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BIO KEY INTERNATIONAL INC

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Date Filed: 2004-06-14

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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 8-K/A

Amendment No. 1

CURRENT REPORT

**PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

Date of Report (Date of earliest event reported):**March 30, 2004**

BIO-KEY INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Minnesota	**1-13463**	**41-1741861**
(State of incorporation or organization)	(Commission file number)	(I.R.S. employer identification no.)

1285 Corporate Center Drive, Suite #175
Eagan, MN 55121
(Address of principal executive office) (Zip code)

Registrant's telephone number, including area code:**(651) 687-0414**

Item 7. Financial Statements, Pro Forma Financial Information and Exhibits.

On March 30, 2004, BIO-key International, Inc. ("BIO-key") filed a Current Report on Form 8-K (the "Form 8-K") to report its acquisition of all of the outstanding capital stock of Public Safety Group, Inc. ("PSG"). BIO-key indicated that it would file certain financial information no later than June 14, 2004 and BIO-key hereby amends Item 7 of the Form 8-K to file such financial information.

(a) Financial Statements of PSG.

Included herein as Exhibit 99.1 to this Form 8-K are the audited balance sheets of PSG as of December 31, 2003 and 2002, and the statements of operations, stockholders' equity (deficit), and cash flows for the years ended December 31, 2003 and 2002, and the notes to these audited financial statements.

(b) Unaudited Pro Forma Financial Information.

The following documents of BIO-key appear as Exhibit 99.2 to this Form 8-K.

(i) Unaudited Pro Forma Condensed Consolidated Balance Sheet as of December 31, 2003;

(ii) Unaudited Pro Forma Condensed Consolidated Statement of Operations for the Year Ended December 31, 2003; and

(iii) Notes to the Unaudited Pro Forma Condensed Consolidated Financial Statements.

The unaudited pro forma condensed consolidated financial statements attached as Exhibit 99.2 to this Form 8-K are presented for illustrative purposes only and are not necessarily indicative of the consolidated financial position or results of operations for future periods or the financial position or results of operations that actually would have been realized had BIO-key and PSG been a combined company during the specified periods. The unaudited pro forma condensed consolidated financial statements, including the related notes, are qualified in their entirety by reference to, and should be read in conjunction with, the historical consolidated financial statements and related notes of BIO-key, included in its Form 10-KSB filed with the Securities and Exchange Commission on March 26, 2004 and the historical financial statements of PSG included herein as Exhibit 99.1.

The unaudited pro forma condensed consolidated financial statements give effect to BIO-key's acquisition of PSG using the purchase method of accounting. The pro forma condensed consolidated financial statements are based on the respective historical financial statements of BIO-key and PSG. The unaudited pro forma condensed consolidated financial information has been prepared on the basis of assumptions described in the notes to the unaudited pro forma condensed consolidated financial statements. In the opinion of management, all adjustments necessary to present fairly this unaudited pro forma condensed consolidated financial information have been made.

The Exhibit Index hereto is incorporated into this Item 7 by reference.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

BIO-KEY INTERNATIONAL, INC.

Date: June 14, 2004

By: /s/ MICHAEL W. DEPASQUALE

Michael W. DePasquale
Chief Executive Officer

Exhibit Index

Exhibit No.	Description
2.1*	Agreement and Plan of Merger dated as of March 30, 2004, by and among BIO-key, BIO-Key Acquisition Corp., PSG and all of the shareholders of PSG
99.1**	Audited Financial Statements of Public Safety Group, Inc. for the years ended December 31, 2003 and 2002.
99.2**	Unaudited Pro Forma Condensed Consolidated Financial Statements of BIO-key International, Inc.

* Previously filed as an exhibit to the Registrant's Form 8-K (File No. 1-13463) filed on April 14, 2004.

** Filed herewith.

QuickLinks

Item 7. Financial Statements, Pro Forma Financial Information and Exhibits.

SIGNATURE
Exhibit Index

Exhibit 99.1

Report of Independent Certified Public Accountants

To the Board of Directors and Stockholders of
Public Safety Group, Inc.

