

BIO KEY INTERNATIONAL INC  
Form S-1/A  
January 20, 2015

**As filed with the Securities and Exchange Commission on January 20, 2015**

**Registration No. 333-200887**

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

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**AMENDMENT NO. 2 TO**

**FORM S-1**

**REGISTRATION STATEMENT**

**UNDER THE SECURITIES ACT OF 1933**

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**BIO-KEY INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

Delaware	3576	41-1741861
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification No.)

3349 Highway 138, Building A, Suite E  
Wall, NJ 07719  
(732) 359-1100  
(Address, including zip code, and telephone number,

including area code, of registrant's principal executive offices)

Michael W. DePasquale  
Chief Executive Officer  
BIO-key International, Inc.  
3349 Highway 138, Building A, Suite E  
Wall, NJ 07719  
(732) 359-1100

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copy to:

Vincent A. Vietti  
Stephen R. Brill

Fox Rothschild LLP

997 Lenox Drive, Building 3

Lawrenceville, NJ 08648

(609) 896-3600

Approximate date of commencement of proposed sale to the public: As soon as practicable following the effectiveness of this Registration Statement.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer
  Accelerated filer  
 Non-accelerated filer (Do not check if a smaller reporting company)
  Smaller reporting company

#### CALCULATION OF REGISTRATION FEE

Title of Each Class of <u>Securities to be Registered</u>	Amount of Shares to be <u>Registered</u>	Proposed Maximum Offering <u>Price Per Share</u>	Proposed Maximum Aggregate <u>Offering Price</u>	Amount of <u>Registration Fee</u>
Common Stock	15,949,997	\$0.13 <sup>(1)</sup>	\$2,073,500	\$240.94
Shares of Common Stock Issuable Upon Exercise of Warrants <sup>(2)</sup>	11,962,499	\$0.15	\$1,794,375	\$208.50
Total	27,912,496		\$3,708,375	\$449.44 <sup>(3)</sup>

Estimated pursuant to Rule 457(c) for the purpose of calculating the registration fee based on the average of the <sup>(1)</sup>high and low prices per share of the registrant’s common stock as reported on the QB tier of the OTC Marketplace on December 11, 2014.

Represents shares of common stock issuable upon the exercise of warrants issued in a November 2014 private placement. Pursuant to Rule 416, there are also being registered such indeterminable additional securities as may be (2) issued to prevent dilution as a result of stock splits, stock dividends, or similar transactions (other than additional securities that may be issued due to “full ratchet” or related pricing protections). Proposed maximum offering price per share is based on the exercise price of the warrants in accordance with Rule 457(g).

(3) Previously paid.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. The selling security holders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

**SUBJECT TO COMPLETION, DATED JANUARY 20, 2015**

**PRELIMINARY PROSPECTUS**

27,912,496 shares of common stock

The 27,912,496 shares of our common stock, \$.0001 par value per share, are being offered by the selling security holders identified in this prospectus. The shares of common stock offered by the selling security holders consist of:

15,949,997 shares of common stock issued in our November 2014 private placement; and  
11,962,499 shares of common stock underlying warrants issued in our November 2014 private placement with an exercise price of \$0.15 per share, which expire five years after the date of grant.

The selling security holders may sell the shares covered by this prospectus through public or private transactions at prevailing market prices or at privately negotiated prices. We will not receive any part of the proceeds from sales of these shares by the selling security holders; however, we will receive proceeds upon any exercise of the warrants by the selling security holders.

In addition to the shares set forth above, our prospectus dated September 15, 2014 covers the public resale by the selling security holders identified therein of an additional 32,114,985 shares of our common stock issued by us in private placement transactions in 2013. These shares consist of 19,917,639 outstanding shares of common stock, 8,697,340 shares of common stock underlying warrants with an exercise price of \$0.25 per share which expire three years after the date of grant, and 3,500,006 shares of common stock underlying warrants with an exercise price of \$0.25 per share which expire five years from the date of grant. These shares may be publicly sold concurrently with sales of shares under this prospectus.

Our common stock trades on the QB tier of the OTC Marketplace (“OTCQB”) under the symbol “BKYL.” The closing price of our common stock on the OTCQB on January 16, 2015, was \$0.10 per share.

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**Investing in our common stock involves a high degree of risk. See “Risk Factors” beginning on page 2 of this prospectus.**

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is \_\_\_\_\_, 2015.

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**You should rely only on the information contained in or incorporated by reference into this prospectus. We have not authorized anyone to provide you with different information. We are not making an offer of these securities in any state where the offer is not permitted. You should not assume that the information provided in this prospectus is accurate as of any date other than the date on the front of this prospectus.**

(i)

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## PROSPECTUS SUMMARY

This summary highlights selected information contained elsewhere in this prospectus. This summary does not contain all of the information that you should consider before investing in the common stock. You should read carefully the entire prospectus, including “*Risk Factors*” and the financial statements and notes thereto, before making an investment decision.

Unless otherwise indicated or the context otherwise requires, all references to the “Company,” the “registrant” “we,” “us” or “our” and similar terms in this prospectus refer to BIO-key International, Inc. and its subsidiaries.

### **BIO-key International, Inc.**

We were founded in 1993 as a fingerprint biometric technology company. Biometric technology is the science of analyzing specific human characteristics which are unique to each individual in order to identify a specific person from a broader population.

We develop and market advanced fingerprint biometric identification and identity verification technologies, cryptographic authentication-transaction security technologies, as well as related identity management and credentialing software solutions. We were pioneers in developing automated, finger identification technology that supplements or compliments other methods of identification and verification, such as personal inspection identification, passwords, tokens, smart cards, ID cards, PKI, credit cards, passports, driver’s licenses, OTP or other form of possession or knowledge-based credentialing. Advanced BIO-key® technology has been and is used to improve both the accuracy and speed of competing finger-based biometrics.

In partnerships with OEMs, integrators, and solution providers, we provide biometric software solutions to private and public sector customers. We provide the ability to positively identify and authenticate individuals before granting access to valuable corporate resources, web portals or applications in seconds. Powered by our patented Vector Segment Technology™, or VST™, WEB-key® and BSP development kits are fingerprint biometric solutions that provide true interoperability with all major reader manufacturers, enabling application developers and integrators to seamlessly integrate fingerprint biometrics into their virtual applications.

We have developed what we believe is the most discriminating and effective commercially available finger-based biometric technology. Our primary focus is in marketing and selling this technology into commercial logical and physical privilege entitlement and access control markets. Our primary market focus includes mobile payments and

credentialing, online payments and credentialing, and healthcare record and payment data security, among other things. Our secondary focus includes government markets, primarily law enforcement forensic investigation, and the Department of Homeland Security.

We continue to research and develop advancements in our capabilities, as well as exploring and developing potential strategic relationships, including potential business combinations and acquisitions, which could help us leverage our capability to deliver our solutions. We have built a direct sales force of professionals and also team with resellers, integrators and partner networks with substantial experience in selling technology solutions to government and corporate customers.

Our principal executive offices are located at 3349 Highway 138, Building A, Suite E, Wall, NJ 07719, and our telephone number is (732) 359-1100. We maintain a website at [www.bio-key.com](http://www.bio-key.com). Information contained on our website does not constitute part of this prospectus.

## **The Offering**

This prospectus covers the public sale of 27,912,496 shares of common stock to be sold by the selling security holders identified in this prospectus, which consist of 15,949,997 shares of common stock and 11,962,499 shares issuable upon the exercise of warrants. We originally issued the shares of common stock and warrants to acquire 23,924,997 shares of common stock (including the 11,962,499 warrants set forth herein) in a private offering in November 2014 for gross cash consideration of \$1,595,000. We will not receive any proceeds from the sale of the common stock by the selling security holders. We will, however, receive proceeds from any exercise of the warrants held by the selling security holders. If such warrants are exercised in full (except on a cashless basis), we would receive gross cash proceeds of approximately \$1,794,375. Any such proceeds are currently expected to be used for working capital and general corporate purposes. No assurances can be given that any of the warrants will be exercised.

The selling security holders may sell the shares covered by this prospectus through public or private transactions at prevailing market prices or at privately negotiated prices. We will not receive any part of the proceeds from sales of these shares by the selling security holders.

## **RISK FACTORS**

*An investment in our common stock involves a high degree of risk. You should carefully consider the following risk factors in addition to other information in this prospectus before purchasing our common stock. The risks and uncertainties described below are those that we currently deem to be material and that we believe are specific to our company, our industry and our stock. In addition to these risks, our business may be subject to risks currently unknown to us. If any of these or other risks actually occurs, our business may be adversely affected, the trading price of our common stock may decline and you may lose all or part of your investment.*

### **Business and Financial Risks**

*Based on our lack of significant revenue and recurring losses from operations since inception, our auditors have included an explanatory paragraph in their opinion as to the substantial doubt about our ability to continue as a going concern.*

Due to, among other factors, our history of losses and limited revenue, our independent auditors have included an explanatory paragraph in their opinion for the year ended December 31, 2013 as to the substantial doubt about our ability to continue as a going concern. Our financial statements have been prepared in accordance with accounting

principles generally accepted in the United States, which contemplate that we will continue to operate as a going concern. Our financial statements do not contain any adjustments that might result if we are unable to continue as a going concern.

