BIO KEY INTERNATIONAL INC
Form 10QSB
November 13, 2002

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

|X| QUARTERLY REPORT PURSUANT TO SECTION 13 OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTER ENDED SEPTEMBER 30, 2002

[_] 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)

MINNESOTA	41-1741861
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

1285 CORPORATE CENTER DRIVE, SUITE # 175, EAGAN, MN 55121

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

(651) 687-0414

(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 X No

Shares of the Registrant's Common Stock, par value $.01 per share, outstanding as of November 7, 2002: 13,788,262 shares.

BIO-KEY INTERNATIONAL, INC.

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PART I. FINANCIAL INFORMATION

PART II. OTHER INFORMATION

BIO-key International, Inc.
(a Corporation in the Development Stage)
BALANCE SHEETS

	December 31, 2001	September 30, 2002
ASSETS		(Unaudited)
CURRENT ASSETS		
Cash and cash equivalents	$ 514,970	$ 98,892
Accounts Receivable	--	48,400
Prepaid expenses	206,634	99,920
Total current assets	721,604	247,212
EQUIPMENT AND FURNITURE AND FIXTURES - AT COST, less accumulated depreciation	--	--
OTHER ASSETS	41,706	121,903
	$ 763,310	$ 369,115

LIABILITIES AND STOCKHOLDERS' DEFICIT		
CURRENT LIABILITIES		
Current maturities of long-term obligations	$ --	$ 5,618,740
Notes payable	--	382,000
Accounts payable	238,496	220,566
Accrued liabilities	90,575	442,007
Total current liabilities	329,071	6,663,313
LONG-TERM OBLIGATIONS, net of discount and current maturities	4,331,238	--
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT		
Preferred stock - authorized, 5,000,000 shares of $ .01 par value (liquidation preference of $100 per share):		
Series B 9% Convertible; issued and outstanding, 21,430 shares as of December 31, 2001 and 20,230 shares as of September 30, 2002	214	202
Common stock - authorized, 60,000,000 shares of $.01 par value; issued and outstanding, 12,528,469 and 13,809,767 shares, respectively	125,285	138,098
Additional contributed capital	15,538,025	16,271,715
Deficit accumulated during the development stage	(19,560,523)	(22,704,213)
	(3,896,999)	(6,294,198)
	$ 763,310	$ 369,115

See accompanying notes to financial statements.

BIO-key International, Inc.
(a Corporation in the Development Stage)
STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2001	2002	2001	2002
Revenues				
Product sales	$ --	$ 1,425	$ --	$ 2
Licensing fees	--	33,375	--	90
Reimbursed research				

and development	--	--	--	
Technical support				
and other services	--	--	--	
	--	34,800	--	93
Costs and other expenses				
Cost of product sales	--	1,200	--	2
Cost of technical support				
and other services	--	--	--	
Selling, general				
and administrative	293,021	527,704	1,087,599	1,525
Research, development				
and engineering	321,720	253,473	776,561	819
	614,741	782,377	1,864,160	2,347
Operating loss	(614,741)	(747,577)	(1,864,160)	(2,254
Other income (expense)				
Interest income and other	(205)	351	(6,034)	1
Interest expense	(68,199)	(270,669)	(173,679)	(882
	(68,404)	(270,318)	(179,713)	(880
Loss before extraordinary gain	(683,145)	(1,017,895)	(2,043,873)	(3,134
Extraordinary gain - troubled				
payable reduction	--	--	--	
NET LOSS	$ (683,145)	$ (1,017,895)	$ (2,043,873)	$ (3,134
Loss applicable to common shareholders:				
Net loss	$ (683,145)	$ (1,017,895)	$ (2,043,873)	$ (3,134
Preferred stock dividends and accretion	--	--	(89,438)	(96
Loss applicable to common stockholders	$ (683,145)	$ (1,017,895)	$ (2,133,311)	$ (3,231
Basic and diluted loss Per common share	$ (.06)	$ (.08)	$ (.19)	$
Preferred stock dividends and accretion	--	--	(.01)	
Loss per common share	$ (.06)	$ (.08)	$ (.20)	$
Weighted average number of common shares outstanding	10,754,533	13,305,343	10,640,836	12,801