We have audited the accompanying balance sheets of Public Safety Group, Inc. as of December 31, 2003 and 2002, and the related statements of operations, stockholders' equity (deficit) and cash flows for each of the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Public Safety Group, Inc. as of December 31, 2003 and 2002, and the results of its operations and cash flows for each of the years then ended, in conformity with accounting principles generally accepted in the United States.

May 28, 2004
Minneapolis, Minnesota

Public Safety Group, Inc.

BALANCE SHEETS

	December 31,	
	2003	2002
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 12,628	$ 2,680
Accounts receivable	50,217	50
Advances to stockholders	233,184	136,623
Prepaid expenses	551	—
Total current assets	296,580	139,353
EQUIPMENT, FURNITURE AND FIXTURES—at cost, less accumulated depreciation	5,555	1,485
	$ 302,135	$ 140,838
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Notes payable	$ 503,836	$ 644,778
Accounts payable	77,823	85,356
Accrued liabilities	101,125	95,312
Deferred revenue	105,944	17,402
Total current liabilities	788,728	842,848
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY (DEFICIT)		
Common stock—authorized, 2,000,000 shares of $.01 par value; issued and outstanding 781,130 and 781,250 shares, respectively	7,811	7,813
Additional contributed capital	42,840	50,677
Accumulated deficit	(537,244)	(760,500)
	(486,593)	(702,010)
	$ 302,135	$ 140,838

The accompanying notes are an integral part of these financial statements.

Public Safety Group, Inc.

STATEMENTS OF OPERATIONS

	Years ended December 31,	
	2003	2002
Revenues		
License fees	$ 821,084	$ 220,308
Maintenance fees	114,577	15,904
Technical support and other services	—	13,750
	935,661	249,962
Costs and other expenses		
Selling and marketing expense	601,970	254,608
General and administrative expense	57,269	47,621
Research, development and engineering	3,024	4,194
	662,263	306,423
Operating profit (loss)	273,398	(56,461)
Other income (deductions)		
Interest expense	(50,244)	(61,846)
Sundry	102	669
	(50,142)	(61,177)
NET EARNINGS (LOSS)	$ 223,256	$ (117,638)

The accompanying notes are an integral part of these financial statements.

Public Safety Group, Inc.

STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)

Years ended December 31, 2003 and 2002

	Common Stock		Additional Contributed Capital	Accumulated Deficit	Total
	Shares	Amount			
Balance, December 31, 2001	1,000	$ 10	$ 990	$ (642,862)	$ (641,862)
Sale of common stock to officers, employees and consultants at $0.01 per share	749,000	7,490	—	—	7,490
Sale of common stock to an investor at $1.60 per share	31,250	313	49,687	—	50,000
Net loss	—	—	—	(117,638)	(117,638)
Balance, December 31, 2002	781,250	7,813	50,677	(760,500)	(702,010)
Common shares redeemed in exchange for forgiveness of advance to stockholder	(120)	(2)	(7,837)	—	(7,839)
Net earnings	—	—	—	223,256	223,256
Balance, December 31, 2003	781,130	$ 7,811	$ 42,840	$ (537,244)	$ (486,593)

The accompanying notes are an integral part of this statement.

Public Safety Group, Inc.

STATEMENTS OF CASH FLOWS

	Years ended December 31,	
	2003	2002
Cash flows from operating activities:		
Net earnings (loss)	$ 223,256	$ (117,638)
Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities:		
Depreciation	1,132	515
Common stock issued for services	—	525
Change in assets and liabilities:		
Accounts receivable	(50,167)	26,198
Prepaid expenses	(551)	2,470
Accounts payable	(7,533)	27,875
Accrued liabilities	5,813	17,630
Deferred revenue	88,542	16,471
Net cash provided by (used in) operating activities	260,492	(25,954)
Cash flows from investing activities:		
Capital expenditures	(5,202)	(1,251)
Cash flows from financing activities:		
Proceeds from note payable	—	40,000
Payments on notes payable	(140,942)	—
Advances to stockholders	(104,400)	(67,314)
Proceeds from issuance of common stock	—	56,965
Net cash provided by (used in) financing activities	(245,342)	29,651
NET INCREASE IN CASH AND CASH EQUIVALENTS	9,948	2,446
Cash and cash equivalents, beginning of year	2,680	234
Cash and cash equivalents, end of year	$ 12,628	$ 2,680

The accompanying notes are an integral part of these financial statements.