***Since our formation, we have historically generated minimal revenue and have sustained substantial operating losses which may continue.***

As of September 30, 2014, we had an accumulated deficit of approximately \$56 million. In order to increase revenue, we have developed a direct sales force and anticipate the need to retain additional sales, marketing and technical support personnel and may need to incur substantial expenses. We cannot assure you that we will be able to secure these necessary resources, that a significant market for our technologies will develop, or that we will be able to achieve our targeted revenue. If we are unable to achieve revenue or raise capital sufficient to cover our ongoing operating expenses, we will be required to scale back operations, including marketing and research initiatives, or in the extreme case, discontinue operations.

*Our biometric technology has yet to gain widespread market acceptance and we do not know whether a significant market will develop for our technology.*

Biometric technology has received only limited market acceptance, particularly in the private sector. Our technology represents a novel security solution and we have not yet generated significant sales. Although recent security concerns relating to identification of individuals and appearance of biometric readers on popular consumer products, including the Apple iPhone 5S®, have increased interest in biometrics generally, it remains an undeveloped, evolving market. Biometric based solutions compete with more traditional security methods including keys, cards, personal identification numbers and security personnel. Acceptance of biometrics as an alternative to such traditional methods depends upon a number of factors including:

national or international events which may affect the need for or interest in biometric solutions;

the performance and reliability of biometric solutions;

marketing efforts and publicity regarding these solutions;

public perception regarding privacy concerns;

costs involved in adopting and integrating biometric solutions;

proposed or enacted legislation related to privacy of information; and

competition from non-biometric technologies that provide more affordable, but less robust, authentication (such as tokens and smart cards).

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

*Biometric technology is a new approach to Internet security which must be accepted in order for our WEB-key® solution to generate significant revenue.*

Our WEB-key® authentication initiative represents a new approach to Internet security which has been adopted on a limited basis by companies which distribute goods, content or software applications over the Internet. The implementation of our WEB-key® solution requires the distribution and use of a finger scanning device and integration of database and server side software. Although we believe our solutions provide a higher level of security for information transmitted over the Internet than existing traditional methods, unless business and consumer markets embrace the use of a scanning device and believe the benefits of increased accuracy outweigh implementation costs, our solution will not gain market acceptance.

***The market for our solutions is still developing and if the biometrics industry adopts standards or a platform different from our standards or platform, our competitive position would be negatively affected.***

The market for identity solutions is still developing. The evolution of this market may result in the development of different technologies and industry standards that are not compatible with our current solutions, products or technologies. Several organizations set standards for biometrics to be used in identification and documentation. Although we believe that our biometric technologies comply with existing standards, these standards may change and any standards adopted could prove disadvantageous to or incompatible with the our business model and current or future solutions, products and services.

***Our software products may contain defects which will make it more difficult for us to establish and maintain customers.***

Although we have completed the development of our core biometric technology, it has only been used by a limited number of business customers. Despite extensive testing during development, our software may contain undetected design faults and software errors, or “bugs” that are discovered only after it has been installed and used by a greater number of customers. Any such defect or error in new or existing software or applications could cause delays in delivering our technology or require design modifications. These could adversely affect our competitive position and cause us to lose potential customers or opportunities. Since our technologies are intended to be utilized to secure physical and electronic access, the effect of any such bugs or delays will likely have a detrimental impact on us. In addition, given that biometric technology generally, and our biometric technology specifically, has yet to gain widespread acceptance in the market, any delays would likely have a more detrimental impact on our business than if we were a more established company.

***In order to generate revenue from our biometric products, we are dependent upon independent original equipment manufacturers, system integrators and application developers, which we do not control. As a result, it may be more difficult to generate sales.***

We market our technology through licensing arrangements with:

Original equipment manufacturers, system integrators and application developers which develop and market products and applications which can then be sold to end users; and

Companies which distribute goods, services or software applications over the Internet.

As a technology licensing company, our success will depend upon the ability of these manufacturers and developers to effectively integrate our technology into products and services which they market and sell. We have no control over these licensees and cannot assure you that they have the financial, marketing or technical resources to successfully develop and distribute products or applications acceptable to end users or generate any meaningful revenue for us. These third parties may also offer the products of our competitors to end users. While we have commenced a significant sales and marketing effort, we have only begun to develop a significant distribution channel and may not have the resources or ability to sustain these efforts or generate any meaningful sales.

***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 are widely adopted, it would significantly reduce the potential market for our fingerprint identification technology.

***We depend on key employees and members of our management team, including our Chairman of the Board and Chief Executive Officer, in order to achieve our goals. We cannot assure you that we will be able to retain or***

*attract such persons.*

Our employment contracts with Michael W. DePasquale, our Chairman of the Board and Chief Executive Officer, and Mira LaCous, our Chief Technology Officer, expire in each year, and renew automatically for successive one year periods unless notice of non-renewal is provided by the Company. Although the contracts do not prevent them from resigning, they do contain confidentiality and non-compete clauses which are intended to prevent them from working for a competitor within one year after leaving our Company. Our success depends on our ability to attract, train and retain employees with expertise in developing, marketing and selling software solutions. In order to successfully market our technology, we will need to retain additional engineering, technical support and marketing personnel. The market for such persons remains highly competitive and our limited financial resources will make it more difficult for us to recruit and retain qualified persons.

***We cannot assure you that the intellectual property protection for our core technology provides a sustainable 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. The U.S. Patent and Trademark Office has issued us a series of patents for our Vector Segment fingerprint technology (VST), and our other core biometric analysis and identification technologies. However, we cannot assure you that we will be able to adequately protect our technology or other intellectual property from misappropriation in the U.S. and abroad. Any patent issued to us could be challenged, invalidated or circumvented or rights granted thereunder may not provide a competitive advantage to us. Furthermore, patent applications that we file may not result in issuance of a patent or, if a patent is issued, the patent may not be issued in a form that is advantageous to us. Despite our efforts to protect our intellectual property rights, others may independently develop similar products, duplicate our products or design around our patents and other rights. In addition, it is difficult to monitor compliance with, and enforce, our intellectual property rights on a worldwide basis in a cost-effective manner. In jurisdictions where foreign laws provide less intellectual property protection than afforded in the U.S. and abroad, our technology or other intellectual property may be compromised, and our business would be materially adversely affected. If any of our proprietary rights are misappropriated or we are forced to defend our intellectual property rights, we will have to incur substantial costs. Such litigation could result in substantial costs and diversion of our resources, including diverting the time and effort of our senior management, and could disrupt our business, as well as have a material adverse effect on our business, prospects, financial condition and results of operations. We can provide no assurance that we will have the financial resources to oppose any actual or threatened infringement by any third party. Furthermore, any patent or copyrights that we may be granted may be held by a court to infringe on the intellectual property rights of others and subject us to the payment of damage awards.



***We may be subject to claims with respect to the infringement of intellectual property rights of others, which could result in substantial costs and diversion of our financial and management resources.***

Third parties may claim that we are infringing on their intellectual property rights. We may violate the rights of others without our knowledge. We may expose ourselves to additional liability if we agree to indemnify our customers against third party infringement claims. While we know of no basis for any claims of this type, the existence of and ownership of intellectual property can be difficult to verify and we have not made an exhaustive search of all patent filings. Additionally, most patent applications are kept confidential for twelve to eighteen months, or longer, and we would not be aware of potentially conflicting claims that they make. We may become subject to legal proceedings and claims from time to time relating to the intellectual property of others in the ordinary course of our business. If we are found to have violated the intellectual property rights of others, we may be enjoined from using such intellectual property, and we may incur licensing fees or be forced to develop alternative technology or obtain other licenses. In addition, we may incur substantial expenses in defending against these third party infringement claims and be diverted from devoting time to our business and operational issues, regardless of the merits of any such claim.

In addition, in the event that we recruit employees from other technology companies, including certain potential competitors, and these employees are used in the development of portions of products which are similar to the development in which they were involved at their former employers, we may become subject to claims that such employees have improperly used or disclosed trade secrets or other proprietary information. If any such claims were to arise in the future, litigation or other dispute resolution procedures might be necessary to retain our ability to offer our current and future services, which could result in substantial costs and diversion of our financial and management resources. Successful infringement or licensing claims against us may result in substantial monetary damages, which may materially disrupt the conduct of our business and have a material adverse effect on our reputation, business, financial condition and results of operations. Even if intellectual property claims brought against us are without merit, they could result in costly and time consuming litigation, and may divert our management and key personnel from operating our business.

