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BIO KEY INTERNATIONAL INC
Form 10KSB/A
June 19, 2002

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

FORM 10-KSB/A
AMENDMENT NO. 2

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2001

COMMISSION FILE NUMBER 1-13463

BIO-KEY INTERNATIONAL, INC.

(NAME OF SMALL BUSINESS ISSUER IN ITS CHARTER)

MINNESOTA

41-1741861

(State or other jurisdiction of
Incorporation of organization)

(IRS Employer Identification Number)

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

(Address of Principal Executive Offices) (Zip Code)

(651) 687-0414

ISSUER'S TELEPHONE NUMBER, INCLUDING AREA CODE.

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS	NAME OF EXCHANGE ON WHICH REGISTERED
Common Stock, \$0.01 par value per share	None

SECURITIES REGISTERED UNDER SECTION 12(g) OF THE EXCHANGE ACT
None

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrants knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this form 10-KSB.

State issuer's revenues for its most recent fiscal year: \$0.00

The aggregate market value of the voting common equity held by non-affiliates of the registrant based on the closing sale price of the

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registrant' common stock as reported on the OTC Bulletin Board on March 20, 2002 was \$6,987,083. The information provided shall in no way be construed as an admission that any person whose holdings are excluded from the figure is an affiliate or that any person whose holdings are included in the figure is not an affiliate, and any such admission is hereby disclaimed. The information provided is solely for the record keeping purposes of the Securities and Exchange Commission.

As of March 20, 2001, 12,685,209 shares of the registrant's common stock were outstanding.

Transitional Small Business Disclosure Formats (check one):

Yes No

DOCUMENTS INCORPORATED BY REFERENCE

None.

PART I

PRIVATE SECURITIES LITIGATION REFORM ACT

The information contained in this Annual Report on Form 10-KSB and in other public statements by the Company and Company officers or directors includes or may contain certain forward-looking statements. The words "may," "will," "expect," "anticipate," "believe," "continue," "estimate," "project," "intend," 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 Section 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. Many of these risks and uncertainties are set forth under the caption "RISK FACTORS" in Item I of this Report. Should any of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may differ materially from those included within the forward-looking statements.

ITEM 1. DESCRIPTION OF BUSINESS

GENERAL DESCRIPTION OF BUSINESS; MARKET

BIO-key, International, Inc., formerly known as SAC Technologies, Inc. (the "Company" or "BIO-key") was formed in 1993 and is in the business of developing and marketing proprietary biometric technology and software solutions. Biometric technology, the science of analyzing specific human characteristics which are unique to each individual in order to identify a specific person from a broader population, is an emerging technology. Examples of the unique biological characteristics that can be used to identify an individual include fingerprints, iris patterns, hand geometry, voice recognition and facial structure. Fingerprint analysis is an accurate and reliable method to distinguish one individual from another and is viewed as less intrusive than many other biometric identification methods. As a result, fingerprint analysis

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has gained the most widespread use for biometric identification. Biometric technology represents a novel approach to identity verification which has only been used in limited applications and has not gained widespread acceptance in any commercial or consumer markets.

BIO-key has pioneered the development of high performance automated finger identification technology that can be used without the aide of non-automated methods of identification such as a personal identification number (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(TM) 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). The Company's proprietary biometric technology

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scans a person's fingerprint and identifies a person typically within a few seconds without the use of any other identifying data. The Company believes that its fingerprint identification technology will have a broad range of possible applications relating to information security and access control, including:

- * Securing Internet sites, Web pages and electronic transactions
- * Securing access to private networks
- * Securing access to building and restricted areas

The Company's initial business plan was to develop an integrated fingerprint identification product consisting of the Company's core technology embedded into an optical reader for mass commercialization and distribution. The Company's current business plan is to:

- * License its core technology to OEMs, systems integrators and application developers to develop products and applications which utilize the Company's core technology.
- * License WEB-key(TM), its web-based biometric authentication solution.

To date, the Company has engaged in limited marketing of its technology and has generated minimal sales, principally to the general access control and computer network security markets. The Company competes in a new and evolving market and offers a novel software solution. For these reasons, the sales cycle is long and the Company has yet to generate any significant revenue.

MARKET OVERVIEW

Although recent security concerns relating to identification of individuals has resulted in an increased interest in biometrics generally, biometric technology has not gained widespread commercial acceptance. Biometric based solutions compete with more traditional security methods such as keys, cards, personal identification numbers and security personnel, as well as competing biometric technologies including voice, face, iris, hand geometry and blood vessel recognition. The market for business-to-business and business-to-consumer transactions is substantial and continues to grow. Such transactions are subject to fraud based on unauthorized persons gaining access to confidential information. The Company believes that its biometric technology provides a more reliable method for confirming the identity of persons in remote locations than existing traditional methods.

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Biometric technology is a novel approach to facility and digital security. Acceptance of biometrics as an alternative to traditional security methods depends upon a number of factors including:

- * The reliability of biometric solutions
- * Public perception regarding privacy concerns
- * Costs involved in adopting and integrating biometric solutions

Commercial markets have been slow to accept biometrics as a viable alternative to traditional security methods. Accordingly, the primary competition for biometric technology has been the traditional security methods described above.

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With respect to competing biometrics, each has its strength and weaknesses and none has emerged as a market leader. Fingerprint identification is generally viewed as inexpensive and non-intrusive, but also as less accurate. Iris scanning is viewed as extremely accurate, but also as inconvenient to use and expensive. Facial recognition has recently received substantial attention, however, it suffers from accuracy limitations. In summary, the market for biometric technology is undeveloped and evolving.

TECHNOLOGY

The Company was formed in 1993 for the purpose of developing an automated fingerprint identification system. Since that time, the Company has developed proprietary fingerprint identification technology consisting of the following:

- * VST(TM) (Vector Segment Technology), the patent pending core algorithm which creates a mathematical representation of a fingerprint based on its particular characteristics.
- * Software which translates and standardizes the image of the fingerprint for computer analysis ("Biometric Solution").
- * SDK (Developers Tool Kit), a biometric application development tool which facilitates integration of the Company's technology for vertical market applications.

Utilizing these technologies, the Company is continuing to develop identification products and software solutions which are designed to assure that only individuals comprising an approved fingerprint in an online or embedded database are allowed access to an application through real time authentication with an emphasis on Web based applications.

Vector Segment Technology. The Company's IT security solutions are built around its patent pending VST(TM) (Vector Segment Technology) which processes features of a live fingerprint. These features are reduced to a mathematical representation unique to the individual. When a person seeking access to a computer network or restricted area places his or her finger on a reader, a new mathematical representation is generated which is compared to an on-line database to determine whether it matches any mathematical representation on file. If there is a match, the person is identified and given access to the application, computer network, Web Site or restricted area. This can be accomplished without the use of a key, password, user-Id, card, PIN number or token. The actual fingerprint is not typically stored in the database for

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commercial applications. For a more complete description of VST, see "CURRENT OFFERINGS" below.

De-coupling of Technologies. In order to effectuate the Company's evolution from a hardware provider to a licensor of software solutions, the Company has modified its core Vector Segment Technology to make it easily adaptable to scanners other than its proprietary readers. In the past, the Company's identification algorithm had required the use of its own high resolution reader technology to provide for reliable identification applications. The further development of the Vector Segment Technology has allowed for the de-coupling of the core identification algorithm from the reader technology allowing the algorithm to be utilized with lower resolution and lower quality readers available from other manufacturers. VST has expanded its hardware independence capabilities with added scanner communications. The Company's finger identification technology is now completely hardware

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independent and can be integrated with virtually any finger reading device. Enrollments or capture of an individual's biometric ID can be done on one type of scanner and looked-up or identified for a match on another type of scanner. This is a very unique capability in the biometric market and allows the Company's software to be used and integrated with almost any finger scanner hardware.

Identification Verses Verification Technology. Management believes that the Company's Vector Segment Technology is superior to similar technologies utilized by its competitors. Unlike many of the biometric technologies currently available, the Company's technology can identify the fingerprint of an unknown person by searching a database to determine whether the current scanned mathematical representation matches any previously stored mathematical representation. Most of the Company's fingerprint competitors simply verify that the fingerprint image of a known person matches a previously stored copy or model of that individual's fingerprint. By their very nature, such verification systems require an additional item of data such as a PIN number or access card to initially identify the user. Verification systems, therefore, do not eliminate the need for cumbersome access cards, keys or PIN numbers and the administrative costs associated with the distribution and replacement of such data. By contrast, the Company's identification technology typically does not require any identifying data other than a person's fingerprint. Based on the foregoing, the Company believes that its identification technology provides it with a meaningful competitive advantage in the marketplace.

CURRENT OFFERINGS

The following is a description of the status of each of the Company's current offerings.

VST (Vector Segment Technology) SDK (Systems Developer Kit). The Company's SDK is a means of delivering its patent-pending finger identification algorithm, called VECTOR SEGMENT TECHNOLOGY (VST) as an integrated software into existing and new applications. The VST SDK is a software kit licensed to original equipment manufacturers, systems integrators and application developers for the purpose of permitting them to develop biometric applications for distribution to their respective customers.

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The VST SDK improves both the accuracy and speed of fingerprint-based security systems. Traditional fingerprint analysis, classifies fingerprints by mapping their MINUTIAE REFERENCE POINTS--distinct features in specific locations. Most automated fingerprint identification systems create a template of these minutiae reference points and uses it as the basis for comparison and verification. However, strictly minutiae-based templates cannot achieve a high level of differentiation, making them unsuitable for real-time identification applications. To achieve rapid verification, they often compromise on detail, supplementing the fingerprint template with a user ID or password. This enables quick one-to-one matching, but not true identification. VST transcends the conflict between differentiation and speed by mapping the fingerprint in an entirely new way. Instead of focusing on minutiae point coordinates, VST also analyzes the vector segment relationships in the entire fingerprint pattern. The result is a highly informative representation of the finger packaged as a mathematical model.