See accompanying notes to financial statements

BIO-key International, Inc.
(a Corporation in the Development Stage)
STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine months ended September 30,		January 7, 1993 (date of inception) through September 30,
	2001	2002	2002
Cash flows from operating activities			
Net loss	$ (2,043,873)	$(3,134,784)	$(21,474,239)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	23,956	--	242,913
Amortization:			
Unearned compensation	--	--	193,333
Discounts on convertible debt related to warrants and beneficial conversion features	--	523,502	1,146,066
Deferred financing costs	21,069	--	426,397
Write-down of inventory	--	--	916,015
Write-down of deferred financing costs	--	--	132,977
Gain on sale of Inter-Con/PC stock	--	--	(190,000)
Revenues realized due to offset of billings against a stock purchase	--	--	(170,174)
Acquired research and development	--	--	117,000
Options and warrants issued for services and other	13,320	383,194	1,784,214
Other	--	--	34,684
Change in assets and liabilities:			
Accounts receivable	9,118	(48,400)	(48,400)
Inventories	--	--	(916,015)
Prepaid expenses	(6,659)	106,713	(99,921)
Accounts payable	4,057	(17,930)	220,566
Accrued liabilities	720,486	372,824	1,954,080
Net cash used in operations	(1,258,526)	(1,814,881)	(15,730,504)
Cash flows from investing activities			
Capital expenditures	--	--	(242,913)
Proceeds from sales of Inter-Con/PC stock	--	--	190,000
Other	(1,636)	(13,197)	(54,903)
Net cash used in investing activities	(1,636)	(13,197)	(107,816)
Cash flows from financing activities			

Net borrowings under short-term borrowing agreements	1,270,000	382,000	3,385,000
Issuance of convertible bridge note	--	--	175,000
Issuance of convertible debentures and long-term notes	--	1,080,000	3,920,000
Issuance of warrants and convertible debentures	--	--	830,000

Deferred financing costs	--	(50,000)	(362,977)
Exercise of stock options and warrants	--	--	190,799
Sales of common stock	--	--	7,093,832
Sale of preferred stock and assigned value of warrant	--	--	843,558
Redemption of common stock	--	--	(138,000)
Net cash provided by financing activities	1,270,000	1,412,000	15,937,212
Net increase (decrease) in cash and cash equivalents	9,838	(416,078)	98,892
Cash and cash equivalents, at beginning of period	48,830	514,970	--
Cash and cash equivalents, at end of period	$ 58,668	$ 98,892	$ 98,892

See accompanying notes to financial statements.

BIO-key International, Inc.
(a Corporation in the Development Stage)
NOTES TO FINANCIAL STATEMENTS
December 31, 2001, and September 30, 2002 (Unaudited)

1. Unaudited Statements

The accompanying unaudited interim financial statements have been prepared by BIO-key International, Inc. (the "Company") in accordance 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.

In the opinion of management, the accompanying unaudited interim 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 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, 2001.

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 had no significant revenues to date, and has accumulated losses since inception of approximately $21,474,000 of which approximately $3,135,000 was incurred during 2002. As of September 30, 2002 there was a stockholders' deficit of approximately $6,294,000.

The Company is in need of substantial 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 advancing beyond the development stage, which in turn 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 might be necessary should the Company be unable to continue in existence.

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.

(a Corporation in the Development Stage)
NOTES TO FINANCIAL STATEMENTS
December 31, 2001, and September 30, 2002 (Unaudited)

4. Prepaid Expenses

	December 31, 2001	September 30, 2002
Consulting fees	$ 188,275	$ --
Insurance	18,359	30,033
Rent and other	--	69,887
	$ 206,634	$ 99,920

5. Other Assets

	December 31, 2001	September 30, 2002
Deferred financing costs	$ --	$ 67,000
Patents pending	26,706	39,903
Security deposits	15,000	15,000
	$ 41,706	$ 121,903

Deferred financing costs

In March 2002, the company engaged an investment banking firm to advise the Company regarding raising additional capital through the potential future issuance of the Company's equity, debt or convertible securities. The Company paid a nonrefundable retainer fee of $50,000 and has been granted a four year warrant to purchase 25,000 shares of the Company's common stock at an exercise price of $1.00 per share. The estimated value of the warrant is $17,000.