***If we are unable to effectively protect our intellectual property rights on a worldwide basis, we may not be successful in the international expansion of our business.***

Access to worldwide markets depends in part on the strength of our intellectual property portfolio. There can be no assurance that, as our business expands into new areas, we will be able to independently develop the technology, software or know-how necessary to conduct our business or that we can do so without infringing the intellectual property rights of others. To the extent that we have to rely on licensed technology from others, there can be no assurance that we will be able to obtain licenses at all or on terms we consider reasonable. The lack of a necessary license could expose us to claims for damages and/or injunction from third parties, as well as claims for indemnification by our customers in instances where we have a contractual or other legal obligation to indemnify them against damages resulting from infringement claims. With regard to our own intellectual property, we actively enforce and protect our rights. However, there can be no assurance that our efforts will be adequate to prevent the misappropriation or improper use of our protected technology in international markets.

***We face inherent product liability or other liability risks that could result in large claims against us.***

We have inherent risk of exposure to product liability and other liability claims resulting from the use of our products, especially to the extent customers may depend on our products in public safety situations that may involve physical harm or even death to individuals, as well as exposure to potential loss or damage to property. Despite quality control systems and inspection, there remains an ever-present risk of an accident resulting from a faulty manufacture or maintenance of products, or an act of an agent outside of our or our supplier's control. Even if our products perform properly, we may become subject to claims and costly litigation due to the catastrophic nature of the potential injury and loss. A product liability claim, or other legal claims based on theories including personal injury or wrongful death, made against us could adversely affect operations and financial condition. Although we may have insurance to cover product liability claims, the amount of coverage may not be sufficient.

***We expect that we will need to obtain additional financing to execute our business plan over the long-term, which may not be available. If we are unable to raise additional capital or generate significant revenue, we may not be able to continue operations.***

Since our inception, we have not generated sufficient recurring revenue and have experienced substantial losses. During 2014, we raised additional capital before expenses of approximately \$1,595,000 from certain private investors through sales of our equity securities. We do not believe that we have sufficient cash resources to fund operations for at least the next twelve months. If we are unable to generate sufficient revenue to cover operating expenses and fund our business plan, we will need to obtain additional third-party financing to (i) conduct the sales, marketing and technical support necessary to execute our plan to substantially grow operations, increase revenue and serve a significant customer base; and (ii) provide working capital. We may, therefore, need to obtain additional financing through the issuance of debt or equity securities. We cannot assure you that we will be able to secure any such additional financing on terms acceptable to us or at all. If we cannot obtain such financing, we will not be able to execute our business plan, will be required to reduce operating expenses, and in the extreme case, discontinue operations.

***We may not achieve sustainable profitability with respect to the biometric component of our business if we are unable to maintain, improve and develop the wireless data services we offer.***

We believe that our future business prospects depend in part on our ability to maintain and improve our current services and to develop new ones on a timely basis. Our services will have to achieve market acceptance, maintain technological competitiveness, and meet an expanding range of customer requirements. As a result of the complexities inherent in our service offerings, major new wireless data services and service enhancements require long development and testing periods. We may experience difficulties that could delay or prevent the successful development, introduction or marketing of new services and service enhancements. Additionally, our new services and service enhancements may not achieve market acceptance. If we cannot effectively develop and improve services, we may not be able to recover our fixed costs or otherwise become profitable.

***If we fail to adequately manage our resources, it could have a severely negative impact on our financial results.***

We could be subject to fluctuations in technology spending by existing and potential customers. Accordingly, we will have to actively manage expenses in a rapidly changing economic environment. This could require reducing costs during economic downturns and selectively growing in periods of economic expansion. If we do not properly manage our resources in response to these conditions, our results of operations could be negatively impacted.

***Our business could be negatively impacted by security threats, including cybersecurity threats, and other disruptions.***

As a technology company, we face various security threats, including cybersecurity threats to gain unauthorized access to sensitive information. Although we utilize various procedures and controls to monitor these threats and mitigate our exposure to such threats, there can be no assurance that these procedures and controls will be sufficient in preventing security threats from materializing. If any of these events were to materialize, they could lead to losses of sensitive information, critical infrastructure, personnel or capabilities, essential to our operations and could have a material adverse effect on our reputation, financial position, results of operations, or cash flows.

Cybersecurity attacks in particular are evolving and include but are not limited to, malicious software, attempts to gain unauthorized access to data, and other electronic security breaches that could lead to disruptions in critical systems, unauthorized release of confidential or otherwise protected information and corruption of data. These events could damage our reputation and lead to financial losses from remedial actions, loss of business or potential liability.

## **Risks Related To Our Common Stock**

*We have issued a substantial number of securities that are convertible into shares of our common stock which could result in substantial dilution to the ownership interests of our existing stockholders.*

As of the date of this prospectus, approximately 35,142,904 shares of our common stock were reserved for issuance upon exercise or conversion of the following securities:

35,013,904 shares upon exercise of outstanding stock options and warrants; and

129,000 shares upon exercise of options available for future grant under our existing option plans.

In addition, we will reserve an additional 11,962,498 shares of common stock issuable upon the exercise of warrants upon the completion of a reverse split of our common stock or an increase in the number of authorized shares of our common stock. 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 stockholders.

*The availability of a substantial number of shares of our common stock for public sale may cause the price of our common stock to decline.*

This prospectus covers the public resale of 27,912,496 shares of our common stock, including 11,962,499 shares issuable upon exercise of warrants exercisable at \$0.15 per share. In addition, our prospectus dated September 15, 2014 covers the public resale of 32,114,985 shares of our common stock, including 12,197,346 shares issuable upon exercise of warrants exercisable at \$0.25 per share. As a result, our stockholders will be offering 60,027,481 shares of common stock to the public which represent approximately 45% of our outstanding shares. The availability of these shares for sale to the public, whether or not sales have occurred or are occurring, and the sale of such shares in the public markets could have an adverse effect on the market price of our common stock. Such an adverse effect on the market price would make it more difficult for us to raise additional financing through the sale of equity or equity-related securities in the future at a time and price that we deem reasonable or appropriate.

*Applicable SEC Rules governing the trading of “penny stocks” limits the trading and liquidity of our common stock, which may adversely affect the trading price of our common stock and the ability to sell our shares.*

Our common stock currently trades on the OTCQB. Since our common stock continues to trade below \$5.00 per share, our common stock is considered a “penny stock” and is subject to SEC rules and regulations, which impose limitations upon the manner in which our shares can be publicly traded. These regulations require the delivery, prior to any transaction involving a penny stock, of a disclosure schedule explaining the penny stock market and the associated risks. Under these regulations, certain brokers who recommend such securities to persons other than established customers or certain accredited investors must make a special written suitability determination regarding such a purchaser and receive such purchaser’s written agreement to a transaction prior to sale. These regulations have the effect of limiting the trading activity of our common stock and reducing the liquidity of an investment in our common stock.

***We intend to raise additional funds in the future through issuances of securities and such additional funding may be dilutive to stockholders or impose operational restrictions.***

We expect that we will need to raise additional capital in the future to help fund our operations through sales of shares of our common stock or securities convertible into shares of our common stock, as well as issuances of debt. Such additional financing may be dilutive to our stockholders, and debt financing, if available, and may involve restrictive covenants which may limit our operating flexibility. If additional capital is raised through the issuance of shares of our common stock or securities convertible into shares of our common stock, the percentage ownership of existing stockholders will be reduced. These stockholders may experience additional dilution in net book value per share and any additional equity securities may have rights, preferences and privileges senior to those of the holders of our common stock.

***Because we do not expect to pay dividends for the foreseeable future, investors seeking cash dividends should not purchase shares of common stock.***

We have never declared or paid any cash dividends on our common stock. We currently intend to retain future earnings, if any, to finance the expansion of our business. As a result, we do not anticipate paying any cash dividends in the foreseeable future. Our payment of any future dividends will be at the discretion of our board of directors after taking into account various factors, including but not limited to our financial condition, operating results, cash needs, growth plans and the terms of any credit agreements that we may be a party to at the time. Accordingly, investors seeking cash dividends should not purchase our shares.

***Provisions of our certificate of incorporation, bylaws and Delaware law may make a contested takeover of our Company more difficult.***

Certain provisions of our certificate of incorporation, bylaws and the General Corporation Law of the State of Delaware (“DGCL”) could deter a change in our management or render more difficult an attempt to obtain control of us, even if such a proposal is favored by a majority of our stockholders. For example, we are subject to the provisions of the DGCL that prohibit a public Delaware corporation from engaging in a broad range of business combinations

with a person who, together with affiliates and associates, owns 15% or more of the corporation's outstanding voting shares (an "interested stockholder") for three years after the person became an interested stockholder, unless the business combination is approved in a prescribed manner. Our certificate of incorporation also includes undesignated preferred stock, which may enable our board of directors to discourage an attempt to obtain control of us by means of a tender offer, proxy contest, merger or otherwise. Finally, our bylaws include an advance notice procedure for stockholders to nominate directors or submit proposals at a stockholders meeting. Delaware law and our charter may, therefore, inhibit a takeover.

*The trading price of our common stock may be volatile.*

The trading price of our shares has from time to time fluctuated widely and in the future may be subject to similar fluctuations. The trading price may be affected by a number of factors including the risk factors set forth in this prospectus as well as our operating results, financial condition, announcements of innovations or new products by us or our competitors, general conditions in the biometrics and access control industries, and other events or factors. We cannot assure you that any of the broker-dealers that currently make a market in our common stock 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.