Unlike other algorithms on the market today, VST processes hundreds of data relationships for each element in the finger model. Because this data is concisely expressed, VST makes it possible to rapidly identify people based on their finger alone, without a user ID, password or smart card. This allows for

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the true identification of users, not just verifying the identity of a known user. No security system can achieve total security as long as a user's identifying data can be stolen or duplicated. Whereas a user ID, a password or even a scanned fingerprint image can be stolen, the mathematical model produced by VST can not. Once a finger is scanned and converted to a VST mathematical model, the scanned image is destroyed. All that remains is a mathematical model that cannot be decoded to obtain the original fingerprint image.

WEB-key(TM). WEB-key is a biometric identification/authentication software solution designed to secure Web based applications through the use of a Web based browser plug-in and a server side plug-in. WEB-key is designed to provide security and identification assuring that a remote user is in fact who they say they are without the need of a password, PIN, or smart card. WEB-key protects personal information such as credit card, address, account numbers and other private data by only disseminating such information upon the authorization of the owner of such information as determined by such person's fingerprint.

WEB-key is an Internet ready three tiered Internet application architecture software security solution. The Company licenses WEB-key(TM) as an integrated solution of it's VST algorithm for securing e-commerce, e-business, and web-based transaction applications. All WEB-key communication is triple-encrypted to prevent secure information from being intercepted over the Internet. Using WEB-key's browser plug-in, users enroll finger identification at a WEB-key enabled Web site from their own PC. After enrollment, WEB-key requests finger identification every time a user begins a secure session. WEB-key's interface guides users through the few steps necessary to gain an accurate finger identification. The entire identification process takes less time than typing a user ID and password.

The Web based server authentication application is an integrated solution involving the distribution of readers and the licensing of client and server based software to provide for reliable and cost effective user

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authentication in connection with the processing of transactions over the Internet. This solution is also intended to secure other Internet applications such as restricting access to specific Web pages, specific information contained on a Web-site or specific applications. The Company believes it has the opportunity to be the first supplier of a reliable electronic identification and authorization solution which operates effectively without the aid of a personal identification number or password supplied by the user.

Architecture. WEB-key provides an easy-to-use and secure method for granting users access via the Internet to proprietary information residing on remote servers.

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WEB-key consists of three basic components:

- * a finger print scanner
- * Vector Segment Technology processing software tightly and securely integrated with a web browser
- * an identification database residing on a web server.

The user simply logs-on a computer or application residing on a computer using their fingerprint in lieu of a PIN number, password, user name or smart card. WEB-key begins by processing a raster scan image which is enhanced using WEB-key software integrated into the web browser. The image enhancing employs a variety of proprietary techniques to improve accuracy and protect against spoofing. The WEB-key software then converts the enhanced image into a unique mathematical representation of the fingerprint using Vector Segment Technology. An encrypted print model is generated for transmission across the Internet to the central WEB-key registry. The WEB-key web server de-encrypts the mathematical model which operates as an index key for searching the database for a match. The web server matches the Vector Segment Technology BIO-key against a database of registered users to obtain a match. If a match is found, the user is allowed access to the protected content on a connected web server.

WEB-key provides a reliable and secure user authentication solution. WEB-key takes advantage of new security features in Microsoft's Internet Explorer versions 5.5 SP2 and 6.0, in addition to 1024 bit enhanced encryption capabilities integrated with public/private key pairs. WEB-key has also been integrated with Oracle9iRAC, which offers advanced speed, scalability, and reliance to WEB-key's database tier. Additional tools and software based on VST technology are under development.

The Company does not currently, and does not intend in the future, to manufacture any hardware. The Company relies on OEMs, or systems integrators and other licensees of its software to supply the necessary hardware, including optical readers. The Company has relationships with hardware manufacturers which enable the Company to supply readers to potential clients as an integrated solution when necessary. Currently, the Company has integrated its software with readers manufactured by Polaroid, Authentec, Ethentica, Siemens, and other independent manufactures. The Company's technology includes proprietary open architecture communication software which allows virtually any reader to be integrated with the Company's technology within several weeks.

POTENTIAL MARKET

The growth of electronic fingerprint identification will be driven by

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the need for secure access to private applications and proprietary databases residing on both private and public network infrastructures. The scope of these opportunities include:

- * corporations that increasingly rely upon the exchange and distribution of proprietary information among staff using intranet or other private networks
- * business-to-business e-commerce among trading partners which share confidential information on a secure basis
- * business-to-consumer e-commerce where the e-commerce service provider wants to restrict access to paying subscribers

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Although electronic commerce has many benefits, the geographical separation of buyers from sellers creates a significant problem arising from the opportunity for fraud. Firewall and encryption software address important aspects of security but do not address the fraud problem inherent in the potential anonymity of a remote user. Corporate intranets are an equally attractive and compelling market. Corporations increasingly rely upon intranet infrastructure for the dissemination of proprietary business data throughout an organization. Since access rights to different classes of data vary among employees, password identification and authorization is integral to all corporate networks.

The current solution to these issues is the association of passwords and PIN numbers with individuals. This solution requires employees or users to remember or retain a growing number of keys cards, passwords and PIN numbers and employers or Internet companies to periodically change passwords and PIN numbers to maintain their integrity. Since such information can be stolen or shared, they provide no assurance that the user is actually who they claim to be. WEB-key has been designed to address each of these concerns. The Company believes that replacement of traditional passwords presents a substantial market opportunity. The Company's technology could virtually replace and eliminate the need for passwords and the associated administrative costs while providing a higher assurance of identity security and user convenience. Government, aviation/transportation and enterprise security present significant additional opportunities.

MARKETING AND DISTRIBUTION

The Company's marketing and distribution efforts consist of:

- * Development of strategic alliances with technology leaders
- * General promotion of biometric technology and the Company's offerings
- * Direct technology licensing efforts to, among others, OEMs, application developers and operators of private network.

The Company's current marketing efforts are conducted primarily through direct selling efforts of its Chief Executive Officer, President and other marketing personnel to OEMs, application developers and operators of private networks.

The Company attends and actively participates in various product conferences and conventions in the technology and security industries to generate market awareness of biometric technology generally and the Company's offerings specifically. In this connection, in October 2000, the Company began a collaborative presentation effort with Intel Corporation whereby the Company and

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Intel created a proof-of-concept demonstration of the Company's WEB-key product. The demonstration was created across the Intel IA32 and Itanium family processor products and was first presented at the Intel Developer Forum (IDF) in February 2001. Proof of concept was presented at WinHec in Anaheim, California on March 25-27, 2001 and RSA in San Francisco, California during April 2001. Intel continues to showcase the Company's biometric IT security solution as a lead application for Intel's next generation Itanium Internet/e-business server and as a solution working with Oracle 9i and Oracles database. Additionally the WEB-key product has been presented in alliance with and part of Intel's exhibit at the Oracle Open World in Berlin and San Francisco. Although the Company intends to participate in events and other conferences with Intel, there can be

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no assurances that Intel will continue to allow the Company to participate with it at any such events or conferences. The Company has been aggressively marketing its WEB-key and SDK technology to leads generated from these efforts.

The Company has also entered into alliances and/or joint sales and marketing arrangements with Oracle, Intel, and Siebel Systems to develop and implement new security systems utilizing the Company's technology for the Federal Government. The events of September 11th have heightened the need for securing data dissemination throughout and between government agencies and automating the positive identification of personnel. The Company believes that its finger identification technology coupled with the capabilities of its alliance partners are the most advanced solutions capable of meeting these needs.

The Company is targeting both Internet infrastructure companies and large portal providers as licensees of its WEB-Key solution. On the Internet infrastructure side, the Company is currently seeking to partner with Internet server manufacturers, providers of database and data warehouse engine software, horizontally positioned application engines, firewall solution providers and peripheral equipment manufacturers. On the portal side, the Company is currently targeting financial service providers such as credit and debit card authorization and issuing institutions, Internet retailers, business-to-business application service providers (ASPs) and corporate intranets.

WEB-key is available for licensing and during 2002, the Company commenced a direct selling effort. During the second quarter of 2002, the Company has entered into license agreements with OEMs and systems integrators to develop applications for distribution to their respective customers. The Company expects to continue to generate revenue during the remainder of 2002 from existing and new customer relationships.

For the following reasons, the Company has yet to generate any significant revenue. The Company competes in a new and evolving market and offers a novel software solution. This has resulted in a long sales cycle as commercial markets continue to evaluate biometrics as a viable alternative to more traditional security methods such as personal identification numbers, passwords and the like. In addition, during 2000 and 2001, the Company was focused on developing and refining its technology and introducing its technology to the market through participation in technology conferences and trade shows. The Company did not begin a direct selling effort until 2002. This effort has resulted in a limited number of sales in the second quarter of 2002.

COMPETITION

The markets for the Company's products and technologies are developing and are characterized by intense competition and rapid technological change. No assurance can be given that the Company's competitors will not develop new or enhanced technologies that will offer superior price, performance or function features or render the Company's products or technologies obsolete. As of the date of this Report, the Company has yet to license its technology or manufacture, market, or sell its products on a wide-scale commercial basis.

In addition to existing commonplace methods of restricting access to facilities such as pass cards, PIN numbers, passwords, locks and keys, there are numerous companies involved in the development, manufacture and marketing of

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fingerprint biometrics products to government, law enforcement, prison and consumer markets. These companies include, but are not limited to, PRINTRAK International, IDENTIX, Safelink, DigitalPersona, Bioscript and BioLink.

Most current automated fingerprint identification product sales have been for government and law enforcement applications, which are typically priced higher than the Company's products and licensing arrangements. Although most of the companies specifically targeting consumer application markets have completed the development of their products, biometric products and technologies have not been widely accepted in the commercial markets.