Public Safety Group, Inc.

NOTES TO FINANCIAL STATEMENTS

December 31, 2003 and 2002

NOTE A—THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Public Safety Group, Inc. (the Company) incorporated on March 1, 2000, with operations in Winter Park, Florida. The Company provides wireless solutions for the public safety industry, government agencies and the private sector. The Company's wireless solutions allow law enforcement officers to access State and Federal databases over a wireless network.

Summary of Significant Accounting Policies

A summary of the significant accounting policies consistently applied in the preparation of the accompanying financial statements follows:

1. Revenue Recognition

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

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

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

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

Maintenance Revenues: Amounts allocated to maintenance revenues are recognized ratably over the contract period. Maintenance contract periods range from nine months to twenty four months. Maintenance contracts provide customers technical assistance and support and new or revised versions of software.

Service Revenues: Revenues from services are comprised of consulting and implementation services. Services are generally separable from other elements under the arrangement since performance of the services is not essential to the functionality of any other element of the transaction. Revenues from services are generally recognized as the services are performed.

2. Cash and Cash Equivalents

Cash equivalents consist of certificates of deposit and all other liquid investments with original maturities of three months or less. The Company maintains its cash balances in a financial institution in Florida. These balances are insured by the Federal Deposit Insurance Corporation up to $100,000.

3. Accounts Receivable

Accounts receivable are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history, and current economic conditions. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received. At December 31, 2003 and 2002, the Company deemed all accounts receivable as collectible.

4. Equipment, Furniture and Fixtures

Equipment, furniture and fixtures are stated at cost. Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over their estimated services lives of three to seven years using the straight-line method. Equipment, furniture and fixtures consisted of the following as of December 31:

	2003	2002
Computer equipment	$ 4,225	$ 1,276
Computer software	3,222	1,187
Furniture	218	—
	7,665	2,463
Less: accumulated depreciation	(2,110)	(978)
	$ 5,555	$ 1,485

5. Advertising Expense

The company expenses the costs of advertising as incurred. Advertising expenses for the years ended December 31, 2003, and 2002, were approximately $3,750 and $1,350, respectively.

6. Research and Development Expenditures

All costs related to development of new products are charged to expense as incurred. Such costs are required to be expensed until technological feasibility and proven marketability of the product are established.

7. Income Taxes

The Company elected in March 2000, to be taxed under the provisions of Subchapter S of the Internal Revenue Code. Under those provisions, the Company does not pay federal corporate income

taxes on its taxable income. Instead, the stockholders are liable for individual federal income taxes on their respective shares of the Company's taxable income.

8. Accounting for Stock-Based Compensation

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

The Company has not adopted a method under SFAS No. 148 to expense stock options but rather continues to apply the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations in accounting for those plans. No stock-based employee compensation expense for options is reflected in net income for the fiscal years presented as all options granted under those plans had an exercise price equal to the market value of the underlying common stock at the date of grant. A pro forma effect table is presented in the Pro Forma Compensation Disclosure section of Note G, which assumes the fair value recognition provisions of SFAS No. 123 would have been adopted for all options granted.

9. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenues and expenses during the reporting period, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates. Significant estimates are made for such items as the valuation of stock options outstanding.

NOTE B—ADVANCES TO STOCKHOLDERS

Advances to stockholders are non-interest bearing receivables and are due on demand.