## **DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS**

The information contained in this prospectus contains certain forward-looking statements. All statements other than statements of historical facts contained or incorporated by reference in this prospectus, including statements regarding our future financial position, business strategy and plans and objectives of management for future operations, are forward-looking statements. The words “anticipate,” “believe,” “estimate,” “will,” “may,” “future,” “plan,” “intend” and “expect” and similar expressions generally identify forward-looking statements. These forward-looking statements are not guarantees and are subject to known and unknown risks, uncertainties and assumptions that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. Although we believe that our plans, intentions and expectations reflected in the forward-looking statements are reasonable, we cannot be sure that they will be achieved. Particular uncertainties that could cause our actual results to be materially different than those expressed in our forward-looking statements include: our history of losses and limited revenue; our ability to raise additional capital; our ability to protect our intellectual property; changes in business conditions; changes in our sales strategy and product development plans; changes in the marketplace; continued services of our executive management team; security breaches; competition between us and other companies in the biometric technology industry; market acceptance of biometric products generally and our products under development; delays in the development of products, and statements of assumption underlying any of the foregoing, as well as other factors set forth under the caption “**Risk Factors**” on page 2 of this prospectus. All subsequent written and oral forward-looking statements attributable to us, or persons acting on our behalf, are expressly qualified in their entirety by the foregoing. Except as required by law, we undertake no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise.

## **MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**



*This Management's Discussion and Analysis of Financial Condition and Results of Operations, and other parts of this prospectus contain forward-looking statements that involve risks and uncertainties. All forward-looking statements included in this prospectus are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of a number of factors, including those set forth in the section captioned "Risk Factors" on page 2 of this prospectus. The following should be read in conjunction with our audited financial statements included elsewhere herein.*

## **OVERVIEW**

We develop and market advanced fingerprint biometric identification and identity verification technologies, cryptographic authentication-transaction security technologies, as well as related identity management and credentialing software solutions. We were pioneers in developing automated, finger identification technology that supplements or complements other methods of identification and verification, such as personal inspection identification, passwords, tokens, smart cards, ID cards, PKI, credit cards, passports, driver's licenses, OTP or other form of possession or knowledge-based credentialing. Advanced BIO-key® technology has been and is used to improve both the accuracy and speed of competing finger-based biometrics.

In partnerships with OEMs, integrators, and solution providers, we provide biometric software solutions to private and public sector customers. We provide the ability to positively identify and authenticate individuals before granting access to valuable corporate resources, web portals or applications in seconds. Powered by our patented Vector Segment Technology™ or VST™, WEB-key® and BSP development kits are fingerprint biometric solutions that provide interoperability with all major reader manufacturers, enabling application developers and integrators to integrate fingerprint biometrics into their applications.

We have developed what we believe is the most discriminating and effective commercially available finger-based biometric technology. Our primary focus is in marketing and selling this technology into commercial logical and physical privilege entitlement & access control markets. Our primary market focus includes, among others, mobile payments & credentialing, online payments and credentialing, and healthcare record and payment data security. Our secondary focus includes government markets, primarily law enforcement forensic investigation and Homeland Security.

## **STRATEGIC OUTLOOK AND RECENT DEVELOPMENTS**

Historically, our largest market has been access control within highly regulated industries such as healthcare. However, we believe the mass adoption of advanced smart-phone and hand-held wireless devices have caused commercial demand for advanced user authentication to emerge as viable. The introduction of smart-phone capabilities, like mobile payments and credentialing, could effectively require biometric user authentication on mobile devices to reduce risks of identity theft, payment fraud and other forms of fraud in the mobile or cellular based world wide web. As more services and payment functionalities, such as mobile wallets and near field communication (NFC), migrate to smart-phones, the value and potential risk associated with such systems should grow and drive demand and adoption of advanced user authentication technologies, including fingerprint biometrics and BIO-key solutions.

In October 2013, Apple Computer Corporation released the Apple iPhone 5s smartphone (“5s”). We believe the 5s to be the first broadly distributed smartphone to incorporate fingerprint biometrics in the phone. Since that time, HTC Corporation has also released a fingerprint biometric enabled smartphone. We believe other smartphone, tablet, laptop and related smart-device manufacturers will additionally make fingerprint-enabled smart devices available for consumer applications. As devices with onboard fingerprint sensors continue to deploy to consumers, we expect that third party application developers will demand the ability to authenticate users of their respective applications (app’s) with the onboard fingerprint biometric. We further believe that authentication will occur on the device itself for potentially low-value, and therefore low-risk, use-transactions and that user authentication for high-value transactions will migrate to the application provider’s authentication server, typically located within their supporting technology infrastructure, or cloud. We have developed our technology to enable, on-device authentication as well as network or cloud-based authentication and believe we may be the only technology vendor capable of providing this flexibility and capability.

We believe there is potential for significant market growth in three key areas:

corporate network access control, including corporate campuses, computer networks and applications;

consumer mobile credentialing, including mobile payments, credit and payment card programs, data and application access, and commercial loyalty programs; and.

government services and highly regulated industries, including Medicare, Medicaid, Social Security, drivers licenses, campus and school ID, passports/visas.

In the near-term, we expect to grow our business within government services and highly-regulated industries in which we have historically had a strong presence, such as the healthcare industry. We believe that continued heightened security and privacy requirements in these industries will generate increased demand for security solutions, including biometrics.

Over the longer term, we intend to expand our business into the cloud and mobile computing industries. The emergence of cloud computing and mobile computing are primary drivers of commercial and consumer adoption of advanced authentication applications, including biometric and BIO-key authentication capabilities. As the value of assets, services and transactions increases on such networks, we expect that security and user authentication demand should rise proportionately. Our integration partners include major web and network technology providers, who we believe will deliver our cloud-applicable solutions to interested service-providers. These service-providers could include, but are not limited to, financial institutions, web-service providers, consumer payment service providers, credit reporting services, consumer data service providers, healthcare providers and others. Additionally, our integration partners include major technology component providers and OEM manufacturers, who we believe will deliver our device-applicable solutions to interested hardware manufacturers. Such manufacturers could include cellular handset and smartphone manufacturers, tablet manufacturer

## RESULTS OF OPERATIONS

### Three Months Ended September 30, 2014 as compared to September 30, 2013

#### Consolidated Results of Operations - Percent Trend

	<b>Three Months Ended</b>			
	<b>September 30,</b>			
	<b>2014</b>	<b>2013</b>		
<b>Revenues</b>				
Services	39 %	57 %		
License fees and other	61 %	43 %		
	100 %	100 %		
<b>Costs and other expenses</b>				
Cost of services	11 %	11 %		
Cost of license fees and other	8 %	13 %		
	19 %	24 %		
Gross Profit	81 %	76 %		
<b>Operating expenses</b>				
Selling, general and administrative	77 %	172 %		
Research, development and engineering	25 %	82 %		
	102 %	254 %		
<b>Operating loss</b>	-21 %	-177 %		

**Other deductions**

Total other deductions	17 %	-4 %
<b>Net loss</b>	-4 %	-181 %

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**Three months ended****September 30,**

	<b>2014</b>	<b>2013</b>	<b>\$ Change</b>	<b>% Change</b>	
<i>Revenues</i>					
Service	\$496,127	\$246,760	\$249,367	101	%
License & other	787,720	184,816	602,904	326	%
<i>Total Revenue</i>	\$1,283,847	\$431,576	\$852,271	197	%
<i>Cost of goods sold</i>					
Service	\$144,224	\$47,531	\$96,693	203	%
License & other	99,730	55,439	44,291	80	%
<i>Total COGS</i>	\$243,954	\$102,970	\$140,984	137	%

***Revenues***

For the three months ended September 30, 2014 and 2013, service revenues included approximately \$179,000 and \$153,000, respectively, of recurring maintenance and support revenue, and approximately \$317,000 and \$93,000 of non-recurring custom services revenue, respectively. Recurring service revenue increased 17% during the current period as a few slow paying customers paid to renew their maintenance agreements. The non-recurring custom services increased 241% due to a customer project that we expect to continue through the balance of 2014.

License and other revenue (comprised of third party hardware and royalties) increased during the three months ended September 30, 2014. The increase consisted of an approximate \$553,000 or 767% increase in our core software, a \$50,000 or 55% increase in third party hardware sales, and equal royalty revenue quarter over quarter. Royalty income during the three months ended September 30, 2014 was derived from an OEM agreement.

***Costs of goods sold***

During the three months ended September 30, 2014, cost of services increased approximately \$97,000 from the corresponding period in 2013 due to increased associated requirements for non-recurring custom services revenue.

License and other costs for the three months ended September 30, 2014 increased \$44,000 from the corresponding period in 2013 due to an increase in hardware orders and associated costs.

*Selling, general and administrative*

	<b>Three months ended</b>			
	<b>September 30,</b>			
	<b>2014</b>	<b>2013</b>	<b>\$ Change</b>	<b>% Change</b>
<b>Selling, general and administrative</b>	\$989,521	\$740,725	\$248,796	34 %

Selling, general and administrative expenses increased 34% during the three months ended September 30, 2014 from the corresponding period in 2013. Increases consisted of increased trade show attendance fees, travel, commissions related to increased sales, and new personnel costs.