With current non-biometric technologies the user must typically possess a key, card, or bit of information such as a PIN number or password. These systems are easily defeated by obtaining possession of the key, card, or password, or by counterfeiting the key or card. The Company's biometric technology is intended to replace such systems and substantially reduce the related security breaches. Although biometric based "verification" systems can identify a person and prevent unauthorized persons from entering into a restricted area, such systems do not eliminate the need for PIN numbers, cards, keys or tokens. By contrast, the Company's identification technology typically does not require the use of any such additional identifier other than the person's fingerprint and "identifies" rather than "verifies" the subject. The Company believes that such end-user convenience creates a meaningful competitive advantage for the Company. There can be no assurance, however, that the Company's competitors will not develop similar or superior "identification" technology, which could have a material adverse effect on the Company's financial condition and results of operation. The Company will also be competing for market share with other biometric technologies including hand geometry, iris scanning, retinal scanning, and signature verification, as well as existing lock/security/card technology.

Many of the Company's competitors have substantially greater financial resources and experience in marketing Internet security applications than the Company. In addition, the Company's WEB-key(TM) offering is a unique approach to Internet security, requires the distribution and use of additional peripheral hardware, namely an optical reader, and has not been adopted by any company conducting business over the Internet. For these and other reasons, there can be no assurance that the WEB-key(TM) solution will gain any meaningful market acceptance or that the Company will be able to compete effectively in its chosen markets.

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INTELLECTUAL PROPERTY RIGHTS

The Company's technology consists of knowledge and information relating to computer hardware and software which is used to create an automated process of imaging a fingerprint, formatting the fingerprint for computer analysis, and identifying and verifying the print relative to an existing database of fingerprint information. The Optic Technology and the Company's Biometrics Solution (STBS) and Vector Segment Technology are owned by the Company. The Company has filed a patent application relating to both the Optic Technology and Biometrics Solution (STBS) components of its technology wherein several claims have been allowed. The Company has also filed a patent application with respect to the Vector Segment Technology. There can be no assurance that any additional patents will be issued, or that, if issued, the Company will have the resources to protect any such issued patent infringement. Although the Company believes that its technology does not infringe upon patents held by others, no assurance can be given that such infringements do not exist.

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Part of the Company's technology consists of software or hardware implementations of software ("firmware"). The Company intends to take measures to ensure copyright protection for its software and firmware releases prior to distribution. Where possible, the firmware/software is serialized in an attempt to ensure that only matched sets will function together. This provides both a mechanism to combat cloning of the Company's products and a method for standardizing products. The Company believes it has developed common law trademark rights in the terms SACMan(TM), SACcat(TM), SAC_Remote(TM), BIO_Key(TM), SACSecure(TM), SACcipher__, WEB-key(TM) and SACbook(TM) and has filed federal trademark applications. The Company does not claim any additional trademarks.

RESEARCH AND DEVELOPMENT

During fiscal years ended December 31, 2000 and 2001 the Company spent approximately \$1,136,000 and \$948,000, respectively, on research and development. The Company's limited customer base did not directly bear these costs, which were principally funded through, outside sources of equity and debt financing. During 2002, the Company's research and development effort will be focused on the continued evolution of its Web based authentication solution and furthering the VST algorithm and SDK.

GOVERNMENT REGULATION

The Company is not currently subject to direct regulation by any government agency, other than regulations generally applicable to businesses. However, in the event of any international sales or overseas manufacturing, the Company would likely be subject to various domestic and foreign laws regulating such exports and export activities.

ENVIRONMENTAL REGULATION

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

EMPLOYEES AND CONSULTANTS

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The Company currently employs twelve (12) individuals on a full-time basis; six (6) in engineering, research and development, three (3) in finance and administration and three (3) in sales and marketing. The Company also utilizes four (4) consultants who provide marketing, engineering and management services to the Company. The Company anticipates retaining additional marketing personnel within the next twelve (12) months to execute its business plan.

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RISK FACTORS

The following material risk factors, among others, may affect the Company's financial condition and results of operations.

BUSINESS AND FINANCIAL RISKS

BASED ON OUR LIMITED WORKING CAPITAL, NEGATIVE NET WORTH AND SUBSTANTIAL LOSSES, OUR AUDITORS HAVE RAISED SUBSTANTIAL DOUBT ABOUT OUR ABILITY TO CONTINUE IN BUSINESS.

We have met our working capital requirements through financing transactions involving the public or private placement of our securities. We do not expect our current working capital to support our operations beyond August 2002 and we are in need of substantial additional capital to fund operations. Since our inception, we have not generated any significant revenue and have experienced substantial losses, including \$2,283,774 during 2001. We also have limited working capital and a negative net worth. As a result of these factors, our independent auditors have included an explanatory paragraph in their opinion for the year ended December 31, 2001 as to the substantial doubt about our ability to continue as a going concern. Our financial statements have been prepared in accordance with accounting principals generally accepted in the United States, which contemplate that we will continue to operate as a going concern. Our financial statements do not contain any adjustments that might result if we are unable to continue as a going concern.

WE ARE DEVELOPMENT STAGE COMPANY, HAVE GENERATED MINIMAL REVENUE AND HAVE SUSTAINED SUBSTANTIAL OPERATING LOSSES. WE EXPECT LOSSES TO CONTINUE WHICH WILL REQUIRE US TO RAISE ADDITIONAL CAPITAL TO CONTINUE OPERATIONS.

We were formed in 1993 and have yet to generate any significant revenue. From inception through December 31, 2001, we have accumulated losses of \$18,339,455 and negative cash flow from operations of \$13,915,623. As of December 31, 2001, we had working capital of \$392,533 and a negative net worth of \$3,896,999. Since our inception, we have focused almost exclusively on developing our core technology and have not had any success marketing our technology. In order to generate revenue, we will have to retain additional marketing personnel and incur substantial marketing expenses. We can not assure you that we will be able to secure these necessary resources, that a significant market for our technology will develop or that we will be able to generate any significant revenues. For these reasons we anticipate that net losses will continue.

WE NEED SUBSTANTIAL ADDITIONAL FINANCING TO EXECUTE OUR BUSINESS PLAN WHICH MAY NOT BE AVAILABLE. IF WE ARE UNABLE TO RAISE ADDITIONAL CAPITAL, WE MAY NOT BE ABLE TO CONTINUE OPERATIONS.

We need substantial additional capital to expand our marketing and sales efforts. Our current resources are insufficient to fund operations beyond August 2002. We believe we need an additional \$5,000,000 to \$7,000,000 to

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execute our business plan and support operations through 2003. Although The Shaar Fund has committed to provide an additional \$1,080,000 in incremental

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monthly advances through August, 2002, this obligation is conditioned upon events outside of our control, including the average trading price of our common stock exceeding \$1.00 per share during the month preceding any advance. For these reasons, we are currently seeking to obtain additional financing through the issuance of debt or equity securities on a negotiated private placement basis with institutional and accredited investors. We have not and can not assure you that we will ever be able to secure any such financing on terms acceptable to us. If we can not obtain such financing, we will not be able to execute our business plan or continue operations.

OUR OUTSTANDING 5% DEBENTURE AND PREFERRED STOCK ARE CONVERTIBLE INTO SHARES OF COMMON STOCK AT A DISCOUNT TO THE TRADING PRICE AT THE TIME OF CONVERSION. IF THE TRADING PRICE OF OUR COMMON STOCK DECLINES, THESE SECURITIES WILL BE CONVERTED INTO A GREATER NUMBER OF SHARES RESULTING IN SUBSTANTIAL DILUTION TO OUR EXISTING SHAREHOLDERS WHICH COULD HAVE A SIGNIFICANT NEGATIVE EFFECT ON THE TRADING PRICE OF OUR COMMON STOCK.

Our 5% debenture and preferred stock are convertible into shares of common stock at a per share conversion price equal to the lesser of \$.75 or a 22% discount to the average of the closing bid prices of our common stock during the five trading days preceding conversion. As a result of these provisions, in the event the trading price of our common stock declines, we will be required to issue a greater number of shares of common stock upon conversion of the debenture and preferred stock. This could result in the issuance of a substantial number of additional shares resulting in substantial dilution to our existing shareholders. For example, if the trading price of our common stock declines from \$.92 to \$.50, we would be required to issue 265,846 additional shares of common stock upon conversion of the debenture and 2,637,839 additional shares of common stock upon conversion of the preferred stock. The issuance of these additional shares could have a substantial negative effect on the trading price of our common stock.

The terms of the debenture and preferred stock prohibit the holder from converting these securities into common stock if the conversion would result in the holder owing in excess of 4.99% of our outstanding shares. Although this limits the holder's right to convert these securities into more than 4.99% of our outstanding shares at any one time, it does not prevent the holder from immediately reselling all shares acquired upon conversion and then converting additional securities into up to an additional 4.99% of our outstanding shares. Accordingly, these provisions do not limit the number of shares we may be required to issue upon conversion of these securities. This will result in substantial dilution to our existing shareholders and could have a significant negative effect on the trading price of our common stock.

OUR TECHNOLOGY HAS NOT GAINED MARKET ACCEPTANCE AND WE DO NOT KNOW WHETHER A MARKET WILL DEVELOP FOR OUR TECHNOLOGY IN THE FORESEEABLE FUTURE TO GENERATE ANY REVENUE.

Biometric technology has received only limited market acceptance, particularly in the private sector. Our technology represents a novel security solution and we have not generated any significant sales. Although recent security concerns relating to identification of individuals has increased interest in biometrics generally, it remains an undeveloped, evolving market. Biometric based solutions compete with more traditional security methods

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including keys, cards, personal identification numbers and security personnel. Acceptance of biometrics as an alternative to such traditional methods depends upon a number of factors including:

- * the reliability of biometric solutions
- * public perception regarding privacy concerns
- * costs involved in adopting and integrating biometric solutions

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

BIOMETRIC TECHNOLOGY IS A NEW APPROACH TO INTERNET SECURITY WHICH MUST BE ACCEPTED IN ORDER FOR OUR WEB-KEY(TM) SOLUTION TO GENERATE ANY REVENUE.

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

OUR SOFTWARE MAY CONTAIN DEFECTS WHICH WILL MAKE IT MORE DIFFICULT FOR US TO ESTABLISH AND MAINTAIN CUSTOMERS WHICH ARE NECESSARY TO GENERATE REVENUE.