NOTE C—ACCRUED LIABILITIES

Accrued liabilities consisted of the following as of December 31:

	2003	2002
Interest	$ 89,364	$ 93,931
Other	11,761	1,381
	$ 101,125	$ 95,312

NOTE D—NOTES PAYABLE

Notes payable consisted of the following as of December 31:

	2003	2002
Note payable	$ 503,836	$ 604,778
Due to reseller	—	40,000
	$ 503,836	$ 644,778

The Company has a note payable with an investment firm. The loan had an original maturity date of June 1, 2003 and was extended by the Company until June 1, 2004, at which time the outstanding principal and all accrued interest is due and payable. Throughout the term of this agreement, the Company is required to make monthly principal payments equal to thirty percent of the Company's actual receipts from license fees during the preceding calendar month. The Company shall also pay all accrued interest on a monthly basis. The note is collateralized by certain personal and intangible property of the Company. Prior to the extension on June 1, 2003, interest accrued at the greater of 4% in excess of the rate established by Bank of America as its "prime rate" from time to time or 10% per annum. Subsequent to June 1, 2003, interest accrues at the rate of 2% in excess of the rate established by Bank of America as its "prime rate" from time to time.

In December 2002, the Company borrowed $40,000, from a reseller agent. The entire amount was repaid in March 2003, along with interest of $500, in full satisfaction of this obligation.

NOTE E—COMMITMENTS AND CONTINGENCIES

In June 2003, the Company was named as a defendant in a civil action initiated in the Superior Court Department in Hampden County, Commonwealth of Massachusetts by The Vince Group, Inc. (TVG). The case has since been removed to the United States District Court for the District of Massachusetts at the request of the Parties. The complaint claims that the Company is obligated to pay a percentage of certain of its revenues to TVG in consideration for a strategic business introduction allegedly made by an agent of TVG. The Company has denied the allegations and filed an answer in the litigation, and as of the date of this report the outcome of the litigation is pending. The claim is for an unspecified amount including actual damages, interest, and attorney's fees. Management believes that the claim is without merit and will be settled out of court for an amount that will not have a material adverse affect on the business, financial condition or operating results of the Company. The Merger Agreement (see Note J) provides that any liability or obligation generated by this litigation will be solely the responsibility of the former shareholders of PSG.

NOTE F—STOCKHOLDERS' DEFICIT

On September 29, 2003, the Company entered into a settlement agreement with a former employee under which the employee returned 120 shares of common stock outstanding in exchange for the Company's forgiveness of an outstanding employee advance of $7,839.

In January 2002, the Company sold 749,000 shares of common stock for $7,490 ($0.01 per share) to certain officers, employees and consultants of the Company. On February 20, 2002, the Company sold 31,250 shares of common stock to an unrelated party for $50,000 ($1.60 per share).

NOTE G—STOCK-BASED COMPENSATION

Under agreements entered into on June 20, 2003, the Company has granted options to purchase an aggregate of 600,000 shares of common stock to various key employees. These options have an exercise price of $1.60 per share, vested immediately upon grant and have a remaining life of approximately 4.5 years as of December 31, 2003. These options were canceled in connection with the subsequent acquisition of the Company as discussed in Note J.

Summary Option Information

The fair value of options granted to employees during 2003 was $1.14 per share. The fair value of each option is estimated as of the date granted using the Black-Scholes option-pricing model utilizing the same assumptions presented in the pro forma compensation disclosure section below.

Pro Forma Compensation Disclosure

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

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

If compensation expense for the stock options granted in 2003 had been determined based on the fair value at the grant date consistent with the method of SFAS No. 123, the Company's pro forma net loss and pro forma loss per share for the year ended December 31, 2003, would have been as follows:

Net earnings (loss)		
As reported	$	223,256
Pro forma	$	(460,744)

In determining the pro forma compensation cost of the options granted, the fair value of each grant was estimated on the date of grant using the Black-Scholes option-pricing model. The assumptions used to determine the fair value of each grant included the following:

Risk free interest rate	1.90%
Expected life of options (in years)	3
Expected dividends	—
Volatility of stock price	120%

NOTE H—FAIR VALUES OF FINANCIAL INSTRUMENTS

The Statement of Financial Accounting Standards Board No. 107 "Disclosures about Fair Value of Financial Instruments" (SFAS 107) requires disclosure of the estimated fair value of an entity's financial instruments. Such disclosures, which pertain to the Company's financial instruments, do not purport to represent the aggregate net fair value of the Company. At December 31, 2003 and 2002, the carrying value of all material financial instruments, for which it is practicable to estimate the fair value, approximated fair value because of the short maturity of those instruments and rates available for similar instruments.