*Research, development and engineering*

	<b>Three months ended</b>			
	<b>September 30,</b>		<b>\$</b>	<b>%</b>
	<b>2014</b>	<b>2013</b>	<b>Change</b>	<b>Change</b>
<b>Research, development and engineering</b>	\$324,992	\$353,583	\$(28,591)	-8 %

During the three months ended September 30, 2014, research, development and engineering costs increased 20% over the corresponding period in 2013, as we engaged temporary outside services and hired additional personnel for specific projects. Some of the projects were paid for by a third party and, therefore, the associated costs were reclassified resulting in a decrease in research, development and engineering costs of 8%.

*Other income and expense*

	<b>Three months ended</b>			
	<b>September 30,</b>		<b>\$</b>	<b>%</b>
	<b>2014</b>	<b>2013</b>	<b>Change</b>	<b>Change</b>
<b>Interest income (expense)</b>	2	(13,942)	13,944	-100 %
<b>Gain on derivative liabilities</b>	223,892	-	223,892	n/a
<b>Income taxes</b>	(800 )	(2,910 )	2,110	-73 %
<b>Total</b>	\$223,094	(16,852)	\$239,946	-1,424 %

Interest income for the quarter ended September 30, 2014 consisted of bank interest. Interest expense during 2013 was comprised of accrued interest on outstanding promissory notes issued in 2010 and 2013 which we repaid in 2013, and the amortized portion of the deferred financing costs associated with notes we issued in 2013.



During the fourth quarter of 2013, we issued various warrants that contained derivative liabilities. Such derivative liabilities are required to be marked-to-market each reporting period.

**Nine Months Ended September 30, 2014 as compared to September 30, 2013**

Consolidated Results of Operations - Percent Trend

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>
<b>Revenues</b>		
Services	34 %	47 %
License fees and other	66 %	53 %
	100 %	100 %
<b>Costs and other expenses</b>		
Cost of services	10 %	7 %
Cost of license fees and other	7 %	12 %
	17 %	19 %
Gross Profit	83 %	81 %
<b>Operating expenses</b>		
Selling, general and administrative	90 %	124 %
Research, development and engineering	42 %	54 %
	132 %	178 %
<b>Operating loss</b>	-49 %	-97 %
<b>Other deductions</b>		
Total other deductions	4 %	-2 %
<b>Net Income (loss)</b>	-45 %	-99 %

	<b>Nine months ended</b>			
	<b>September 30,</b>			
	<b>2014</b>	<b>2013</b>	<b>\$ Change</b>	<b>% Change</b>
<i>Revenues</i>				
Service	\$1,027,069	\$781,172	\$245,897	31 %
License & other	2,027,089	877,304	1,149,785	131 %
<i>Total Revenue</i>	\$3,054,158	\$1,658,476	\$1,395,682	84 %

*Cost of goods sold*

Service	\$ 296,504	\$ 116,395	\$ 180,109	155	%
License & other	225,925	199,353	26,572	13	%
<i>Total COGS</i>	\$ 522,429	\$ 315,748	\$ 206,681	65	%

***Revenues***

For the nine months ended September 30, 2014 and 2013, service revenues included approximately \$472,000 and \$505,000, respectively, of recurring maintenance and support revenue, and approximately \$555,000 and \$276,000, respectively, of non-recurring custom services revenue. Recurring service revenue decreased 7% from 2013 to 2014 as some customers have been slow to renew existing maintenance agreements. The non-recurring custom services increased 101% due to a customer project that we expect to continue through the balance of 2014.

For the nine months ended September 30, 2014 and 2013, license and other revenue (comprised of third party hardware and royalty) increased approximately 131% as a result of several contributing factors. Software license revenue increased approximately \$1,158,000 or 251% as a result of licenses purchased for both new and existing customers. We also shipped orders from a new partner NEXT Biometrics for continued expansion of biometric ID deployments with commercial partners LexisNexis, Educational Biometric Technology, and Identimetrics, and continued expansion of our footprint in the healthcare market. Third-party hardware sales increased by approximately \$24,000 or 7%, as a result smaller healthcare deployments. Finally, royalty income from an OEM agreement decreased 35% to approximately \$62,000 from \$94,000 during the corresponding period in 2013 due to a cancelled international contract.

### *Costs of goods sold*

For the nine months ended September 30, 2014, cost of service increased approximately \$180,000 from the corresponding period in 2013 primarily as a result of costs associated with non-recurring custom services revenue. License and other costs for the nine months ended September 30, 2014 increased approximately \$27,000 from the corresponding period in 2013, due to the increase in third party hardware revenue.

### *Selling, general and administrative*

	<b>Nine months ended</b>			
	<b>September 30,</b>			
	<b>2014</b>	<b>2013</b>	<b>\$ Change</b>	<b>% Change</b>
<b>Selling, general and administrative</b>	\$2,741,665	\$2,054,110	\$687,555	33 %

Selling, general and administrative expenses for the nine months ended September 30, 2014 increased 33% from the corresponding period in 2013. Increases included sales and marketing personnel and recruiting costs, commissions and channel marketing expense due to increased revenue, trade show attendance, travel, factoring fees, and non-cash compensation.

### *Research, development and engineering*

#### **Nine months ended**

	September 30,				
	2014	2013	\$	%	
			Change	Change	
<b>Research, development and engineering</b>	\$1,282,536	\$902,558	\$379,978	42	%

During the nine months ended September 30, 2014, research, development and engineering costs increased 42% from the corresponding period in 2013, as we engaged temporary outside services and hired additional personnel for specific projects. Some of the projects were paid for by a third party and, therefore, the associated costs were reclassified and are not included in the 42% increase.

*Other income and expense*

	Nine months ended			
	September 30,		\$ Change	% Change
	2014	2013		
<b>Interest income (expense)</b>	5	(36,113)	36,118	-100 %
<b>Gain on derivative liabilities</b>	117,153	-	117,153	n/a
<b>Income taxes</b>	(1,712 )	(2,910 )	1,198	-41 %
<b>Total</b>	\$115,446	\$(39,023)	\$154,469	-396 %

Interest income for the period ended September 30, 2014 consisted of bank interest. Interest expense during 2013 was comprised of accrued interest on outstanding promissory notes issued in 2010 and 2013 which we repaid in 2013, and the amortized portion of the deferred financing costs associated with notes we issued in 2013.

During the fourth quarter of 2013, we issued various warrants that contained derivative liabilities. Such derivative liabilities are required to be marked-to-market each reporting period.

**Year Ended December 31, 2013, compared to the Year Ended December 31, 2012**Percent Trend

	Years ended			
	December 31, 2013		2012	
<b>Revenues</b>				
Services	50 %	29 %		
License fees and other	50 %	71 %		

	100 %	100 %
<b>Costs and other expenses</b>		
Cost of services	7 %	6 %
Cost of license fees and other	12 %	9 %
	19 %	15 %
Gross Profit	81 %	85 %
<b>Operating expenses</b>		
Selling, general and administrative	139 %	59 %
Research, development and engineering	68 %	25 %
	207 %	84 %
<b>Operating income (loss)</b>	-127 %	1 %
<b>Other income (deductions)</b>		
Total other income (deductions)	-3 %	-1 %
<b>Net income (loss)</b>	-130 %	0 %

***Revenues and Costs of goods sold***

			<b>2013 - 2012</b>	
	<b>2013</b>	<b>2012</b>	<b>\$ Chg</b>	<b>% Chg</b>
<i>Revenues</i>				
Service	\$988,003	\$1,094,731	\$(106,728 )	-10 %
License & other	997,973	2,741,162	(1,743,189)	-64 %
<i>Total Revenue</i>	\$1,985,976	\$3,835,893	\$(1,849,917)	-48 %
<i>Cost of goods sold</i>				
Service	\$145,702	\$221,027	\$(75,325 )	-34 %
License & other	241,326	350,706	(109,380 )	-31 %
<i>Total COGS</i>	\$387,028	\$571,733	\$(184,705 )	-32 %

**Revenues**

For the years ended December 31, 2013 and 2012, service revenues included approximately \$326,000 and \$407,000, respectively, of non-recurring maintenance and support revenue, and approximately \$662,000 and \$688,000, respectively, of recurring custom services revenue. Recurring service revenue decreased 4% from 2012 to 2013 increasing as we continued to bundle maintenance agreements to our expanding customer license base, offset by the delay in a large deployment renewal.

For the years ended December 31, 2013 and 2012, license and other revenue (comprised of third party hardware and royalty) decreased approximately 64% as a result of several contributing factors. Software license revenue decreased approximately \$1,589,000 or 76%. During the years ended December 31, 2013 and 2012, we shipped orders from McKesson for their continued deployment of our identification technology in their AccuDose® product line, and for continued expansion of biometric ID deployments with commercial partners LexisNexis, Educational Biometric Technology, and Identimetrix. Third-party hardware sales decreased by approximately \$153,000 (28%), as a result smaller healthcare industry deployments. Royalty income, from an OEM agreement, for the year ended December 31, 2013, decreased 1% to approximately \$115,000 from \$116,000 during the corresponding period in 2012.