Although we have completed the development of our core technology, it has not been used by any business customer. Despite extensive testing during development, our software may contain undetected design faults and software errors, or "bugs" that are discovered only after it has been installed and used by customers. Any such default or error in new or existing software or applications could cause delays in delivering our technology or require design modifications. These could adversely affect our competitive position and cause us to lose potential customers or opportunities. Since our technology is intended to be utilized to secure physical and electronic access, the effect of any such bugs or delays will likely have a detrimental impact on us. In addition, given that biometric technology generally, and our technology specifically, has not gained any meaningful acceptance in the market, any delays would likely have a more detrimental impact on our business than if we were a more established company.

WE HAVE NOT DEVELOPED ANY EFFECTIVE DISTRIBUTION CHANNELS FOR OUR TECHNOLOGY.

We market our technology through licensing arrangements with:

- * Original equipment manufacturers, systems integrators and application developers which develop and market products and applications which can then be sold to end users
- * companies which distribute goods, services or software applications over the Internet
- * operators of private networks

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Our success will depend upon the ability of these manufacturers to effectively integrate and market reliable and affordable products which utilize our technology and upon commercial entities adopting biometric solutions. While we have commenced a significant marketing effort, we have not developed any effective distribution channels and may not have the resources or ability to sustain these efforts or generate any meaningful sales.

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IN ORDER TO GENERATE REVENUE, WE ARE DEPENDENT UPON INDEPENDENT ORIGINAL EQUIPMENT MANUFACTURERS, SYSTEMS INTEGRATORS AND APPLICATION DEVELOPERS WHICH WE DO NOT CONTROL. AS A RESULT, IT MAY BE MORE DIFFICULT TO GENERATE SALES.

As a technology licensing company, we are dependent upon original equipment manufacturers, systems integrators and application developers to integrate our technology into products and technologies which they develop and sell. Licensing revenue from our technology is dependent upon the success of these third parties in developing and distributing products and applications which incorporate our technology. We have no control over these licensees and can not assure you that any of them will have the financial, marketing or technical resources to successfully develop and distribute products or applications acceptable to end users or generate any meaningful revenue for us. These third parties may also offer the products of our competitors to end users.

WE FACE INTENSE COMPETITION AND MAY NOT HAVE THE FINANCIAL AND HUMAN RESOURCES NECESSARY TO KEEP UP WITH RAPID TECHNOLOGICAL CHANGES WHICH MAY RESULT IN OUR TECHNOLOGY BECOMING OBSOLETE.

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

WE DEPEND ON OUR EXECUTIVE OFFICERS AND NEED ADDITIONAL MARKETING AND TECHNICAL PERSONNEL TO SUCCESSFULLY MARKET OUR TECHNOLOGY. WE CAN NOT ASSURE YOU THAT WE WILL BE ABLE TO RETAIN OR ATTRACT SUCH PERSONS.

A loss of one or more of our current officers could severely and negatively impact our operations. We have employment contracts with Jeffrey R. Brown, our Chief Executive Officer, H. Donald Rosacker, II, our President, and Mira LaCous, our Vice President of Technology. Although these employment contracts do not prevent such persons from resigning, they do contain non-compete clauses which are intended to prevent these persons from working for a competitor within one year after leaving our Company. During the past 18 months we have also retained additional employees with expertise in developing, marketing and selling software solutions. In order to successfully market our technology, we will need to retain additional technology and marketing

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personnel. The market for such persons remains highly competitive and our limited financial resources will make it more difficult for us to recruit and retain qualified persons.

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WE CAN NOT ASSURE YOU THAT THE LIMITED INTELLECTUAL PROPERTY PROTECTION FOR OUR CORE TECHNOLOGY PROVIDES A MEANINGFUL COMPETITIVE ADVANTAGE OR BARRIER TO ENTRY AGAINST OUR COMPETITORS.

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

RISKS RELATED TO OUR COMMON STOCK

WE HAVE ISSUED A SUBSTANTIAL NUMBER OF SECURITIES CONVERTIBLE INTO SHARES OF OUR COMMON STOCK WHICH WILL RESULT IN SUBSTANTIAL DILUTION TO THE OWNERSHIP INTERESTS OF OUR EXISTING SHAREHOLDERS.

As of December 31, 2001, 20,519,123 shares of our common stock were reserved for issuance upon exercise or conversion of the following securities:

- * 9,639,947 upon exercise of outstanding stock options and warrants.
- * 809,951 shares upon exercise of options available for future grant under our existing option plans.
- * 1,333,333 shares upon conversion of our non interest convertible debenture due September 30, 2003.
- * 5,457,226 shares upon conversion of our secured convertible note due September 30, 2003.
- * 2,857,333 shares or more upon conversion of our outstanding shares of Series B Convertible Preferred Stock. In the event of a decline in the market price of our common stock we would be required to issue an indeterminate number of additional shares upon conversion of these preferred shares.
- * 421,333 or more shares upon conversion of our 5% convertible debenture due September 30, 2003. In the event of a decline in the market price of our common stock we would be required to issue an indeterminate number of additional shares upon conversion of this debenture.

The exercise or conversion of these securities will result in a significant increase in the number of outstanding shares and substantially dilute the ownership interests of our existing shareholders. We have filed a registration statement covering the public sale of 16,484,765 of these shares. In addition, The Shaar Fund has agreed to provide an additional \$1,080,000 through August, 2002 in incremental monthly advances so long as certain conditions are satisfied. In the event that advances are made, additional

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secured convertible notes will be issued which will further dilute the ownership interest of our existing shareholders.

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THE TRADING PRICE OF OUR COMMON STOCK AND OUR ABILITY TO RAISE ADDITIONAL FINANCING MAY BE ADVERSELY EFFECTED BY THE INFLUX INTO THE MARKET OF A SUBSTANTIAL NUMBER OF SHARES.

We filed a registration statement covering the public sale of 16,484,765 or more shares of our common stock. This significant increase in the number of shares available for public sale may have a negative impact on the trading price of our shares. The Shaar Fund's obligation to provide \$1,080,000 in incremental monthly advances through August, 2002 is conditioned upon the average trading price of our common stock exceeding \$1.00 per share during the month preceding the advance. To the extent that this influx of shares into the public market or other factors reduce the trading price of our common stock to below \$1.00, The Shaar Fund would have no obligation to provide this financing and our ability to raise this necessary financing would be significantly impaired. In the event that advances are made, additional secured convertible notes will be issued. We have agreed to register the public resale of the shares issuable upon conversion of any notes issued which will further increase the number of share available for public sale.

OUR OUTSTANDING 5% DEBENTURE AND PREFERRED STOCK ARE CONVERTIBLE INTO SHARES OF COMMON STOCK AT A DISCOUNT TO THE TRADING PRICE AT THE TIME OF CONVERSION. THESE CONVERSION PROVISIONS COULD CAUSE INVESTORS TO SHORT SELL OUR SHARES WHICH MAY ADVERSELY AFFECT THE TRADING PRICE OF OUR COMMON STOCK.

Our 5% debenture and preferred stock are convertible into shares of common stock at a per share conversion price equal to the lesser of \$.75 or a 22% discount to the average of the closing bid prices of our common stock during the five trading days preceding conversion. As a result of these provisions, in the event the trading price of our common stock declines, we will be required to issue a greater number of shares of common stock upon conversion of the debenture and preferred stock. This could result in the issuance of a substantial number of additional shares resulting in substantial dilution to our existing shareholders. To the extent these factors are viewed negatively by the market, they may provide an incentive for persons to execute short sales of our common stock which could further adversely affect the trading price of our common stock. Since the holders of the 5% debenture and preferred stock receive additional shares upon conversion if the trading price of our common stock declines, they may have an incentive to execute short sales of our common stock. The agreement under which these securities were issued precludes the holder from executing short sales of our common stock except in the connection with a conversion of such securities.

APPLICABLE SEC RULES GOVERNING THE TRADING OF "PENNY STOCKS" LIMITS THE TRADING AND LIQUIDITY OF OUR COMMON STOCK WHICH MAY AFFECT THE TRADING PRICE OF OUR COMMON STOCK.

Our common stock currently trades on the OTC Bulletin Board. Since our common stock continues to trade below \$5.00 per share, our common stock is considered a "penny stock" and is subject to SEC rules and regulations which impose limitations upon the manner in which our shares can be publicly traded. These regulations require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule explaining the penny stock market and the

associated risks. Under these regulations, certain brokers who recommend such securities to persons other than established customers or certain accredited investors must make a special written suitability determination for the purchaser and receive the purchaser's written agreement to a transaction prior to sale. These regulations have the effect of limiting the trading activity of our common stock and reducing the liquidity of an investment in our common stock.

WE DO NOT INTEND TO PAY DIVIDENDS IN THE FORESEEABLE FUTURE.

We have never declared or paid a dividend on our common stock. We intend to retain earnings, if any, for use in the operation and expansion of our business and, therefore, do not anticipate paying any dividends in the foreseeable future.

THE TRADING PRICE OF OUR COMMON STOCK MAY BE VOLATILE.

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

MINNESOTA ANTI-TAKEOVER LAW AND CERTAIN PROVISIONS OF OUR ARTICLES OF INCORPORATION MAY DISCOURAGE ATTEMPTS TO EFFECT A CHANGE IN CONTROL OF OUR COMPANY, WHICH MAY ADVERSELY AFFECT THE VALUE OF OUR COMMON STOCK.

We are governed by the provisions of Section 302A.673 of the Minnesota Business Corporation Act ("MBCA"). In general, the law prohibits a public Minnesota corporation from engaging in a "business combination" (with an "interested shareholder") for a period of four years after the date of the transaction in which the person became an interested shareholder, unless the business combination is approved in a prescribed manner. "Business Combination" includes mergers, share exchanges, asset sales, plan or proposal of liquidation or dissolution, recapitalization, issuance and transfers of shares in excess of 5% or more of the Company's shares. "Interested Shareholder" means any person who owns directly or indirectly 10% or more of a public corporation's outstanding voting stock or an affiliate or associate of a public corporation which owns, or within four years did own, 10% or more of the public corporation's outstanding voting stock. These provisions regarding certain business combinations under the MBCA could have the effect of delaying, deferring, or preventing a change in control of the company or the removal of existing management. We have no control over, and therefore cannot predict, what effect these impediments to the ability of third parties to acquire control of us might have on the market price of our common stock. In addition, we are authorized to 5,000,000 shares of preferred stock which may be issued by our Board of Directors on such terms and with such rights, preferences and

designations as the Board may determine. Depending upon the rights, preferences and designations assigned to it, issuance of shares of preferred stock could delay, deter or prevent a change in control of our company to the detriment of our shareholders.

