2005 (the June 2005 Note), such aggregate deferred principal amounts being equal to $625,000 and $187,500, respectively. 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 paid at the same time the final payments are due with respect to that note upon maturity. The deferred principal amount under the June 2005 Note is now due on June 7, 2008, the maturity date of that note, and will be paid at the same time the final payments are due with respect to that note upon maturity. The Company will remain obligated to pay all monthly interest amounts under these notes as they are currently due.

Pursuant to this Amendment and Waiver, the Company issued an aggregate of 612,166 shares of its Common Stock as consideration for this principal payment deferral. The Company entered into a Registration Rights Agreement dated as of August 31, 2005 (the Registration Rights Agreement) pursuant to which the Company has agreed to file a registration statement with the Securities and Exchange Commission (the SEC) covering the resale of these shares of Common Stock on or before August 31, 2006.

The Company also entered into Amendment and Waiver dated as of August 31, 2005, pursuant to which certain Subordinated Investors 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 the Convertible Term Notes in the aggregate original principal amount of $2,800,000 issued by the Company to the Subordinated investors on September 29, 2004 (the Subordinated Notes), such aggregate deferred principal amount being equal to $350,004. The deferred principal amount under each Subordinated Note is now due on September 29, 2007, the maturity date of each such note, and will be paid at the same time the final payments are due with respect to each such note upon maturity. The Company will remain obligated to pay all monthly interest amounts under these notes as they are currently due.

Pursuant to these Amendment and Waivers, the Company issued an aggregate of 263,706 shares of its Common Stock to the Subordinated Investors as consideration for this principal payment deferral. The Company entered into the Registration Rights Agreement with each of the Subordinated Investors, pursuant to which the Company has agreed to file a registration statement with the SEC covering the resale of these shares of Common Stock on or before August 31, 2006.

Certain holders of convertible term notes issued by the Company on September 29, 2004 and May 31, 2005 did not permit the Company to defer such principal payments, but instead waived certain provisions of those notes, specifically regarding anti-dilution adjustments of the Fixed Conversion Price that would otherwise have been triggered as a result of the issuance of the above described shares in connection with the debt deferral. In consideration of these waivers, the warrants held by these note holders were modified to reflect an exercise prince of $1.35.

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

In October 2005, the Company completed a restructuring and cost reduction program to better focus on growth and profitability. Current monthly operating expenses are approximately $1,100,000 and monthly interest payments are approximately $350,000. At this level, the Company would need to increase revenue to approximately $1,500,000 per month in order to break-even. This is significantly higher than the monthly revenue generated by the Company in the nine months ending September 30, 2005. Accounts Receivable and Costs and Earnings in Excess of Billings, totaling $8,346,310 at September 30, 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.

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. During the quarter ended June 30, 2005, the Company was delinquent with respect to certain principal and interest obligations on certain subordinated notes issued in September 2004. These obligations have subsequently been brought current.

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

ITEM 3. CONTROLS AND PROCEDURES

An evaluation of the effectiveness of the Company s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act)) was carried out by the Company under the supervision and with the participation of the Company s Co-Chief Executive Officers (Co-CEOs) and Chief Financial Officer (CFO). As part of this evaluation, the Company s Co-CEOs and CFO considered the letter dated April 18, 2005 from the Company s independent auditors to the Audit Committee of the Company s Board of Directors, as previously disclosed by the Company, which identified material weaknesses in the Company s internal control systems.

Specifically, the Company s auditors stated in their letter that they found the Company to be deficient in its design and implementation of its internal control system and that, due to two recent acquisitions, the Company is not staffed properly in its accounting and reporting department, and it may not have 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. Based upon their evaluation, the Company s CO-CEOs and CFO concluded that, as of the end of the period covered by this quarterly report, the Company s disclosure controls and procedures were not effective 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.

The Company is in the process of addressing these issues to ensure that the Company s disclosure controls and procedures are improved so as to provide such reasonable assurance. Specifically, during fiscal 2005, the Company has hired a Controller, 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 in the fourth quarter 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 implemented.