**Costs of goods sold**



For the year ended December 31, 2013, cost of service decreased approximately \$75,000 primarily as a result of costs associated with non-recurring custom services revenue. License and other costs for the year ended December 31, 2013 decreased approximately \$109,000 due to the decrease in third party hardware revenue.

**Selling, general and administrative**

2013	2012	2013 - 2012	
		\$ Chg	% Chg
<b>Total</b>	\$2,776,559	\$2,288,903	\$487,656 21 %

Selling, general and administrative expenses for the year ended December 31, 2013 increased 21% from the corresponding period in 2012. Increases included, sales and marketing personnel, channel marketing expense, and the comparative reversal of the allowance for doubtful accounts of approximately \$377,000 in 2012 as the result of a payment received on an overdue contract. The forgoing increases were offset by a decrease in commissions related to reduced revenue, and reduced legal fees due to the settlement of the Blue Spike litigation in 2012.

**Research, development and engineering**

2013	2012	2013 - 2012	
		\$ Chg	% Chg
<b>Total</b>	\$1,344,070	\$947,371	\$396,699 42 %

For the year ended December 31, 2013, research, development and engineering costs increased 42% as we engaged temporary outside services and hired additional personnel for specific projects.

**Other income and expense**

	2013	2012	2013 - 2012	
			\$ Chg	% Chg
Interest income	\$7	\$7	\$—	— %
Interest expense	(136,484)	(24,626)	(111,858)	454 %
Income tax	(2,805 )	—	(2,805 )	n/a
Gain on derivative liabilities	78,812	—	78,812	n/a
	\$(60,470 )	\$(24,619)	\$(35,851 )	146 %

The interest expense for the fiscal year ended 2013 was attributable to the related party note payable and the InterDigital Note, both of which were repaid in full during the year. Interest expense in 2013 also includes the amortization of deferred costs with respect to the issuance of the InterDigital Note in February 2013 in the amount of \$107,203. As the note and all accumulated interest payable were repaid by the Company in November 2013, the remaining deferred cost balance was expensed at that time. Interest expense for the 2012 period related solely to the related party note payable.

In 2013, the Company issued various equity securities that contained derivative liabilities. Such derivative liabilities are required to be marked-to-market each reporting period.

**LIQUIDITY AND CAPITAL RESOURCES**

*Cash Flow from Operating Activities*

*Nine Months Ended September 30, 2014*

Net cash used for operations during the nine months ended September 30, 2014 was approximately \$1,700,000. The cash used in operating activities was primarily attributable to the following items:

Positive cash flows related to adjustments to depreciation, amortization, share-based compensation and fair value adjustments of approximately \$210,000; and

Negative cash flows related to an increase in accounts receivable and due from factor and a decrease in accounts payable, net of an increase in accrued expenses of approximately \$306,000, due to working capital management.

*Year Ended December 31, 2013*

Net cash used for operations during the year ended December 31, 2013 was approximately \$2,684,000. The cash used in operating activities was primarily attributable to the following items:

Positive cash flows related to a decrease in accounts receivable of approximately \$321,000 due to a large payment outstanding in 2012 of approximately \$293,000 being paid in the second quarter and approximately \$187,000 in payments received from factored receivables, less an overadvance repayment of approximately \$49,000;

Negative cash flows related to a decrease in accounts payable and accrued expenses of approximately \$736,000 due to working capital management, and an increase in prepaid expenses of approximately \$48,000 due to prepaid trade shows, insurance and software licensing; and

We recorded approximately \$82,000 of charges in 2013 for the expense of issuing options to employees for services.

***Cash Flow from Investing Activities***

*Nine Months Ended September 30, 2014*

Net cash used for investing activities during the nine months ended September 30, 2014 was approximately \$9,000 and related to capital expenditures.

*Year Ended December 31, 2013*

Net cash used for investing activities during the year ended December 31, 2013 was approximately \$129,000 and were due to the purchase of capital expenditures

***Cash Flow from Financing Activities***

*Nine Months Ended September 30, 2014*

Net cash used for financing activities during the nine months ended September 30, 2014 was \$150,000 and consisted of the repurchase of a warrant.

*Year Ended December 31, 2013*

Net cash provided by financing activities during the year ended December 31, 2013 was approximately \$4,753,000 and attributable primarily to the following activities:

Positive cash flows from the issuance of shares of common stock and warrants of approximately \$5,650,000, and from the issuance of the InterDigital Note in the principal amount of \$497,307.

Negative cash flows of approximately \$321,000 from the repayment of the related party note payable, \$497,307 from the repayment of the InterDigital Note, and approximately \$576,000 for the one time transaction costs associated with the stock issuances and the issuance of the InterDigital Note.

## **Capital Resources**

Since our inception, our capital needs have been principally met through proceeds from the sale of equity and debt securities. We expect capital expenditures to be less than \$100,000 during the next twelve months. We do not currently maintain a line of credit or term loan with any commercial bank or other financial institution.

The following sets forth our primary sources of capital during recent years:

Effective December 31, 2010, Thomas Colatosti (“Colatosti”), our Chairman of the Board agreed to exchange all of his outstanding shares of Series D Convertible Preferred Stock, including all accrued and unpaid dividends thereon, and the 7% Convertible Promissory Note dated as of December 28, 2009 in the original principal amount of \$64,878, for a new non-convertible 7% Secured Promissory Note in the original principal amount of \$350,804 (the “Colatosti Note”). In February 2013, the principal balance and accrued interest owing under the Colatosti Note was repaid in full from the proceeds of the financing with InterDigital described below.



As of December 2011, we entered into a 24-month accounts receivable factoring arrangement with a financial institution (the “Factor”). Pursuant to the terms of this arrangement, from time to time, we sell to the Factor certain of our accounts receivable balances on a non-recourse basis for credit approved accounts. The Factor remits 75% of the accounts receivable balance to us (the “Advance Amount”), with the remaining balance, less fees payable by us, once the Factor collects the full accounts receivable balance from the customer. Factoring fees range from 2.75% to 15% of the face value of the invoice factored and are determined by the number of days required for collection of the invoice. In April 2012, the terms were updated from monthly to quarterly, and the 24-month arrangement was extended to August 1, 2014. In August of 2014, the 24-month arrangement was renewed with lower quarterly factoring obligations by the Company. We expect to continue to use this factoring arrangement periodically to assist with our general working capital requirements due to contractual requirements.

On February 26, 2013, we issued a promissory note in the principal amount of \$497,307 (the “InterDigital Note”) to DRNC Holdings, Inc. (“DRNC”). The InterDigital Note accrues interest at a rate of 7% per annum, with a default rate of 9% per annum while a nonpayment default is continuing, matures on December 31, 2015, is secured by all of our tangible and intangible assets, and is subject to acceleration upon an event of default. A portion of the proceeds from the sale of the InterDigital Note was used to repay the Colatosti Note in full, and the remaining proceeds were used for general corporate purposes. On November 22, 2013, we repaid in full the \$497,307 balance due under the InterDigital Note. In connection with the repayment, DRNC's security interest in all of our tangible and intangible assets was terminated.

On February 26, 2013, we issued 4,026,935 shares of common stock to DRNC for an aggregate purchase price of \$402,693.

On February 26, 2013, we also issued 5,000,000 shares of common stock to a limited number of investors for an aggregate purchase price of \$500,000.

On July 23, 2013, we issued units to certain investors consisting of 3,500,006 shares of our common stock and warrants to purchase an additional 3,500,006 shares of our common stock at a purchase price \$0.30 per unit, for an aggregate purchase price of \$1,050,000. The warrants are exercisable at \$0.40 per share and expire five years after the date of the grant. On December 2, 2013, we agreed to reduce the exercise price of the warrants to \$0.25 per share.

On October 25 and November 8, 2013, we issued an aggregate of 24,647,337 units consisting of 24,647,337 shares of common stock and warrants to purchase an additional 24,647,337 shares of common stock at a purchase price \$0.15 per unit for an aggregate purchase price of \$3,697,100 prior to a deduction for placement agent fees and expenses. The warrants are exercisable at \$0.25 per share and expire three years after the date of the grant.

In November 2014, we issued an aggregate of 15,949,997 shares of our common stock and warrants to purchase an additional 23,924,997 shares of common stock for an aggregate purchase price of \$1,595,000 prior to a deduction for expenses. The warrants have a term of five years and an exercise price of \$0.15 per share. Warrants to purchase 11,962,499 shares of common stock are immediately exercisable, and the remaining warrants to purchase 11,962,498 shares of common stock will become exercisable upon the completion of a 1-for-2 reverse split of our common stock, or such other action that provides us with additional authorized and unissued shares of common stock sufficient to reserve for the issuance of the remaining shares underlying the warrants. If within 90 days of the closing there are not sufficient shares available and reserved for the exercise of all of the warrants, we are required to issue to each investor additional warrants to purchase 0.25 shares for each share purchased by such investor in the offering. If within 180 days of the closing there are not sufficient shares reserved for exercise of all of the warrants, the exercise price of the warrants will be automatically reduced to 2/3 of the exercise price in effect immediately prior to such reduction. The foregoing issuance and exercise price adjustments will only be made for investors that voted in favor of any action proposed to our stockholders that, if adopted, would have provided us with sufficient authorized and unissued shares to reserve for the exercise of all of the warrants.