ITEM 2. DESCRIPTION OF PROPERTY

The Company does not own any real estate. The Company conducts its operations from leased premises in Eagan, Minnesota. The Company leases approximately 6,000 square feet of space at 1285 Corporate Center Drive, Suite No. 175 under a five-year lease, which terminates on August 31, 2004 and currently provides for monthly rent of \$3,325 which increases ratably over the term of the lease to \$3,610. The Company believes that its current facility is adequate for the foreseeable future.

ITEM 3. 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 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On February 27, 2002, the Company conducted a special meeting of shareholders to consider two (2) proposals. Proposal number one requested approval of an amendment to the Company's Amended and Restated Articles of Incorporation to increase the number of shares of common stock the Company is authorized to issue from 20,000,000 to 60,000,000. This proposal was approved by the affirmative vote of 7,769,593 shares of common stock with 109,873 shares voting against and 12,200 abstaining. There were 2,291,562 broker non-votes. Proposal number two requested approval of an amendment to the Company's Amended and Restated Articles of Incorporation to change the Company's name from SAC Technologies, Inc. to BIO-key International, Inc. This proposal was approved by the affirmative vote of 10,176,209 shares of common stock with 1,019 shares voting against and 6,000 shares abstaining. There were no broker non-votes.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

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

2001:	HIGH	LOW
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Quarter ended December 31, 2001	\$1.07	\$.15
Quarter ended September 30, 2001	.25	.13

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Quarter ended June 30, 2001	.4375	.18
Quarter ended March 31, 2001	.4375	.2656
2000:	HIGH	LOW
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Quarter ended December 31, 2000	\$1.0625	\$.2656
Quarter ended September 30, 2000	1.0469	.50
Quarter ended June 30, 2000	1.0625	.375
Quarter ended March 31, 2000	1.375	.8125

The last price of the Company's common stock as reported on the OTC Bulletin Board on March 20, 2002 was \$.79 per share.

HOLDERS

As of March 19, 2001 the number of stockholders of record of the Company's common stock was 150. Based on broker inquiry conducted in connection with the distribution of proxy solicitation materials in connection with the Company's special meeting of shareholders in 2002, the Company believes that there are approximately 1,900 beneficial owners of its common stock.

DIVIDENDS

The Company has not paid any cash dividends to date, and has no intention of paying any cash dividends on our common stock in the foreseeable future. The declaration and payment of dividends is subject to the discretion of the Company's Board of Directors and to certain limitations imposed under the Minnesota Business Corporation Act. The timing, amount and form of dividends, if any, will depend on, among other things, the Company's results of operations, financial condition, cash requirements and other factors deemed relevant by the Company's Board of Directors.

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RECENT SALES OF UNREGISTERED SECURITIES.

1. On November 22, 2001, the Company issued options and warrants to purchase an aggregate of 500,000 shares of common stock at an exercise price of \$.3832 per share to certain consultants, including Benjamin Netanyahu, the former Prime Minister of Israel, in consideration of services rendered to the Company, 276,000 of which were issued under the Company's 1996 Option Plan. Under the terms of its agreement with the consultants the Company is obligated to pay additional fees to them based on sales generated as a result of their efforts. At Mr. Netanyahu's option, these fees are convertible into up to 575,000 shares of common stock, at a conversion price of \$.3832 provided that such issuance does not cause Mr. Netanyahu to beneficially own in excess of 4.99% of the Company's outstanding common stock. 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 November 26, 2001, the Company issued a 5% convertible debenture in the principal amount \$539,625, a non-interest convertible debenture in the principal amount of \$1,000,000, a secured convertible in the principal of \$4,092,920, 21,430 shares of Series B Convertible B Preferred Stock and warrants to purchase 4,000,000 shares of common stock to The Shaar Fund Ltd. in consideration of the conversion of \$3,567,546 of outstanding indebtedness,

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conversion of 18,449 shares of Series A Convertible Stock together with all accrued dividends and interest due thereon, and gross cash proceeds of \$1,065,000. These securities were issued to one (1) accredited investor 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.

3. Between November 27, 2001 and February 6, 2002, the Company issued an aggregate of 623,050 shares of common stock to The Shaar Fund Ltd. upon conversion of \$323,626 principal amount and \$175 of accrued interest due under the Company's 5% Convertible Debenture due September 30, 2003. These securities were issued to one (1) accredited investor 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.

4. On December 1, 2001, the Company issued warrants to purchase 27,000 shares of common stock at an exercise price of \$1.00 per share to a government relations consultant in consideration of services rendered to the Company. 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.

5. On March 20, 2002, the Company issued warrants to purchase 168,000 and 25,000 shares of common stock at exercise prices of \$1.00 and \$1.20 per share, respectively, in settlement of a dispute with a former consultant of the Company. These securities were issued in a private placement transaction exempt from the registration requirements of the Securities Act pursuant to Section

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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.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS AND PLAN OF OPERATION

This Management's Discussion and Analysis and Plan of Operation and other parts of this Report contain forward-looking statements that involve risks and uncertainties. All forward-looking statements included in this Report are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statements. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth in the Section captioned "RISK FACTORS" in Item 1 and elsewhere in this Report. The following should be read in conjunction with the audited financial statements of the Company included elsewhere herein.

OVERVIEW

Historically, the Company's 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

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markets. This included the development of the 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(TM) (Vector Segment Technology(TM)) 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(TM) 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.

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The Company has completed the development of its core technology, has commenced the marketing of its technology and expects 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 August 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.

PLAN OF OPERATION

The following is a description of the Company's Plan of Operation for the next twelve (12) months.

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BUSINESS STRATEGY

The Company's initial goal was to develop automated fingerprint identification products which were portable, easily integrated with existing applications and affordable for mass commercialization and distribution through OEMs, distributors and to a lesser degree, system integrators in the computer network, general access control and other markets. This included the development of readers. During 1998 and 1999 the Company pursued an OEM licensing program and in 2000 and 2001 the Company developed WEB-key(TM), an integrated Web based biometric authentication system.

The Company's current business plan consists of a threefold strategy of:

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- * continued development of technology
- * licensing its core technology (SDK and Web-key) to OEMs, system integrators, Internet service providers and software application developers addressing industry-specific applications
- * licensing its Web-based biometric authentication software solution to e-commerce and Internet content companies to secure Web based transactions and corporations to secure private networks.

Although the Company has developed significant core fingerprint identification software technology, it has not gained any meaningful commercial acceptance, the Company has only generated minimal revenue since inception and it has not entered into any significant licensing arrangements. In addition, the Company's business model, particularly the Web authentication initiative, represents a unique approach to Internet security, requires the distribution and use of additional peripheral hardware, namely an optical reader, and the integration of client and server software. It has not been adopted by any company that conducts business over the Internet. There can be no assurance that there will be a demand for such a solution or that the Company will have the financial, marketing and human resources necessary to successfully market such a software solution.

COMPANY PRODUCTS

Overview. The Company's primary initiative is the licensing of its Software Developer's Toolkit (SDK) for integration into other applications and WEB-key(TM), its Web-based, Internet ready three tiered Internet application architecture software security solution. This initiative has involved transitioning the Company's technology to focus on identification applications for large databases and Web based server authentication applications, including porting to multiple platforms and peer group reader technology. These efforts have resulted in the de-coupling of the core identification algorithm from the reader technology providing for the algorithm to be utilized with virtually any reader or scanner. The Company believes that the versatility provided by the de-coupling of the identification algorithm and reader technology will facilitate the pursuit of licensing Web based server authentication applications. Successful execution of this initiative has also required the development of enhanced software to provide an effective interface between client and server-based software. The Company continues to refine this software.

VST (Vector Segment Technology), Patent Pending, Systems Developer Kit

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(SDK). The Company's SDK is a means of delivering its patent-pending finger identification algorithm, called VECTOR SEGMENT TECHNOLOGY (VST) as an integrated software into existing and new applications. The VST SDK is a software kit licensed to original equipment manufacturers, systems integrators and application developers for the purpose of permitting them to develop biometric applications for distribution to their respective customers.

The VST SDK improves both the accuracy and speed of fingerprint-based security systems. Traditional fingerprint analysis classifies fingerprints by mapping their MINUTIAE REFERENCE POINTS--distinct features in specific locations. Most automated fingerprint identification systems create a template of these minutiae reference points and uses it as the basis for comparison and verification. However, strictly minutiae-based templates cannot achieve a high level of differentiation, making them unsuitable for real-time identification applications. To achieve rapid verification, they often compromise on detail, supplementing the fingerprint template with a user ID or password. This enables quick one-to-one matching, but not true identification. VST transcends the

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conflict between differentiation and speed by mapping the fingerprint in an entirely new way. Instead of focusing on minutiae point coordinates, VST also analyzes the vector segment relationships in the entire fingerprint pattern. The result is a highly informative representation of the finger packaged as a mathematical model.

Unlike other algorithms on the market today, VST processes hundreds of data relationships for each element in the finger model. Because this data is concisely expressed, VST makes it possible to rapidly identify people based on their finger alone, without a user ID, password or smart card. This allows for the true identification of users, not just verifying the identity of a known user. No security system can achieve total security as long as a user's identifying data can be stolen or duplicated. Whereas a user ID, a password or even a scanned fingerprint image can be stolen, the mathematical model produced by VST can not. Once a finger is scanned and converted to a VST mathematical model, the scanned image is destroyed. All that remains is a mathematical model that cannot be decoded to obtain the original fingerprint image.