NOTE I—SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION

	Years ended December 31,	
	2003	2002
Cash paid for:		
Interest	$ 54,810	$ 42,458
Non-cash transaction		
Redemption of common stock in exchange for forgiveness of advance to stockholder	$ 7,839	$ —

NOTE J—EVENTS OCCURRING SUBSEQUENT TO DECEMBER 31, 2003

On March 30, 2004, all of the outstanding capital stock of the Company was acquired by a wholly-owned subsidiary of BIO-key International, Inc. ("BIO-key") pursuant to an Agreement and Plan of Merger (the "Merger Agreement"). The shareholders of the Company received an aggregate of 2,416,108 shares of BIO-key common stock and $500,000 in cash. In addition, BIO-key assumed $600,000 in aggregate net liabilities of the Company. The Merger Agreement provides that any liability or obligation of the Company in excess of the $600,000 limitation will be solely the responsibility of the former shareholders of the Company. Additional earnout consideration may also be paid to the former shareholders of the Company based on the revenues attained by the Company during 2004 and 2005.

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Exhibit 99.2

BIO-key International, Inc.

INTRODUCTION TO UNAUDITED PRO FORMA FINANCIAL INFORMATION

We are providing the following unaudited pro forma condensed consolidated financial information of BIO-key International, Inc. (BIO-key) and its acquisition of Public Safety Group, Inc. (PSG) to present the results of operations and financial position of BIO-key had the merger been completed at an earlier date.

On March 30, 2004, (the Closing Date) BIO-key entered into and completed an Agreement and Plan of Merger (the Merger Agreement) to acquire all of the issued and outstanding common stock of PSG. PSG has operations in Winter Park, Florida and provides wireless solutions for the public safety industry, government agencies and the private sector. PSG's wireless solutions allow law enforcement officers to access State and Federal databases over a wireless network.

Pursuant to the Merger Agreement, the Company purchased all of the outstanding capital stock of PSG from the former shareholders of PSG in exchange for 2,416,108 shares, at $1.49 per share of our common stock issued to the former shareholders of PSG, 6,000 shares of our common stock issued to Harward Investments, Inc. (Harward) pursuant to an arrangement involving the discharge of certain outstanding debt obligations of PSG to Harward, $500,000 in cash, and the assumption of $600,000 in aggregate net liabilities of PSG. The Merger Agreement provides that any liability or obligation of PSG in excess of such $600,000 limitation will be solely the responsibility of the former shareholders of PSG. Additional earnout consideration, determined as a proportion of qualified revenues, as defined, attained by the Public Safety Division over fiscal years 2004 and 2005, may be paid to the former shareholders of PSG. During 2004, earnout consideration shall be earned at the following rates: Five percent (5%) of all 2004 Qualifying Revenue less than $2 million, less the Accounts Receivable Holdback; as defined; Ten percent (10%) of all 2004 Qualifying Revenue equal to or greater than $2 million but less than $4 million; Twenty percent (20%) of all 2004 Qualifying Revenue equal to or greater than $4 million but less than $7 million; and Thirty percent (30%) of all 2004 Qualifying Revenue equal to or greater than $7 million. During 2005, earnout consideration shall be earned at the following rates: Ten percent (10%) of all 2005 Qualifying Revenue equal to or greater than $7 million but less than $10 million; and Twenty percent (20%) of all 2005 Qualifying Revenue equal to or greater than $10 million. The Company will make payments of such additional consideration on the last day of the month following each month in which the Public Safety Division achieves specified revenue milestones during fiscal years 2004 and 2005. Such payments will be made in cash, unless the aggregate amount of earnout consideration exceeds sixty percent (60%) of the aggregate consideration paid by the Company in the merger transaction. Any such excess amounts will be paid in shares of common stock of the Company priced as of two (2) days prior to the date on which any earnout payment becomes due. In connection with this acquisition, three former employees of PSG, who were also shareholders of PSG, entered into two-year employment agreements with the Company to serve within the Public Safety Division.