6. Accrued Liabilities

	December 31, 2001	September 30, 2002
Interest	$ 42,509	$ 394,661
Compensation	36,699	45,700
Other	11,367	1,646
	$ 90,575	$ 442,007

7. Long-term Obligations

As part of the Company's November 2001 recapitalization transaction with an investor group (the Investor), the Investor agreed to provide additional financing (the Funding Agreement) in incremental monthly installments during the six-month period commencing March 1, 2002, subject to certain conditions. In the nine months ended September 30, 2002 the Company has received $1,080,000 and issued notes payable to the Investor. The terms of the notes require the principal to be repaid on September 30,2003,interest to be accrued at 10%, payable semi-annually on April 30 and September 30 commencing September 30, 2002, and provide for conversion of principal and accrued interest into shares of the Company's common stock at a conversion price of $0.75 per share. The Company has not made the scheduled semi-annual interest payment due September 30, 2002. The Investor has waived this interest non-payment as a default item.

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As part of an August 2002 bridge note agreement with the Investor, the Investor agreed to provide up to $750,000 of additional financing in incremental monthly installments during the four-month period commencing August 28, 2002. As of September 30, 2002, the Company has received $382,000 and issued the corresponding notes payable to the Investor. The terms of the notes require the principal and accrued 7% per annum interest to be repaid by February 28, 2003. In the event the Company completes a private placement of equity securities resulting in gross proceeds of at least $5,000,000 on or before December 31, 2002 the principal amount and accrued interest due under the note is convertible at the option of the Investor, into the securities sold in such transaction at a conversion price equal to the sale price of such securities. Upon completion of such a transaction, the Investor also has the right to request repayment of the note. In the event that such a transaction is not completed by December 31, 2002, the principal amount and accrued interest is convertible at the option of the Investor into shares of the Company's series B preferred stock at a conversion of $100 per share.

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BIO-key International, Inc.
(a Corporation in the Development Stage)
NOTES TO FINANCIAL STATEMENTS
December 31, 2001, and September 30, 2001 (Unaudited)

8. Stockholders Equity

Conversion of Debt into Common Stock

All of the Company's notes payable to the Investor are convertible into shares of the Company's common stock. During the nine-month period ended September 30, 2002, the Investor elected to convert the remaining $316,000 principal amount and $6,392 of accrued interest due under the Company's 5% Convertible Debenture into 803,198 shares of common stock.

Series B Convertible Preferred Stock Dividends

The Company's series B preferred stock accrues dividends at 9% payable semi-annually on June 15 and December 15. As of September 30, 2002 cumulative dividends in arrears were approximately $97,570. All of the Company's series B preferred stock to the Investor are convertible into shares of the Company's common stock. During the nine-month period ended September 30, 2002, the Investor elected to convert 1,200 shares of Series B preferred stock and $8,905 of dividends in arrears and accrued interest thereon into 478,100 shares of the Company's common stock.

Options and Warrants

The following summarizes option and warrant activity since December 31, 2001:

	Number of Shares				
	1996 Plan	1999 Plan	Non-Plan	Warrants	Total
Balance, December 31, 2001	390,380	1,456,669	1,981,000	5,811,898	9,639,947
Granted	--	75,000	--	218,000	293,000
Cancelled	--	75,000	168,000	--	243,000
Balance, June 30, 2002	390,380	1,456,669	1,813,000	6,029,898	9,689,947
Granted	--	380,000	350,000	--	730,000
Cancelled	--	--	--	172,216	172,216
Balance, September 30, 2002	390,380	1,836,669	2,163,000	5,857,682	10,247,731
Available for future grants, September 30, 2002	266,620	163,331	--	--	429,951

9. Events Occurring Subsequent to September 30, 2002

Pursuant to the bridge note agreement with the Investor discussed in note 7, during October 2002 the Company issued notes payable in the aggregate principal amount of $160,000.