WEB-key(TM). WEB-key(TM) is the Company's Web-based, Internet ready three tiered Internet application architecture software security solution. The Company licenses WEB-key(TM) as an integrated solution of it's VST algorithm for securing e-commerce, e-business, and web-based transaction applications. All WEB-key communication is triple-encrypted to prevent secure information from being intercepted over the Internet. Using WEB-key's browser plug-in, users enroll finger identification at a WEB-key enabled Web site from their own PC. After enrollment, WEB-key requests finger identification every time a user begins a secure session. WEB-key's interface guides users through the few simple steps necessary to gain an accurate finger identification. The entire identification process takes less time than typing a user ID and password.

The Web based server authentication application is an integrated solution involving the distribution of readers and the licensing of client and server based software to provide for reliable and cost effective user authentication in connection with the processing of transactions over the Internet. This solution is also intended to secure other Internet applications such as restricting access to specific Web pages, specific information contained on a Web-site or specific applications. The Company believes it has the

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opportunity to be the first supplier of a reliable electronic identification and authorization solution which operates effectively without the aid of a personal identification number or password supplied by the user.

The Company does not currently, and does not intend in the future, to manufacture any hardware. The Company relies on OEMs systems integrators and other licensees of its software to supply the necessary hardware, including optical readers. The Company has relationships with hardware manufacturers which enable the Company to supply readers to potential customers as an integrated solution when necessary. Currently, the Company has integrated its software with readers manufactured by Polaroid, Authentec, Ethentica, Siemens, and other independent manufactures. The Company's technology includes proprietary open architecture communication software which allows virtually any reader to be integrated with the Company's software within several weeks.

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The Company's SDK and WEB-key software are available for licensing and during 2002, the Company commenced a direct selling effort. During the second quarter of 2002, the Company has entered into license agreements with OEMs and systems integrators and other licensees of its software to develop applications for distribution to their respective customers. The Company expects to continue to generate revenue during the remainder of 2002 from existing and new customer relationships.

MARKETING AND DISTRIBUTION

The Company's marketing and distribution efforts consist of:

- * Development of strategic alliances with technology leaders
- * General promotion of biometric technology and the Company's offerings
- * Direct technology licensing efforts to, among others, OEMs, application developers and operators of private network.

The Company's current marketing efforts are conducted primarily through direct selling efforts of its Chief Executive Officer, President and other marketing personnel to OEMs, application developers and operators of private networks.

The Company attends and actively participates in various product conferences and conventions in the technology and security industries to generate market awareness of biometric technology generally and the Company's offerings specifically. In this connection, the Company has made a collaborative presentations with Intel Corporation during the past 2 years. See "BUSINESS OF THE COMPANY - MARKETING AND DISTRIBUTION". The Company has been aggressively marketing its WEB-key and SDK technology to leads generated from these efforts.

The Company has also entered into alliances and/or joint sales and marketing arrangements with Oracle, Intel, and Siebel Systems to develop and implement new security systems utilizing the Company's technology for the Federal Government. The events of September 11th have heightened the need for securing data dissemination throughout and between government agencies and automating the positive identification of personnel. The Company believes that its finger identification technology coupled with the capabilities of its alliance partners are the most advanced solutions capable of meeting these needs.

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The Company is targeting both Internet infrastructure companies and large portal providers as licensees of its WEB-Key solution. On the Internet infrastructure side, the Company is currently seeking to partner with Internet server manufacturers, providers of database and data warehouse engine software, horizontally positioned application engines, firewall solution providers and peripheral equipment manufacturers. On the portal side, the Company is currently targeting financial service providers such as credit and debit card authorization and issuing institutions, Internet retailers, business-to-business application service providers (ASPs) and corporate intranets.

For the following reasons, the Company has yet to generate any significant revenue. The Company competes in a new and evolving market and offers a novel software solution. This has resulted in a long sales cycle as commercial markets continue to evaluate biometrics as a viable alternative to more traditional security methods such as personal identification numbers, passwords and the like. In addition, during 2000 and 2001, the Company was focused on developing and refining its technology and introducing its technology

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to the market through participation in technology conferences and trade shows. The Company did not begin a direct selling effort until 2002. This effort has resulted in the Company generating revenue in the second quarter of 2002.

CAPITAL REQUIREMENTS

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 for only three additional months (August, 2002). The Company needs approximately \$1,800,000 to continue to operate at current levels for the next twelve (12) months. Unless the Company is able to generate in excess of \$180,000 of revenue per month, it will be required to raise additional capital to continue operations beyond the short term. See "LIQUIDITY AND CAPITAL RESOURCES" below.

RESEARCH AND DEVELOPMENT

Although management believes that the Company's identification technology is one of the most advanced and discriminating fingerprint technologies available on the market today, the markets in which the Company competes are characterized by rapid technological change and evolving standards. In order to maintain its position in the market, the Company will continue to upgrade and refine its existing technologies. During the next twelve months, the Company will continue to focus on enhancing its identification technology for large databases, Web based server authentication applications, including porting to multiple platforms, and peer group reader technology. The Company expects successful development of this solution will require additional financing to which there can be no assurance.

RESULTS OF OPERATIONS

YEAR ENDED DECEMBER 31, 2001 AS COMPARED TO YEAR ENDED DECEMBER 31, 2000:

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REVENUES

The Company had no revenue during 2001 or 2000. This was due to the Company's decision to deploy substantially all human and capital resources to executing its new business plan targeted at licensing biometric identification IT security and identity theft solution software for Internet, intranet and electronic commerce applications. As a result, the Company's limited resources were used to refine its technology to develop the applications needed to execute against this plan.

COSTS AND OTHER EXPENSES

Selling, general and administrative expenses. Selling, general and administrative expenses decreased \$534,402 to \$1,318,465 during 2001 as compared to \$1,852,867 in 2000. Of the decrease, approximately \$117,869 related to a

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decrease in costs for administrative personnel, approximately \$301,126 related to a decrease in costs associated with the services of an administrative consultant, approximately \$256,212 related to a decrease in outside professional service charges, approximately \$58,909 related to a decrease in general operating costs, and approximately \$94,500 related to a decrease in the non-cash accrual of penalties incurred for failing to file a registration statement covering the public sale of common shares issuable upon conversion of the Company's Series A Convertible Preferred Stock. These amounts were offset by an increase of approximately \$294,214 in sales and marketing costs associated with the implementation of the Company's revised business plan. In order to preserve its limited resources, the Company has reduced selling, general and administrative expenses from \$2,151,466 to \$1,318,465 during the past two years. Although the Company continues to closely monitor expenses to reduce overhead, it expects marketing expenses to increase as it continues to focus on generating revenue and does not expect to further materially reduce expenses during 2002.

Research and Development. Research, development and engineering expenses decreased \$188,308 to \$947,932 in 2001 as compared to \$1,136,240 in 2000. Of the decrease, approximately \$137,500 was due to a decrease in personnel costs and approximately \$102,315 was due to a decrease in general operation expenses. These amounts were offset by an increase of approximately \$51,507 for services of outside programming sub-contractors.

Interest Expense. Interest expense increased \$176,286 to \$317,627 in 2001 as compared to \$141,341 in 2000. The increase was due to an increase in interest accrued on additional short term indebtedness of approximately \$1,370,000.

NET OPERATING LOSS CARRYFORWARDS

As of December 31, 2001, the Company has federal net operating loss carryforwards of approximately \$18,155,000. The carryforwards expire between 2008 and 2021. Such net operating carryforwards may be limited in the future in the event of a change in ownership of the Company as defined in the Internal Revenue Code.

YEAR ENDED DECEMBER 31, 2000 AS COMPARED TO YEAR ENDED DECEMBER 31, 1999:

REVENUES

The Company did not generate any revenue during the year ended December

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31, 2000 resulting in a \$157,970 decrease from the year ended December 31, 1999. This decrease was due to the Company's decision to deploy substantially all human and capital resources to executing its new business plan targeted at Internet, intranet and electronic commerce security. As a result, the Company's limited resources were used to refine its technology to develop the applications needed to execute against the Company's revised business plan.

COSTS AND OTHER EXPENSES

Cost of product sales. The Company had no revenue during 2000 and, therefore, did not incur any cost of product sales. During 1999, the Company incurred cost of sales of \$452,593 which was \$294,623 in excess of 1999 revenue. As set forth above, during 2000, the Company focused its resources exclusively on the development of its technology.

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Selling, general and administrative expenses. Selling, general and administrative expenses decreased \$298,599 to \$1,852,867 during 2000 as compared to \$2,151,466 in 1999. Of the decrease, approximately \$341,000 related to a decrease in costs for selling and administrative personnel, approximately \$360,000 related to a decrease in marketing expenses, approximately \$235,000 related to a decrease in outside professional service charges, and approximately \$194,000 related to a decrease in general operating costs. These amounts were offset by an increase in the non-cash accrual of penalties incurred for failing to file a registration statement for the Company's Series A Convertible Preferred Stock of approximately \$498,000 and approximately \$369,000 for costs associated with the services of an administrative consultant, approximately \$200,000 of which consisted of non cash accrual of the fair value of options issued in consideration of such services.

Research and Development. Research, development and engineering expenses increased \$279,553 to \$1,136,245 in 2000 as compared to \$856,692 in 1999. Of the increase, approximately \$70,000 was due to an increase in personnel costs, approximately \$170,000 was due to an increase in costs associated with the services of outside programming sub-contractors and the balance was due to general operation expenses associated with increased development activity.

Additional Income. The Company did not generate any additional income in 2000 as compared to \$208,621 in 1999. Of the decrease, approximately, \$190,000 represented proceeds from the sale of the Company's interest in Inter-con P/C, Inc. in 1999 with no comparable transaction in 2000.

Interest Expense. Interest Expense decreased \$192,856 to \$141,341 in 2000 as compared to \$334,197 in 1999. Of the decrease, approximately \$205,000 related to a decrease in the amortization of the fair market value of warrants issued in financing transactions in 2000 as compared to 1999, \$44,000 related to a reduction in interest charges associated with a lower principal balance on the convertible debenture as a result of conversions of such debenture during 1999 and 2000. These amounts were offset by a \$57,000 increase in interest accrued on short term indebtedness.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities during 2001 was \$1,925,725, and was principally due to operating losses. The operating losses were primarily funded by cash on hand at December 31, 2000 and proceeds from the sale of Company securities and unsecured short term financing.