Other than the remedial measures discussed above, which the Company believes have, and will continue to, materially improve its internal control over financial reporting, there has been no change in the Company s internal control over financial reporting identified in connection with the evaluation that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II - OTHER INFORMATION

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

1. On July 15, 2005, the Company issued secured convertible term notes in the aggregate principal amount of $450,000 and warrants to purchase 133,333 shares of common stock at an exercise price of $1.50 per share to institutional investors. These securities were issued in a private placement transaction exempt from the registration requirements of the Securities Act pursuant to Section 4(2) thereof directly by the Company without engaging in any advertising or general solicitation of any kind and without payment of underwriting discounts or commissions to any person.

2. On August 31 2005, the Company issued 875,871 shares of the Company s common stock in exchange for the deferral of certain debt payments under previously issued secured convertible term notes. These securities were issued to accredited investors in a private placement transaction exempt from registration under the Securities Act of 1933, as amended (the Securities Act), pursuant to Rule 506 of Regulation D thereunder. The Shares have not been registered under the Securities Act or applicable state securities laws and may not be offered or sold in the United States absent registration under the Securities Act and applicable state securities laws or an applicable exemption from registration requirements. The Company has agreed to file a registration statement with the SEC covering the resale of the Shares.

ITEM 6. EXHIBITS

The exhibits listed in the Exhibits Index immediately preceding such exhibits are filed as part of this Report.

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	BIO-Key International, Inc.
Dated: November 23, 2005	/s/ Thomas J. Colatosti Thomas J. Colatosti Co-Chief Executive Officer
Dated: November 23, 2005	/s/ Michael W. DePasquale Michael W. DePasquale Co-Chief Executive Officer
Dated: November 23, 2005	/s/ Francis J. Cusick Francis J. Cusick Chief Financial Officer

EXHIBIT INDEX

Exhibit No.	Description
10.61(1)	Amendment and Waiver, dated as of August 31, 2005, by and between the Company and Laurus Master Fund, Ltd.
10.62(1)	Amendment and Waiver, dated as of August 31, 2005, by and between the Company and The Shaar Fund, Ltd.
10.63(1)	Amendment and Waiver, dated as of August 31, 2005, by and between the Company and Longview Special Finance
10.64(1)	Amendment and Waiver, dated as of August 31, 2005, by and between the Company and Etienne Des Roys
10.65(1)	Amendment and Waiver, dated as of August 31, 2005, by and between the Company and Eric Haber
10.66(1)	Amendment and Waiver, dated as of August 31, 2005, by and between the Company and Investors Management Corporation
10.67(1)	Amendment and Waiver, dated as of August 31, 2005, by and between the Company and The Tocqueville Fund
10.68(1)	Amendment and Waiver, dated as of August 31, 2005, by and between the Company and The Tocqueville Amerique Value Fund
10.69(1)	Registration Rights Agreement, dated as of August 31, 2005, by and among the Company, Laurus Master Fund, Ltd., The Shaar Fund, Ltd., Longview Special Finance, Etienne Des Roys, Eric Haber, Investors Management Corporation, The Tocqueville Fund and The Tocqueville Amerique Value Fund.
31.1 (2)	Certificate of Co-CEO of Registrant required under Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended
31.2 (2)	Certificate of Co-CEO of Registrant required under Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended
31.3 (2)	Certificate of CFO of Registrant required under Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended
32.1 (2)	Certificate of Co-CEO of Registrant required under 18 U.S.C. Section 1350
32.2 (2)	Certificate of Co-CEO of Registrant required under 18 U.S.C. Section 1350
32.3 (2)	Certificate of CFO of Registrant required under 18 U.S.C. Section 1350

(1) Filed as an exhibit to the registrant s registration statement on Form SB-2, File No. 333-126492 dated October 21, 2005 and incorporated herein by reference.

(2) Filed herewith.