On November 4, 2002, the Investor elected to convert 800 shares of Series B Preferred Stock and $7,022 of dividends in arrears and accrued interest thereon into 293,598 shares of the Company's common stock.

On November 11, 2002, the Investor elected to convert 200 shares of Series B Preferred Stock and $1,777 of dividends in arrears and accrued interest thereon Into 60,173 shares of the Company's common stock.

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10. Supplementary Disclosures of Cash Flow Information

	Nine months Ended September 30,		January 7, 1993 (date of inception through September 30,
	2001	2002	2002

Cash paid for:			
Interest	$ --	$ --	$ 28,544
Noncash Financing Activities:			
Conversion of short-term notes, accrued interest and penalties into long-term notes and debentures	--	--	4,567,546
Conversion of convertible debentures, bridge notes, and accrued interest into common stock	--	322,392	2,907,360
Accretion of preferred stock beneficial conversion feature	--	--	877,000
Issuance of Series B preferred stock in exchange for Series A preferred stock and cumulative dividends in arrears, thereon	--	--	281,049
Issuance of common stock in exchange for preferred stock and cumulative dividends in arrears thereon	--	128,905	160,531
Issuance of warrants or stock effected through reduction of debt	--	--	382,000
Unearned compensation reversal related to employee termination	--	--	227,111
Common stock repurchases offset by a reduction in amounts billed to Jasper for research and development	--	--	170,174
Offset deferred offering costs against proceeds of initial public offering, and other	--	--	159,021

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

PRIVATE SECURITIES LITIGATION REFORM ACT

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. The words "may", "intend", "will", "expect", "anticipate", "believe", "estimate", "project", and similar expressions used in this Report are intended to identify forward-looking statements within the meaning of Section 27A of the U.S. Securities Act of 1933 and Sections 21E of the U.S. Securities Exchange of 1934. You should not place undue reliance on these forward-looking statements, which speak only as of the date made. We undertake no obligation to publicly release the result of any revision of these forward-looking statements to reflect events or circumstances after the date they are made or to reflect the occurrence of unanticipated events. You should also know that such statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions. These factors include, but are not limited to, the Company's ability to successfully develop and market its technology and to obtain additional financing as well as those risks described in detail in the Company's Annual Report on Form 10-KSB under the caption "Risk Factors". Should any of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, the actual results may differ materially from those included within the forward-looking statements.

OVERVIEW

Historically, BIO-key International, Inc.'s (the "Company") goal was to develop automated fingerprint identification products which were portable, easily integrated with existing applications and affordable for mass commercialization and distribution through Original Equipment Manufacturers ("OEM"s), distributors and to a lesser degree, system integrators in the computer network, general access control and other markets. This included the development of proprietary readers. During 1998 and 1999, the evolution of the Company's technology allowed it to shift from providing biometric hardware to developing and licensing biometric identification IT security and identity theft solution software.

These solutions are built around the advanced capabilities of the Company's proprietary patent pending VST(Vector Segment Technology) algorithm. The Company has pioneered the development of automated, finger identification technology that can be used without the aide of non-automated methods of identification such as a personal identification (PIN), password, token, smart card, ID card, credit card, passport, drivers license or other form of possession based 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).

Over the past two years, recognizing the growth in electronic commerce, private networks and related security concerns, the Company has actively positioned its technology for the licensing of a Web based biometric authentication software solution to e-commerce and other companies conducting business over the Internet. This integrated solution involves the licensing of client and server based software to provide for reliable and cost effective user authentication in connection with the processing of e-commerce transactions or securing access to private networks.

The Company has completed the development of its core technology, has commenced the marketing of its technology and has begun to generate revenue from licensing arrangements during 2002.

Although the Company has developed significant identification technology, it has not gained any meaningful commercial acceptance and the Company has only generated minimal revenue since inception. The Company did not generate any revenue during 2000 or 2001. The Company's business model, particularly the Web authentication initiative, represents a novel approach to Internet and network security which as of the date of this report has not been adopted by any company conducting business over the Internet. Although recent security concerns relating to the identification of individuals has increased interest in biometrics generally, there can be no assurance that there will be a demand for such a solution or that the Company will have the financial or other resources necessary to successfully market such a software solution.