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Net cash provided by financing activities in 2001 was \$2,394,500, which consisted of the issuance of \$1,370,000 principal amount of short term notes to The Shaar Fund Ltd. (the "Fund") between January and November 2001 and \$1,024,500 realized from a recapitalization transaction with the Fund on November 26, 2001.

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Pursuant to the recapitalization transaction, the Company obtained \$1,065,000 of additional financing through the issuance of a secured convertible promissory note (the "Secured Note"). All existing promissory notes payable to the Fund together with all accrued and unpaid interest due thereon (\$3,027,920) 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 \$.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 \$1,024,500 after giving effect to offering costs of \$40,500.

The Fund has agreed to provide up to \$1,080,000 of additional financing in incremental monthly installments during the six month period commencing March 1, 2002. Any such funding will be provided pursuant to a secured promissory note on the terms described above. The Fund's obligation to provide this financing is conditioned upon:

- * The Company being in compliance with all material obligations under the November 26, 2001 funding agreement between the parties, the Secured Note and debentures issued to the Fund pursuant thereto, and the other agreements 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 upon ten (10) business days written notice from the Company which notice shall be delivered not earlier than the first business day of the month of the requested advance. On or about March 15, 2002, the Company requested and received an advance in the amount of \$180,000. After the final advance has been made, the Company has agreed to file a registration statement covering the public resale of the shares of common stock issuable upon conversion of the secured promissory notes issued against each advance.

Working capital increased \$3,761,382 during 2001 to a surplus of \$392,533 on December 31, 2001 as compared to a deficit of \$3,368,849 on December 31, 2000. This increase is principally due to an increase in cash of approximately \$466,000 (primarily from new borrowings less cash used in operations of approximately \$1,926,000), a decrease in short-term obligations of approximately \$1,999,000 (primarily due to the effects of the recapitalization transaction), a decrease in accounts payable and accrued liabilities of approximately \$1,121,000 (primarily due to the effects of the recapitalization transaction), and an increase in prepaid expenses of approximately \$185,000.

Since January 7, 1993 (date of inception), the Company's capital needs

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have been principally met through proceeds from the sale of equity and debt securities.

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

As of June 19, 2002, the Company has cash resources of approximately \$240,000. Pursuant to its agreement with the Fund, \$285,000 of additional financing is available to the Company upon fulfillment of the conditions described above. Although the Fund has, in the past, provided financing to the Company notwithstanding that all of the conditions have not been 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 for only three additional months (August, 2002). The Company needs approximately \$1,800,000 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 second quarter of 2002, the Company has entered into license agreements, begun to generate revenue and believes it 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 this connection, in March 2002 the Company retained a financial advisory firm to assist the Company in raising the necessary additional capital. The financial advisory firm continues to conduct its due diligence of the Company and management expects to be introduced to potential funding sources in the coming months. As of June 19, 2002, 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 7. FINANCIAL STATEMENTS

See Financial Statements beginning on page F-1.

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PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT

The following sets forth certain information about each director and executive officer of the Company.

NAME ----	AGE ---	POSITIONS HELD -----
Jeffrey R. Brown	53	Chief Executive Office and Chairman of the Board of Directors
H. Donald Rosacker, II	40	President, Director
Gary E. Wendt	60	Chief Financial Officer, Secretary and Director
Jeffrey J. May	41	Director
Mira K. LaCous	40	Vice President of Technology

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

JEFFREY R. BROWN has served as Director of the Company since September 1999, as President of the Company from November 13, 2000 to July 1, 2001 and as Chief Executive Officer since July 1, 2001. Between 1999 and July 2000, Mr. Brown served as managing director for Chancellor Media Group, a division of AmFm Media. From 1995 to 1999, Mr. Brown served as a marketing, promotion and sponsorship consultant for such clients as Signature Sports, Born Information Services and the JC Penney Company. As Senior Vice President Business Development for Gage Marketing Group, LLC between 1992 and 1995, Mr. Brown represented clients such as Proctor and Gamble, Paramount, RJ Reynolds, and Frito Lay.

H. DONALD ROSACKER, II has served as the President and a Director of the Company since August 1, 2001. Mr. Rosacker has primary responsibility for the operations, sales and marketing functions of the Company. Between 1994 and 2000, Mr. Rosacker served as the President and Chief Executive Officer of Tekmerchant.com/FlowersandGifts.com, a Minneapolis, Minnesota based e-commerce company, where he managed the restructure of that company from a business-to-consumer Internet company to a business-to-business technology development company. Between 1992 and 1994, Mr. Rosacker served as President of Mantech Corporation, a Minneapolis, Minnesota based software developer where he managed the launch of advanced technology applications for the manufacturing industry. Mr. Rosacker has in excess of 15 years of financial and marketing management experience in start-up and emerging growth companies. Mr. Rosacker earned a Bachelors degree in Computer Science from the University of Minnesota in 1983.

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GARY E. WENDT has served as the Chief Financial Officer and a Director of the Company since its inception in 1993. Mr. Wendt has primary responsibility for the Company's financial reports and administers accounting operations. From 1993 to 1994, Mr. Wendt was Treasurer and Chief Financial Officer of Esprit Technologies, Inc., a computer manufacturer which produced high speed PCs marketed primarily to government and industry in the Midwestern United States. Mr. Wendt attended Metropolitan State University, North Hennepin Community College, and the Academy of Accountancy where he was certified in public accounting. Mr. Wendt is not a Certified Public Accountant.

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

MIRA K. LACOUS has served as Vice President of Technology and Development of the Company since May 15, 2000. On November 20, 2001, Ms. LaCous was appointed to serve as an executive officer of the Company. Ms. LaCous has primary responsibility for all engineering and software development functions of the Company. Ms. LaCous has over 15 years computer software design experience in the areas of Voice Automation, Commercial Building Control, Information Scanning and Internet Systems, and Internet Security Training. From 1997 until joining the Company, she was employed by National Computer Systems, Inc. as Director Software Development. Between 1997 and March 2000, Ms. LaCous acted as an independent consultant serving such clients as TEL-line Systems and Security Analysts. From 1989 to 1997 Ms. LaCous served as a Senior Project Manager with The Trane Company. Ms. LaCous earned a Bachelors degree in Computer Science for North Dakota State University.

DIRECTORS' TERMS OF OFFICE

Gary Wendt was elected as a director at the Company's 1998 Annual Meeting of Shareholders to hold office for a term of one (1) year until his successor is duly elected and qualified. Jeffrey R. Brown, H. Donald Rosacker, II and Jeffrey J. May were appointed by the Board of Directors to fill vacancies created by the resignations or death of directors and to serve until the next annual meeting of shareholders until their successors are duly elected and qualified.

BOARD OF DIRECTORS

All directors hold office until the next annual meeting of shareholders and the election and qualification of their successors. Officers are elected annually by the Board of Directors and serve at the discretion of the Board.

ADVISOR TO BOARD OF DIRECTORS

On November 22, 2001, the Company retained Benjamin Netanyahu, the former Prime Minister of Israel, to serve as a senior strategy advisor to the Board of Directors for a term of ten (10) months. During the term, Mr. Netanyahu

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is prohibited from consulting with other companies in the biometric identification market.

DIRECTORS COMPENSATION

Directors who are also officers of the Company receive no additional compensation for serving on the Board of Directors, other than reimbursement of reasonable expenses incurred in attending meetings. The Company's 1996 stock

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incentive plan provides for the grant of options to purchase 50,000 shares of common stock to each non-employee director upon first being elected or appointed to the Board of Directors.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the U.S. Securities and Exchange Act of 1934, as amended (the "Exchange Act"), requires the Company's officers and directors and persons who own more than ten percent (10%) of the Company's Common Stock to file with the Securities and Exchange Commission ("SEC") initial reports of ownership and reports of changes in ownership of the Company's Common Stock. Such officers, directors and ten percent (10%) stockholders are also required by applicable SEC rules to furnish the Company with copies of all forms filed with the SEC pursuant to Section 16(a) of the Exchange Act. Based solely on its review of the copies of such forms received by it, or written representations from such persons that no other reports were required for such persons, the Company believes that during the fiscal year ended December 31, 2001, all Section 16(a) filing requirements applicable to the Company's officers, directors and ten percent (10%) stockholders were satisfied in a timely fashion except that Mira LaCous did not timely file a Form 3 upon being appointed to serve as an executive officer of the Company.

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ITEM 10. EXECUTIVE COMPENSATION

The following table provides certain summary information concerning compensation paid to or accrued by the Company's Chief Executive Officer, and all other executive officers of the Company during the fiscal years ended December 31, 1999, 2000 and 2001:

SUMMARY COMPENSATION TABLE

NAME AND PRINCIPAL POSITION	FISCAL YEAR	SALARY (\$)	BONUS (\$)	SECURITIES UNDERLYING OPTIONS (#)
Jeffry R. Brown, (1) Chief Executive Officer	2001	144,000	--	400,000
	2000	18,000	--	580,000
H. Donald Rosacker, II, (2) President	2001	45,400	--	400,000

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Gary E. Wendt,	2001	92,427	--	--
Chief Financial Officer	2000	89,039	--	--
	1999	100,274	--	97,000
Mira LaCous, (3)	2001	99,984		340,000
Vice President of	2000	61,657	15,000	100,000
Technology and				
Development				
Barry M. Wendt, (4)	2001	119,463	--	--
Former Chief Executive	2000	112,926	--	--
Officer	1999	128,440	--	--

- (1) Mr. Brown served as President of the Company from November 13, 2000 until July 1, 2001. Mr. Brown has served as the Chief Executive Officer of the Company since July 1, 2001.
- (2) Mr. Rosacker has served as President of the Company since August 1, 2001.
- (3) Ms. LaCous has served as Vice President of Technology and Development of the Company since May 15, 2000
- (4) Barry M. Wendt resigned as Chief Executive Officer of the Company on July 1, 2001 and as Chairman of the Board of Directors on December 8, 2001. Includes \$63,000 paid pursuant to a consulting agreement which terminated January 31, 2002.