## **Liquidity Outlook**

As of the date of this prospectus, our total cash and cash equivalents were approximately \$1,244,000, as compared to approximately \$2,023,000 at December 31, 2013.



As discussed above, we have historically financed our operations through access to the capital markets by issuing secured and convertible debt securities, convertible preferred stock, common stock, and recently through factoring receivables. We currently require approximately \$475,000 per month to conduct our operations, a monthly amount that we have been unable to consistently achieve through revenue generation. We do not expect to incur any material capital expenditures during the next 12 months. During the first nine months of 2014, we generated approximately \$3,054,000 of revenue, which is below our average monthly requirements. As a result, we do not expect that our available cash resources will be sufficient to fund our operations for the next 12 months.

If we are unable to generate sufficient revenue to fund current operations or meet our goals, we will need to obtain additional third-party financing to (i) conduct the sales, marketing and technical support necessary to execute our plan to substantially grow operations, increase revenue and serve a significant customer base; and (ii) provide working capital. We will, therefore, need to obtain additional financing through the issuance of debt or equity securities. No assurance can be given that any form of additional financing will be available on terms acceptable to us, that adequate financing will be obtained by us, or that such financing would not be dilutive to existing shareholders.

Due to several factors, including our history of losses and limited revenue, our independent auditors have included an explanatory paragraph in their opinion related to our annual financial statements as to the substantial doubt about our ability to continue as a going concern. Our long-term viability and growth will depend upon the successful commercialization of our technologies and our ability to obtain adequate financing. To the extent that we require such additional financing, no assurance can be given that any form of additional financing will be available on terms acceptable to us, that adequate financing will be obtained to meet our needs, or that such financing would not be dilutive to existing stockholders. If available financing is insufficient or unavailable or we fail to continue to generate sufficient revenue, we may be required to further reduce operating expenses, delay the expansion of operations, be unable to pursue merger or acquisition candidates, or continue as a going concern.

#### **OFF-BALANCE SHEET ARRANGEMENTS**

We do not have any off-balance sheet arrangements that have, or are in the opinion of management reasonably likely to have, a current or future effect on our financial condition or results of operations.

#### **CRITICAL ACCOUNTING POLICIES**

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. We base our estimates on

historical experience and on various other assumptions that we believe to be reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Our actual results may differ significantly from these estimates under different assumptions or conditions. There have been no material changes to these estimates for the periods presented in this Annual Report on Form 10-K.

We believe that of our significant accounting policies, which are described in Note A of the notes to our consolidated financial statements included in this Annual Report on Form 10-K, the following accounting policies involve a greater degree of judgment and complexity. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our financial condition and results of operations.

### *1. Revenue Recognition*

Revenues from software licensing are recognized in accordance with ASC 985-605, "Software Revenue Recognition. Accordingly, revenue from software licensing is recognized when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is probable.

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

*Multiple-Element Arrangements:* For multiple-element arrangements, we apply the residual method in accordance with ASC 985-605. The residual method requires that the portion of the total arrangement fee attributable to the undelivered elements be deferred based on its VSOE of fair value and subsequently recognized as the service is delivered. The difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements, which is generally the software license. VSOE of fair value for all elements in an arrangement is based upon the normal pricing for those products and services when sold separately. VSOE of fair value for support services is additionally determined by the renewal rate in customer contracts. The Company has established VSOE of fair value for support as well as consulting services.

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

Revenue from licensing software, which requires significant customization and modification, is recognized using the percentage of completion method, based on the hours of effort incurred by us in relation to the total estimated hours to complete. In instances where third party hardware, software or services form a significant portion of a customer's contract, we recognize revenue for the element of software customization by the percentage of completion method described above. Otherwise, third party hardware, software, and services are recognized upon shipment or acceptance as appropriate. If we make different judgments or utilize different estimates of the total amount of work expected to be required to customize or modify the software, the timing and revenue recognition, from period to period, and the margins on the project in the reporting period, may differ materially from amounts reported. Anticipated contract losses are recognized as soon as they become known and are estimable.

*Service Revenues:* Revenues from services are comprised of maintenance and consulting and implementation services. Maintenance revenues include providing for unspecified when-and-if available product updates and customer telephone support services, and are recognized ratably over the term of the service period. Consulting services are generally sold on a time-and-materials basis and include a range of services including installation of software and assisting in the design of interfaces to allow the software to operate in customized environments. Services are generally separable from other elements under the arrangement since performance of the services are not essential to the functionality of any other element of the transaction and are described in the contract such that the total price of the arrangement would be expected to vary as the result of the inclusion or exclusion of the services. Revenues from services are generally recognized as the services are performed.

We provide customers, free of charge or at a minimal cost, testing kits which potential licensing customers may use to test compatibility/acceptance of our technology with the customer's intended applications.

*Costs and other expenses:* Includes professional compensation and other direct contract expenses, as well as costs attributable to the support of client service professional staff, depreciation and amortization costs related to assets used in revenue-generating activities, and other costs attributable to serving our client base. Professional compensation consists of payroll costs and related benefits including stock-based compensation and bonuses. Other direct contract expenses include costs directly attributable to client engagements, such as out-of-pocket costs including travel and subsistence for client service professional staff, costs of hardware and software and costs of subcontractors. The allocation of lease and facilities charges for occupied offices is included in costs of service.

We account for our warranties under the FASB ASC 450 "Contingencies." We generally warrants that our products are free from defects in material and workmanship for a period of one year from the date of initial delivery to our customers. The warranty does not cover any losses or damage that occurs as a result of improper installation, misuse or neglect or repair or modification by anyone other than us or our authorized repair agent. Our policy is to accrue

anticipated warranty costs based upon historical percentages of items returned for repair within one year of the initial sale. Our repair rate of products under warranty has been minimal, and a historical percentage has not been established. Our software license agreements generally include certain provisions for indemnifying customers against liabilities if our software products infringe upon a third party's intellectual property rights. We have not provided for any reserves for warranty liabilities as it was determined to be immaterial.

*2. Impairment or Disposal of Long Lived Assets, including Intangible Assets*

We review our long-lived assets, including intangible assets subject to amortization, whenever events or changes in circumstances indicate that the carrying amount of such an asset may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amount to the future undiscounted cash flows the assets are expected to generate. If such assets are considered impaired, the impairment to be recognized is equal to the amount by which the carrying value of the assets exceeds their fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique. In assessing recoverability, we must make assumptions regarding estimated future cash flows and discount factors. If these estimates or related assumptions change in the future, we may be required to record impairment charges. Intangible assets with determinable lives are amortized over their estimated useful lives, based upon the pattern in which the expected benefits will be realized, or on a straight-line basis, whichever is greater. We did not record any impairment charges in any of the years presented.

### *3. Research and Development Expenditures*

Research and development expenses include costs directly attributable to the conduct of research and development programs primarily related to the development of our software products and improving the efficiency and capabilities of our existing software. Such costs include salaries, payroll taxes, employee benefit costs, materials, supplies, depreciation on research equipment, services provided by outside contractors, and the allocable portions of facility costs, such as rent, utilities, insurance, repairs and maintenance, depreciation and general support services. All costs associated with research and development are expensed as incurred.

### *4. Income Taxes*

The provision for, or benefit from, income taxes includes deferred taxes resulting from the temporary differences in income for financial and tax purposes using the liability method. Such temporary differences result primarily from the differences in the carrying value of assets and liabilities. Future realization of deferred income tax assets requires sufficient taxable income within the carryback, carryforward period available under tax law. We evaluate, on a quarterly basis whether, based on all available evidence, if it is probable that the deferred income tax assets are realizable. Valuation allowances are established when it is more likely than not that the tax benefit of the deferred tax asset will not be realized. The evaluation, as prescribed by ASC 740-10, "Income Taxes," includes the consideration of all available evidence, both positive and negative, regarding historical operating results including recent years with reported losses, the estimated timing of future reversals of existing taxable temporary differences, estimated future taxable income exclusive of reversing temporary differences and carryforwards, and potential tax planning strategies which may be employed to prevent an operating loss or tax credit carryforward from expiring unused. Because of our historical performance and estimated future taxable income a full valuation allowance has been established.