The Company believes its existing financial resources will only last through December 2002. See "Liquidity and Capital Resources" below. Due to this and other uncertainties, the Company's independent auditors have included an explanatory paragraph in their opinion for the year ended December 31, 2001 as to the substantial doubt about the Company's ability to continue as a going concern. The Company's long-term viability and growth will depend upon the successful commercialization of its technologies and its ability to obtain adequate financing, among other matters, as to which there can be no assurances.

RESULTS OF OPERATIONS

THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2002 AS COMPARED TO THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2001

Revenues

The Company generated approximately $35,000 of revenue during the three months ended September 30, 2002 consisting of $33,000 from licensing fees and $2,000 from reader sales. There was no revenue for the same period in 2001.

The Company generated approximately $93,000 of revenue during the nine months ended September 30, 2002 consisting of $91,000 from licensing fees and $2,000 from reader sales. There was no revenue for the same period in 2001.

Costs and Other Expenses

Cost of goods sold were approximately $1,000 during the three months ended September 30, 2002 as compared to $0 for the corresponding period in 2001. There were no sales in the corresponding period in 2001.

Cost of goods sold were approximately $2,000 during the nine months ended September 30, 2002 as compared to $0 for the corresponding period in 2001. There were no sales in the corresponding period in 2001.

Selling, general and administrative expenses increased approximately $235,000 to approximately $528,000 during the three months ended September 30, 2002 as compared to approximately $293,000 for the corresponding period in 2001. Of the increase, approximately $340,000 was due to an increase in marketing costs as the Company focused on marketing its Web-based biometric authentication software solution and approximately $74,000 was due to an increase in professional services costs subsequent to the recapitalization transaction in November 2001 and the filing of a registration statement with the Securities and Exchange Commission in 2002. These were offset by an approximate $179,000 decrease of a non-cash accrual of penalties incurred for failing to file a registration statement for the Company's Series A convertible preferred stock.

Selling, general and administrative expenses increased approximately $438,000 to approximately $1,525,000 during the nine months ended September 30, 2002 as compared to approximately $1,100,000 for the corresponding period in 2001. Of the increase, approximately $914,000 was due to a increase in marketing costs as the Company focused on marketing its Web-based biometric authentication software solution and approximately $145,000 was due to an increase in professional services costs subsequent to the recapitalization transaction in November 2001 and the filing of a registration statement with the Securities and Exchange Commission in 2002. These were offset by an approximate $537,000 decrease of a non-cash accrual of penalties incurred for failing to file a registration statement for the Company's Series A convertible preferred stock, a decrease of approximately $25,000 due to a reduction in general and administrative operating costs, and approximately $59,000 was due to a reduction in salaries and wages for administrative personnel.

Research, development, and engineering expenses decreased approximately $69,000 to approximately $253,000 during the three months ended September 30, 2002 as compared to approximately $322,000 for the corresponding period in 2001. Of the decrease, approximately $119,000 was due to a decrease in software sub-contracting costs. These were offset by an approximate $52,000 increase in wages for development personnel.

Research, development, and engineering expenses increased approximately $43,000 to approximately $820,000 during the nine months ended September 30, 2002 as compared to approximately $777,000 for the corresponding period in 2001. Of the increase, approximately $204,000 was due to a increase in wages for development personnel and approximately $61,000 was due to an increase in general development and engineering costs. These were offset by an approximate $222,000 decrease in software sub-contracting costs.

Other income and expense increased approximately $202,000 to approximately $270,000 during the three months ended September 30, 2002 as compared to approximately $68,000 for the corresponding period in 2001. The increase was primarily due to an increase in interest costs associated with the November 2001 recapitalization transaction and new long-term borrowings.