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OPTION GRANTS IN YEAR ENDED DECEMBER 31, 2001
(Individual Grants)

The following table sets forth for the named executive officer information regarding stock options granted to such officer during the 2001 fiscal year.

INDIVIDUAL GRANTS				
NAME	OPTIONS GRANTED (#)	% OF TOTAL OPTIONS GRANTED TO EMPLOYEES IN FISCAL YEAR	EXERCISE OR BASE PRICE (\$/Sh)	EXPIRATION DATE
Jeffry R. Brown	400,000 (1)	31.25	.20	June 30, 2008
H. Donald Rosacker, II	400,000 (2)	31.25	.20	July 31, 2008
Mira LaCous	340,000 (3)	26.56	.46	November 19, 2008

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- (1) Options to purchase 200,000 shares vested upon issuance with the remainder vesting in equal monthly installments over a one year period.
- (2) Options to purchase 60,000 shares vested upon Mr. Rosacker completing 90 days of employment with the Company (the "Initial Vesting Date") with the remainder vesting in equal monthly installments over a three year period commencing on the Initial Vesting Date. Options to purchase 300,000 shares were issued under the Company's 1999 Stock Option Plan.
- (3) Options to purchase 75,000 shares vested upon issuance with the remainder vesting in equal monthly installments over a three year period commencing on the date of grant. Options to purchase 200,000 shares were issued under the Company's 1999 Stock Option Plan.

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AGGREGATED OPTION EXERCISES IN THE
2001 FISCAL YEAR AND FISCAL YEAR-END OPTION VALUE

The following table sets forth for each named executive officer, information regarding stock options exercised by such officer during the 2001 fiscal year, together with the number and value of stock options held at 2001 fiscal year-end, each on an aggregated basis.

INDIVIDUAL GRANTS				
NAME	NUMBER OF SHARES ACQUIRED ON EXERCISE	VALUE REALIZED	NUMBER OF UNEXERCISED OPTIONS AT FISCAL YEAR-END EXERCISABLE/ UNEXERCISABLE (#)	VALUE OF IN-THE- AT FIS EXE UNEXERC
Jeffry R. Brown	--	--	716,667/313,333	314,1
Gary E. Wendt	--	--	144,280/29,100	5
H. Donald Rosacker, II	--	--	88,332/311,668	64,4
Mira LaCous	--	--	157,361/282,639	56,7

- (1) The last sales price of the Company's Common Stock as reported on the OTC Bulletin Board on December 31, 2001 was \$.93.

EMPLOYMENT AGREEMENTS

JEFFRY R. BROWN. On November 13, 2000, the Company entered into two-year (the "Initial Term") employment agreement with Jeffry R. Brown to serve as the President of the Company at an annual base salary of \$144,000, and an

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annual bonus payable at the discretion of the Board of Directors. In recognition of the nearly full time attention Mr. Brown provided to the Company as a non employee director, the agreement also provided for a \$24,000 signing bonus. The employment agreement will be renewed automatically for successive one year periods unless the Company provides written notice of non-renewal at least three months prior to the date employment would otherwise terminate. The employment agreement contains standard and customary confidentiality, non-solicitation and "work made for hire" provisions as well as a covenant not to compete which prohibits Mr. Brown from doing business with any current or prospective customer of the Company or engaging in a business competitive with that of the Company during the term of his employment and for the one year period thereafter.

The agreement may be terminated by the Company at any time with or without cause. In the event of termination without cause, Mr. Brown shall continue to be paid his then current base salary for a period of nine months from the date of such termination; and if the termination occurs during the Initial Term, options to purchase the lesser of (A) one hundred fifty thousand and three (150,003) shares of common stock; and (B) the number of shares of common stock issuable upon the exercise of the remaining unvested options shall vest immediately upon termination. Mr. Brown may terminate the employment

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agreement if his current salary or benefits are reduced by more than 30%, in which event Mr. Brown will continue to be paid his then current base salary for a period of nine months from the date of such termination.

H. DONALD ROSACKER. On August 1, 2001, the Company entered into a one year employment agreement with Mr. Rosacker to serve as the President of the Company at an annual base salary of \$108,000 and a bonus of up to 50% of his base salary payable at the discretion of the Board of Directors. The agreement automatically renews for an additional one year term unless written notice of termination is received at least one month prior to the date it would otherwise terminate. The agreement contains standard and customary confidentiality, non-solicitation and "work made for hire" provisions as well as a covenant not to compete which prohibits Mr. Rosacker from doing business with any current or prospective customer of the Company or engaging in a business competitive with that of the Company during the term of his employment and for the one year period thereafter.

The agreement may be terminated by the Company at any time with or without cause. In the event Mr. Rosacker is terminated without cause after completing nine months of employment with the Company, Mr. Rosacker shall continue to be paid his then current base salary for a period of nine months from the date of such termination. Mr. Rosacker may terminate the agreement if his current salary or benefits are reduced by more than 30%, in which event Mr. Rosacker shall continue to be paid his then current base salary for a period of two months from the date of such termination.

GARY E. WENDT. On May 10, 1996, the Company entered into a five-year employment agreement with Gary E. Wendt to serve as the Chief Financial Officer of the Company. The employment agreement was renewed for a one year term and renews from year to year for consecutive one year terms unless written notice of termination is received at least six months prior to the end of the renewal term. The agreement provides for a base salary subject to an annual increase by the Board of Directors and a bonus payable at the discretion of the Board of Directors. Under the agreement, Mr. Wendt may be terminated only for "cause" as that term is defined in the employment agreement.

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The employment agreement contains standard and customary confidentiality, "work made for hire" and non-solicitation provisions and incorporates a Non-Competition Letter entered into in connection with his employment. The Non-Competition Letter prohibits Mr. Wendt from competing with the Company for a period of three years if the Company terminates employment for cause and a period of two years if Mr. Wendt voluntarily terminates employment. In the event of a termination without cause, or a "constructive termination", which is defined to include an adverse change in Mr. Wendt's status or position in the Company, a reduction of his base salary other than for austerity purposes, or breach by the Company of any of its other contractual obligations for other than austerity reasons, Mr. Wendt's non-competition obligations lapse and he will receive severance in an amount equal to his base salary for two years.

MIRA LACOUS. On November 20, 2001, the Company entered into a one year employment agreement with Mira LaCous to serve as the Vice President of Technology and Development of the Company at an annual base salary of \$100,000 and a bonus of up to 50% of her base salary payable at the discretion of the Board of Directors. Ms. LaCous has been employed by the Company since May 15,

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2000. The agreement automatically renews for an additional one year term unless written notice of termination is received at least one month prior to the date it would otherwise terminate. The agreement contains standard and customary confidentiality, non-solicitation and "work made for hire" provisions as well as a covenant not to compete which prohibits Ms. LaCous from doing business with any current or prospective customer of the Company or engaging in a business competitive with that of the Company during the term of her employment and for the one year period thereafter.

The agreement may be terminated by the Company at any time with or without cause. In the event Ms. LaCous is terminated without cause after completing one year of employment with the Company, Ms. LaCous shall continue to be paid her then current base salary for a period of nine (9) months from the date of such termination. Ms. LaCous may terminate the agreement if her current salary or benefits are reduced by more than 30%, in which event Ms. LaCous shall continue to be paid her then current base salary for a period of two months from the date of such termination.

CHANGE IN CONTROL PROVISIONS

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

In the event of a "Change In Control" both Plans provide for the immediate vesting of all options issued thereunder. The 1999 Plan provides for the Company to deliver written notice to each optionee under the 1999 Plan fifteen (15) days prior to the occurrence of a Change In Control during which

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all options issued under the 1999 Plan may be exercised. Thereafter, all options issued under the 1999 Plan automatically expire. The 1996 Plan provides for all options to remain exercisable for the remainder of their respective terms and permits the Company to make a cash payment to the any or all optionees in respect of any or all options equal to the difference between the exercise price of such option and the fair market value of the Company's Common Stock immediately prior to the Change In Control.

Options issued to executive officers outside of the Plans contain change in control provisions substantially similar to those contained in the 1999 Plan.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth, as of March 20, 2002, information with respect to the securities holdings of all persons which the Company, pursuant to filings with the Securities and Exchange Commission, has reason to believe may be deemed the beneficial owners of more than five percent (5%) of the Company's outstanding common stock. The following table also sets forth, as of such date, the beneficial ownership of the Company's common stock by all officers and directors, individually and as a group.

NAME AND ADDRESS OF BENEFICIAL OWNER -----	AMOUNT AND NATURE OF BENEFICIAL OWNERSHIP (1) -----	PERCENTAG OF CLASS (2) -----
Jeffry R. Brown 1285 Corporate Center Drive Suite No. 175 Eagan, MN 55121	883,332 (2)	6.5%
Gary E. Wendt 1285 Corporate Center Drive Suite No. 175 Eagan, MN 55121	556,555 (3)	4.3%
H. Donald Rosacker II 1285 Corporate Center Drive Suite No. 175 Eagan, MN 55121	123,886 (4)	*
Jeffrey J. May 1285 Corporate Center Drive Suite No. 175 Eagan, MN 55121	75,000 (5)	*
Mira LaCous 1285 Corporate Center Drive Suite No. 175 Eagan, MN 55121	219,166 (6)	1.7%
Barry M. Wendt c/o SAC Technologies, Inc. 1285 Corporate Center Drive	960,800	7.6%

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Richard T. Fiskum 28690 660th Avenue Litchfield, MN 55355	1,237,500	9.8%
N. Deanne Wittig and Richfield Bank & Trust Co., Co-Trustees under the Will dated October 23, 1998, The Qualified Property Marital Trust II (7) 10264 Scarborough Circle Bloomington, MN 55437	1,237,500	9.8%
All officers and directors as a group (5) persons	1,857,939	13.1%

*Less than 1%

(1) The securities "beneficially owned" by an individual are determined in accordance with the definition of "beneficial ownership" se