The 2,416,108 shares issued to the former PSG shareholders (the Merger Shares) are subject to escrow provisions contained in the Merger Agreement and a related escrow agreement, which provide for periodic releases of the shares from escrow on a schedule determined primarily by the revenue achieved by the Public Safety Division during fiscal year 2004. The owners of such escrowed shares, however, will continue to enjoy all the rights and privileges attributable to the shares, including, without limitation, the right to vote and receive dividends. The principal terms of such escrow arrangement are as follows:

- One-twelfth ($^1/_{12}$) of the Merger Shares (the Initial Shares) are being held in escrow for the purpose of securing certain prior obligations of PSG to Harward and will be released upon the effectiveness of this registration statement to Harward and the former shareholders of PSG. Specifically, Harward will receive an amount of Initial Shares that is equal to $110,000 divided by the closing price of our common stock as reported by the OT Bulletin Board on such date.

The balance of the Initial Shares will be concurrently released to the former shareholders of PSG.

- An additional one-twelfth ($^{1}/_{12}$) of the Merger Shares will be released from the escrow to the former shareholders of PSG on each of June 30, 2004, September 30, 2004 and December 31, 2004.

- The remaining eight-twelfths ($^{8}/_{12}$) of the Merger Shares (the Remaining Shares) will be released from the escrow to the former shareholders of PSG based on a distribution schedule determined by the license, service and maintenance fee revenue achieved by the Public Safety Division during fiscal year 2004. Specifically, the Remaining Shares will be released according to the following schedule: (i) in the event that such qualifying revenue is less than $2 million, one-twelfth ($^{1}/_{12}$) of the Remaining Shares will be released on each of March 31, 2005, June 30, 2005, September 30, 2005, December 31, 2005, March 31, 2006, June 30, 2006, September 30, 2006, December 31, 2006, March 31, 2007, June 30, 2007, September 30, 2007 and December 31, 2007; (ii) in the event that such qualifying revenue is equal to or greater than $2 million, one-eighth ($^{1}/_{8}$) of the Remaining Shares will be released on each of March 31, 2005, June 30, 2005, September 30, 2005, December 31, 2005, March 31, 2006, June 30, 2006, September 30, 2006 and December 31, 2006 and (iii) in the event that such qualifying revenue is equal to or greater than $6 million, one-sixth ($^{1}/_{6}$) of the Remaining Shares will be released on each of March 31, 2005, June 30, 2005, September 30, 2005, December 31, 2005, March 31, 2006 and June 30, 2006.

- Of the shares remaining in escrow following the effectiveness of this registration statement, those shares owned by former employees of PSG who became employees of the Company by virtue of the merger transaction are subject to repurchase by the Company under certain circumstances involving the termination of such employee's employment. Shares remaining in escrow may also be used to fund indemnification obligations of the former PSG shareholders pursuant to the Merger Agreement.

The unaudited pro forma condensed consolidated balance sheet of the Company gives effect to the merger as if it had occurred on December 31, 2003 and the unaudited pro forma condensed consolidated statement of operations of the Company gives effect to the merger as if it had occurred on January 1, 2003 for the twelve months ended December 31, 2003.

The acquisition of PSG is accounted for under the purchase method of accounting in accordance with the Statement of Financial Accounting Standards No. 141, Business Combinations ("SFAS 141"). Under the purchase method of accounting, assets acquired and liabilities assumed are recorded at their estimated fair values. Goodwill and other finite intangible assets are created to the extent that the merger consideration, including certain acquisition and closing costs, exceeds the fair value of the net identifiable assets acquired at the date of the merger. Based on the preliminary information currently available, we expect to recognize goodwill and other finite intangible assets of approximately $4,600,000. Upon completion of a formal purchase price allocation there may be a decrease in the amount assigned to goodwill and a corresponding increase in tangible or other intangible assets.