Other income and expense increased approximately $701,000 to approximately $881,000 during the nine months ended September 30, 2002 as compared to approximately $180,000 for the corresponding period in 2001. The increase was primarily due to an increase in interest costs associated with the November 2001 recapitalization transaction and new long-term borrowings.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities during the nine months ended September 30, 2002 was approximately $1,815,000 compared to approximately $1,259,000 during the nine months ended September 30, 2001. The primary use of cash for both years was to fund the net loss. Net cash used in investing activities for the nine months ended September 30, 2002 was approximately $13,000 compared to net cash used in investing activities of approximately $2,000 for the same period in 2001. Net cash provided by financing activities during the nine months ended September 30, 2002 was $1,412,000 compared to $1,270,000 in the same period in 2001 and consisted primarily of long-term borrowing activities partially offset by costs related to capital raising efforts.

Working capital decreased approximately $6,809,000 during the nine months ended September 30, 2002 to a deficit of approximately $6,416,000 as compared to a surplus of approximately $393,000 as of December 31, 2001. This decrease is primarily due to operating losses and approximately $5,619,000 of long-term debt becoming classified as a current liability due to its maturity date of September 30, 2003.

Pursuant to the November 2001 recapitalization transaction with an investment group (the Investor), the Company obtained $1,065,000 of additional financing through the issuance in 2001 of a secured convertible promissory note (the "Secured Note"). All existing promissory notes payable to the Investor together with all accrued and unpaid interest due thereon ($3,028,000) were cancelled and converted into the Secured Note. The Secured Note is due September 30, 2003, is secured by substantially all of the Company's assets, including its intellectual property, accrues interest at the rate of 10% per annum payable quarterly in arrears commencing September 30, 2002, may be prepaid without penalty and is convertible into shares of common stock at a conversion price of $0.75 per share. The security interest terminates upon the Company obtaining $5,000,000 of additional equity financing. In this transaction, the Company received net cash proceeds of $1,024,000 after giving effect to offering costs of $41,000. Accrued interest of $351,000 was due on September 30, 2002. The Investor has waived the Company's compliance with this payment date.

Pursuant to the recapitalization transaction, between March and September 2002, the Investor provided $1,080,000 of additional financing in incremental monthly installments. All such funding was provided pursuant to secured promissory notes on the terms described above. Accrued interest of $41,940 was due on September 30, 2002. The Investor has waived the Company's compliance with this payment date.

On August 28, 2002, the Company entered into a bridge note agreement with the Investor to provide up to $750,000 of additional financing in incremental monthly installments during the four-month period commencing August 28, 2002 pursuant to the terms of a convertible promissory note (the "August Note"). The August Note is due February 28, 2003,is secured by substantially all of the Company's assets, including its intellectual property, accrues interest at the rate of 7% per annum payable on maturity and may be prepaid without penalty. In the event the Company completes a private placement of equity securities resulting in gross proceeds of at least $5,000,000, on or before December 31, 2002, the principal amount and accrued interest due under the August Note is convertible at the option of the Investor, into the securities sold in such transaction at a conversion price equal to the sale price of such securities. Upon completion of such a transaction, the Investor also has the right to request repayment of the August Note. In the event that such a transaction is not completed by December 31, 2002, the principal amount and accrued interest is convertible at the option of the Investor into shares of the Company's Series B Preferred Stock at a conversion of $100 per share.

The Investor's obligation to provide financing under the August Note is conditioned upon:

- The Company being in compliance with all material obligations under the August 28, 2002 note purchase agreement between the parties.

- The continued truth and accuracy of the representations and warranties of the Company set forth in the funding agreement.

- The average closing bid price of the Company's common stock during the calendar month preceding the advance exceeding $1.00 per share.

Provided the forgoing conditions are satisfied, funds are advanced on the fifteenth of each Month. As of the date of this report, the Company has received $542,000 of financing under the August Note.

Since January 7, 1993 (date of inception), the Company's capital needs have been principally met through proceeds from the sale of equity and debt securities.

The Company does not currently maintain a line of credit or term loan with any commercial bank or other financial institution.

Primarily all of the Company's interest expense is related to obligations due the Fund.

As of the date of this report, the Company has minimal cash resources. Although the Investor has, in the past, provided financing to the Company notwithstanding that all of the conditions were not satisfied, there can be no assurance that it will continue to do so. During the past year, the Company has reduced its administrative expenses such that it currently requires approximately $180,000 per month to conduct operations. Based on available cash resources and the existing funding obligations, the Company believes it can maintain operations at current levels through December 2002. The

Company needs approximately $2,160,000 to continue to operate at current levels for the next twelve (12) months. Ideally, the Company needs approximately $5,000,000 to $7,000,000 to execute its business plan and support the growth of operations through 2003 and to continue product enhancements. The additional financing is required to conduct the sales and marketing effort necessary to engage in significant direct selling and marketing activities.

During the nine month period ended September 30, 2002, the Company entered into license agreements and generated approximately $93,000 of revenue. Management believes the Company will continue to generate revenue from existing and new relationships during the remainder of the year. Anticipated revenues are expected to defray operating expenses and reduce the amount of required additional financing but are not expected to be sufficient for the Company to expand operations.

In addition to generating revenue, the Company is seeking to obtain additional financing through the issuance of additional debt or equity securities of the Company on a negotiated private placement basis to institutional and accredited investors. In March 2002, the Company retained a financial advisory firm to assist the Company in raising the necessary additional capital. The financial advisory firm has introduced the Company to potential funding sources, however, as of the date of this report, the Company has not reached any definitive agreement with any potential investor regarding the specific terms of an investment in the Company. 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 stockholders. If available financing is insufficient or unavailable or the Company fails to generate any meaningful revenue, it may be required to further reduce operating expenses, suspend operations, seek a merger or acquisition candidate or ultimately liquidate its assets.

ITEM 3 - CONTROLS AND PROCEDURES

Within the 90-day period prior to the filing of this report, an evaluation was carried out under the supervision and with the participation of the Company's management, including the Chief Executive officer ("CEO") and Chief Financial Officer ("CFO"), of the effectiveness of the Company's disclosure controls and procedures. Based on that evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out this evaluation.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The Company is not a party to any material pending legal proceeding nor is it aware of any proceeding contemplated by any governmental authority involving the Company.

ITEM 2. CHANGES IN SECURITIES

1. During September, 2002, the Company issued an aggregate of 478,100 shares of common stock upon conversion of 1,200 shares of the Company's Series B 9% Convertible Preferred Stock and $8,905 of dividends and accrued interest thereon. The shares were issued in a private placement transaction exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) thereunder without payment of underwriting discounts of commissions to any person.

2. On September 5, 2002, the Company issued options to purchase 200,000 shares of common stock under the Company's 1999 Stock Option Plan at an exercise price of $.33 per share, the closing market price of the Company's stock on the date of grant, to Thomas J. Colatosti in connection with his appointment as a Director of the Company. See Part II Item 5 below. The options vest in quarterly installments during the two (2) year period commencing on the date of grant. The options terminate on the earlier of seven (7) years from the date of grant or three (3) months after cessation of service as a director, unless cessation is for cause, in which case, the options expire on the date of cessation. The options were issued in a private placement transaction exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4 (2) thereunder without payment of underwriting discounts of commissions to any person.

3. On September 4, 2002, the Company issued options to purchase in the aggregate 180,000 shares of common stock under the Company's 1999 Stock Option Plan at an exercise price of $.31 per share, the closing market price of the Company's common stock on the date of grant, to various employees of the Company. The options vest 10% upon grant and the remainder vest in equal quarterly installments during the three (3) year period commencing 90 days from the day of grant. The options terminate on the earlier of seven (7) years from the date of grant or 90 days after termination of employment unless such termination is for cause, in which case, the options expire on the date of such termination. The options were issued in a private placement transaction exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4 (2) thereunder, without payment of underwriting discounts or commissions to any person.