This unaudited pro forma condensed consolidated financial information is based on the estimates and assumptions set forth herein and in the notes thereto. The unaudited pro forma results for the twelve months ended December 31, 2003 have been prepared utilizing (a) the audited financial statements of BIO-key included in Form 10-KSB for the fiscal year ended December 31, 2003; and (b) the audited financial statements of PSG for the twelve months ended December 31, 2003.

The following unaudited pro forma financial information is presented for informational purposes only and is not necessarily indicative of (i) the results of operations of the Company that actually would have occurred had the Merger Agreement been consummated on the dates indicated or (ii) the results

of operations of the Company that may occur or be attained in the future. The following information is qualified in its entirety by reference to and should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations," BIO-key's audited consolidated financial statements, including the notes thereto contained in its Annual Report on Form 10-KSB for the year ended December 31, 2003, PSG's audited financial statements, including the notes thereto, for the years ended December 31, 2003 and 2002, and other historical financial information appearing elsewhere herein.

BIO-key International, Inc. and Subsidiary

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED BALANCE SHEET

	December 31, 2003			
	BIO-key	PSG	Pro Forma Adjustments (Note 2)	Pro Forma Consolidated after PSG Acquisition
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	$ 1,012,790	$ 12,628	$(b)(500,000)	$ 125,418
			(e)(400,000)	
Accounts receivable	409,803	50,217		460,020
Advances to stockholder	—	233,184	(a)(233,184)	—
Inventory	65,857	—	—	65,857
Prepaid expenses	165,929	551	—	166,480
Total current assets	1,654,379	296,580	(1,133,184)	817,775
EQUIPMENT, FURNITURE AND FIXTURES—at cost, less accumulated depreciation	60,157	5,555	—	65,712
GOODWILL AND OTHER FINITE INTANGIBLE ASSETS	—	—	(c)4,595,533	4,595,533
OTHER ASSETS	150,206	—	—	150,206
	$ 1,864,742	$ 302,135	$3,462,349	$ 5,629,226
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)				
CURRENT LIABILITIES				
Note payable	$ —	$ 503,836	$(a)(103,836)	$ —
			(e)(400,000)	
Advances from stockholder	34,030	—	—	34,030
Accounts payable	351,742	77,823	(a)(39,984)	389,581
Accrued liabilities	173,736	101,125	(a)(89,364)	185,497
Deferred revenue	10,000	105,944	—	115,944
Total current liabilities	569,508	788,728	(633,184)	725,052
LONG-TERM OBLIGATIONS	10,431,223	—		10,431,223
STOCKHOLDERS' EQUITY (DEFICIT)				
Preferred stock—series B 9% Convertible	42	—	—	42
Common stock	212,229	7,811	(d)16,410	236,450
Additional contributed capital	18,327,992	42,840	(d)3,541,879	21,912,711
Accumulated deficit	(27,676,252)	(537,244)	(d)537,244	(27,676,252)
	(9,135,989)	(486,593)	4,095,533	(5,527,049)
	$ 1,864,742	$ 302,135	$3,462,349	$ 5,629,226

BIO-key International, Inc. and Subsidiary

UNAUDITED PRO FORMA CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS

	Year ended December 31, 2003			
	BIO-key	PSG	Pro Forma Adjustments (Note 3)	Pro Forma Consolidated after PSG Acquisition
Revenues				
Product sales	$ 102,007	$ —	$ —	$ 102,007
License fees	411,400	821,084	—	1,232,484
Maintenance fees	—	114,577	—	114,577
Technical support and other services	10,694	—	—	10,694
	524,101	935,661	—	1,459,762
Costs and other expenses				
Cost of product sales	87,387	—	—	87,387
Cost of technical support and other services	1,694	—	—	1,694
Selling, general and administrative	2,118,122	659,239	(a)411,600	3,188,961
Research, development and engineering	1,037,330	3,024	—	1,040,354
	3,244,533	662,263	411,600	4,318,396
Operating profit (loss)	(2,720,432)	273,398	(411,600)	(2,858,634)
Other income (deductions)				
Interest expense	(1,109,786)	(50,244)	(b)50,244	(1,109,786)
Sundry	4,145	102	—	4,247
	(1,105,641)	(50,142)	50,244	(1,105,539)
NET EARNINGS (LOSS)	$ (3,826,073)	$ 223,256	$ (361,356)	$ (3,964,173)
Basic and diluted earnings (loss) to common stockholders				
Net earnings (loss)	$ (3,826,073)	$ 223,256	$ (361,356)	$ (3,964,173)
Convertible preferred stock dividends and accretion	(136,755)	—	—	(136,755)
Earnings (loss) applicable to common stockholders	$ (3,962,828)	$ 223,256	$ (361,356)	$ (4,100,928)
Basic and diluted loss per common share				
Net loss	$ (.22)			$ (.20)
Convertible preferred stock dividend and accretion	(.01)			(.01)
Loss applicable per common share	$ (.23)			$ (.21)
Weighted average number of common shares outstanding	17,543,586			19,965,694

BIO-key International, Inc. and Subsidiary

NOTES TO UNAUDITED PRO FORMA CONDENSED CONSOLIDATED

FINANCIAL STATEMENTS

Year Ended December 31, 2003

Note 1.

BIO-key is a publicly held corporation whose newly formed subsidiary acquired all of the outstanding capital stock of PSG. For accounting purposes, this transaction has been treated as an acquisition with the net assets of the acquired company being stated at fair value in accordance with the purchase method of accounting.

Note 2.

The unaudited pro forma condensed consolidated balance sheet at December 31, 2003 presented herein has been prepared as if the merger of BIO-key and PSG had been consummated on December 31, 2003. Pro forma balance sheet adjustments have been made for the following:

(a) Prior to the acquisition, PSG used advances to shareholders to reduce outstanding debts.

(b) To record the cash consideration of $500,000 paid to the shareholders of PSG at the closing of the acquisition.

(c) To reflect the excess of acquisition cost over the estimated fair value of the net assets acquired (goodwill and other finite intangible assets). The allocation of the purchase price is based on financial information of PSG as of December 31, 2003. There might be further adjustments to the purchase price allocation upon finalization of financial information as of the date of the merger. However, we do not believe that the final purchase price allocation will have a material impact on our pro forma results of operations or financial position. The purchase price and purchase price allocation are summarized as follows:

Purchase price paid as:		
Cash consideration	$	500,000
Common stock issued		3,608,940
Total purchase price consideration		4,108,940
Allocated to:		
Historical net book value of PSG at December 31, 2003		(486,593)
Cost in excess of net assets acquired	$	4,595,533

(d) To reflect the elimination of the shareholders' equity accounts of PSG of ($486,593) and the issuance of BIO-key common stock. To effect the merger, BIO-key issued 2,422,108 shares of BIO-key common stock with a fair value of approximately $3,608,940, based on the closing price of its common stock on March 30, 2004 of $1.49 per share.

(e) Pursuant to the Merger Agreement, BIO-key agreed to pay off the remaining note payable balance of $400,000.

Note 3.

The unaudited pro forma condensed consolidated statements of operations for the twelve months ended December 31, 2003 presented herein has been prepared as if the merger of BIO-key and PSG

had been consummated as of January 1, 2003. Pro forma statement of operations adjustments for the twelve months ended December 31, 2003 have been made for the following:

(a) To record a full year of amortization for the fair value of finite intangible assets acquired related to the PSG acquisition, as if the acquisition had been consummated as of January 1, 2003. Accordingly, additional amortization of $411,600 is included as a pro forma adjustment.

(b) To eliminate interest expense recorded on the note payable that was paid off pursuant to the Merger Agreement, as if the acquisition had been consummated as of January 1, 2003. Accordingly, a reduction of interest expense of $50,244 is included as a pro forma adjustment.

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