4. On September 5, 2002 the Company issued options to purchase 150,000 shares of common stock at an exercise price of $.33 per share, the closing market price of the Company's common stock on the date of grant, to Thomas J. Colatosti in connection with his consulting arrangement with the Company. The options vest in equal quarterly installments during a one (1) year period commencing on the date of grant. The options terminate seven (7) years from the date of grant unless the consulting agreement with Mr. Colatosti is terminated for cause, in which case, the options expire on the date of such termination. The options were issued in a private placement transaction exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4 (2) thereunder, without payment of underwriting discounts or commissions to any person.

5. On November 4, 2002, the Company issued an aggregate of 293,598 shares of common stock upon conversion of 800 shares of the Company's Series B 9% Convertible Preferred Stock and $7,022 of dividends and accrued interest thereon. The shares were issued in a private placement transaction exempt

from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) thereunder without payment of underwriting discounts of commissions to any person.

6. On November 11, 2002, the Company issued an aggregate of 60,173 shares of common stock upon conversion of 200 shares of the Company's Series B 9% Convertible Preferred Stock and $1,777 of dividends and accrued interest thereon. The shares were issued in a private placement transaction exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) thereunder without payment of underwriting discounts of commissions to any persons.

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ITEM 3. DEFAULTS UPON SENIOR SECURITIES

As of September 30, 2002,the Company has accrued and unpaid dividends in arrears on its outstanding shares of Series B Convertible Preferred Stock in the amount of approximately $97,570.

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

None

ITEM 5. OTHER EVENTS

On September 5, 2002, Mr. Thomas J. Colatosti, was appointed to the Board of Directors of the Company. In connection with his appointment to the Board, the Company issued Mr. Colatosti options under the Company's 1999 Option Plan to purchase 200,000 shares of common stock on the terms described in Item 2 above. The Company also entered into a consulting arrangement with Mr. Colatosti to provide business development consulting services to the Company for one (1) year in consideration of a monthly payment of $4,000 and the issuance of options to purchase an additional 150,000 shares of Company Common Stock on the terms described in Item 2 above.

The following is a brief description of the business experience of Mr. Colatosti.

Thomas J. Colatosti currently serves as the Chief Executive Officer of American Security Ventures, a Lexington, Massachusetts based consulting firm he founded which specializes in providing strategic management consulting services to emerging and developing companies in the homeland security industry. From 1999 through June 2002, Mr. Colatosti served as the Chief Executive Officer of Viisage Technology, Inc., a publicly traded biometric technology company focusing on biometric face-recognition technology and delivering highly secure identification documents and systems. From 1997 through 1998, Mr. Colatosti served as Viisage's Chief Operating Officer. Between 1995 and 1997, Mr. Colatosti served as President and Chief Executive Officer of CIS

Corporation, a higher education industry leader that designed and implemented integrated and flexible systems solutions to manage entire university administrative operations. Prior to CIS, Mr. Colatosti had a 20-year career with Digital Equipment Corporation. His responsibilities included Vice President and General Manager of Digital's $1.2 billion Federal System Division and Vice President and General Manager of a billion dollar cross-industry commercial business unit. Mr. Colatosti has spoken widely on homeland security issues, has appeared on national media programs such as the Today Show, CNN and CBS; and has presented at the White House, Congressional Committee and other Federal agencies on homeland security issues. Mr. Colatosti earned a Bachelor of Science degree in Management and Finance as well as a Masters degree in Business Administration from Suffolk University.

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ITEM 6. EXHIBITS

(a) Exhibits

99.1 Certificate of CEO of Registrant Pursuant to 18 USC Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99.2 Certificate of CFO of Registrant Pursuant to 18 USC Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K

None.

SIGNATURES

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

Dated: November 13, 2002 BIO-Key International, Inc.

/s/ Jeffry R. Brown

Jeffry R. Brown, Chief Executive Officer

/s/ Gary Wendt

Gary Wendt, Chief Financial Officer

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CERTIFICATION

I, Jeffry R. Brown, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of BIO-key International, Inc. (the "registrant")

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002

/S/ Jeffry R. Brown

Jeffry R. Brown
Chief Executive Officer

CERTIFICATION

I, Gary Wendt, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of BIO-key International, Inc. (the "registrant")

2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;

3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and

c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 13, 2002

/S/ Gary Wendt

Gary Wendt
Chief Financial Officer

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