### *5. Accounting for Stock-Based Compensation*

We account for share based compensation in accordance with the provisions of ASC 718-10, "Compensation — Stock Compensation," which requires measurement of compensation cost for all stock awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest. The majority of our share-based compensation arrangements vest over either a three or four year vesting schedule. We expense our share-based compensation under the ratable method, which treats each vesting tranche as if it were an individual grant. The fair value of stock options is determined using the Black-Scholes valuation model, and requires the input of highly subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them (the "expected option term"), the estimated volatility of our common stock price over the option's expected term, the risk-free interest rate over the option's expected term, and the Company's expected annual dividend yield. Changes in these subjective assumptions can materially affect the estimate of fair value of stock-based compensation and consequently, the related amount recognized as an expense in the consolidated statements of operations. As required under the accounting rules, we review our valuation assumptions at each grant

date and, as a result, are likely to change our valuation assumptions used to value employee stock-based awards granted in future periods. The values derived from using the Black-Scholes model are recognized as expense over the service period, net of estimated forfeitures (the number of individuals that will ultimately not complete their vesting requirements). The estimation of stock awards that will ultimately vest requires significant judgment. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results, and future changes in estimates, may differ substantially from our current estimates.

## **RECENT ACCOUNTING PRONOUNCEMENTS**

Effective January 1, 2014, the Company adopted Accounting Standards Update (“ASU”) No. 2013-11, “Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists” (“ASU 2013-11”). ASU 2013-11 is expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The amendments in this update should be applied prospectively for annual and interim periods beginning after December 15, 2013. The adoption of ASU 2013-11 did not have a material effect on its consolidated financial statements.

In May 2014, ASU No. 2014-09, “Revenue from Contracts with Customers” was issued. The comprehensive new standard will supersede existing revenue recognition guidance and require revenue to be recognized when promised goods or services are transferred to customers in amounts that reflect the consideration to which the Company expects to be entitled in exchange for those goods or services. The guidance will also require that certain contract costs incurred to obtain or fulfill a contract, such as sales commissions, be capitalized as an asset and amortized as revenue is recognized. Adoption of the new rules could affect the timing of both revenue recognition and the incurrence of contract costs for certain transactions. The guidance permits two implementation approaches, one requiring retrospective application of the new standard with restatement of prior years and one requiring prospective application of the new standard with disclosure of results under old standards. The new standard is effective for reporting periods beginning after December 15, 2016 and early adoption is not permitted. For us, the new standard will be effective January 1, 2017. We are currently evaluating the impact of adoption and the implementation approach to be used.

In June 2014, ASU 2014-12, “Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period” (“ASU No. 2014-12”) was issued. ASU No. 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period is treated as a performance condition. An entity should recognize compensation cost in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. ASU 2014-12 becomes effective for interim and annual periods beginning on or after December 15, 2015. Early adoption is permitted. We are currently evaluating the effects of adopting ASU 2014-12 on its consolidated financial statements but the adoption is not expected to have a significant impact on our consolidated financial statements.

In June 2014, ASU 2014-15, “Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern” (“ASU No. 2014-15”) was issued. Before the issuance of ASU 2014-15, there was no guidance in U.S. GAAP about management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern or to provide related footnote disclosures. This guidance is expected to reduce the diversity in the timing and content of footnote disclosures. ASU 2014-15 requires management to assess an entity’s ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards as specified in the guidance. ASU 2014-15 becomes effective for the annual period ending after December 15, 2016 and for annual and interim periods thereafter. Early adoption is permitted. We are currently evaluating the effects of adopting ASU 2014-15 on its consolidated financial statements but the adoption is not expected to have a significant impact on our consolidated financial statements.

Management does not believe that any other recently issued, but not yet effective, accounting standard if currently adopted would have a material effect on the accompanying consolidated financial statements.

## **BUSINESS**

### **Overview**

We were founded in 1993 to develop and market advanced fingerprint biometric technology and related security software solutions. First incorporated as BBG Engineering, we were renamed SAC Technologies in 1994 and, again, renamed BIO-key International, Inc. in 2002.

We develop and market advanced fingerprint biometric identification and identity verification technologies, cryptographic authentication-transaction security technologies, as well as related identity management and credentialing software solutions. We were pioneers in developing automated, finger identification technology that supplements or compliments other methods of identification and verification, such as personal inspection identification, passwords, tokens, smart cards, ID cards, PKI, credit cards, passports, driver's licenses, OTP or other form of possession or knowledge-based credentialing. Additionally, advanced BIO-key® technology has been and is used to improve both the accuracy and speed of competing finger-based biometrics.



We have developed what we believe is the most discriminating and effective commercially available finger-based biometric technology. Our primary focus is in marketing and selling this technology into commercial logical and physical privilege entitlement and access control markets. Example primary markets include mobile payments & credentialing, online payments and credentialing, and healthcare record and payment data security, among others. Our secondary focus includes government markets, primarily law enforcement forensic investigation and the Department of Homeland Security. We continue to research and develop advancements in our capabilities, as well as exploring and developing potential strategic relationships, including potential business combinations and acquisitions, which could help us leverage our capability to deliver our solutions. We have built a direct sales force of professionals, and also team with resellers, integrators and partner networks with substantial experience in selling technology solutions to government and corporate customers.

## **Products**

### *Finger-based Biometric Identification and Personal Identity Verification*

We are a leader in finger-based biometric identification and personal identity verification, as well as authentication-transaction security. Stand-alone, or in partnerships with OEMs, integrators, and solution providers, we provide biometric software solutions and authentication-transaction security solutions to private and public sector customers. We help customers reduce risk by providing the ability to control access to facilities and services, in either the logical or physical domain. Our capabilities positively identify individuals and verify, or confirm, their identity before granting access to valuable corporate resources, privileged or subscribed data and services, web portals, applications, physical locations or assets, among other things. Our capabilities are software based and both hardware and operating-system agnostic.

We do not develop, manufacture or produce hardware components that are used in conjunction with our software. However, we do sell third-party hardware components with our software in various configurations required by our customers, as do our partners. Our products are interoperable with all major fingerprint reader and hardware manufacturers, enabling application developers, Value Added Resellers (“VARs”) and channel partners to integrate our fingerprint biometrics into their application, while dramatically reducing maintenance, upgrade and life-cycle costs. Our core technology supports interoperability on over 60 different commercially available fingerprint readers. The technology is also interoperable across Windows and Linux, as well as Apple iOS and Android mobile operating systems. This interoperability is unique in the industry and a key differentiator for our products in the biometric market and, in our opinion, makes our technology more viable than competing technologies and expands the size of the overall market for our products.

Our biometric identification technology improves both the accuracy and speed of screening individuals, for identification purposes or for personal identity verification, by extracting unique data from a fingerprint and comparing it to existing similar fingerprint data. These comparisons are conducted to identify an individual, either in a

forensic investigation, or to screen the individual upon the application for a privilege, or to verify the individual's identity upon such individuals request to access the previously entitled privilege. The technology has been built to be completely scalable and can handle databases containing millions of fingerprints. We achieve the highest levels of discrimination without requiring any other identifying data (multi-factor) such as a user ID, smart ID cards, or tokens, although our technology can be used in conjunction with such additional factors.

We support industry standards, such as BioAPI, and have received National Institute of Standards and Technology independent laboratory certification of our ability to support Homeland Security Presidential Directive #12 (HSPD-12) and ANSI/INCITS-378 templates, as well as validation of our fingerprint match speed and accuracy in large database environments.

Our finger identification algorithm—Vector Segment Technology (VST™) is the core intellectual property behind our full suite of biometric products that include:

Vector Segment Technology SDK (VST)—Our biometric software development kit (“SDK”) that provides developers the ability to incorporate our biometric capabilities into their respective product offerings or infrastructure. VST is available as a low level SDK for incorporation into any application architecture to increase security while not sacrificing convenience. VST runs on Windows and Linux as well as within WEB-key on iOS and Android systems.

Intelligent Image Indexing®—Our biometric identification solution that offers both large-scale one-to-many user identification. This solution enables customers to perform false alias and fast entry checks, including preventing fraudulent access to systems and privileges. Intelligent Image Indexing scales identification capabilities from thousands to millions of users. The solution runs on commercially available hardware making it scalable for any size system.

Biometric Service Provider—We provide support for the BioAPI (a standards-based solution meeting worldwide needs) for a compliant interface to applications using biometrics for verification and identification. We enhance the traditional use of BioAPI by adding 64-bit support and other advanced features, supporting identification calls and also providing a single user interface for multiple fingerprint readers.

ID Director<sup>™</sup>—Our Single Sign On (SSO) is a suite of solutions for integration with CA Technologies SiteMinder, Oracle's Fusion Middleware SSO, IBM Tivoli Access Manager and other solutions, utilizing the power and security of WEB-key. This solution provides a simple to implement, custom authentication scheme for companies looking to enhance authentication. ID Director is designed to add a level of security and convenience to the transaction level of any application.

### *Authentication Transaction Security*

Our authentication-transaction security technology, WEB-key®, provides the ability to conduct identification and identity verification transactions in potentially insecure environments, including the World Wide Web or in off-site cloud environments.

WEB-key makes cloud-based biometric user-authentication viable and eliminates technology constraints on online service providers, who are otherwise held dependent on handset provider hardware and software platform decisions. It extends all features and functionalities of the VST algorithm to customers looking to add an enhanced level of security to their thin client and client/server applications. WEB-key is currently supported by both Windows and Linux operating systems. Clients are available on Windows, iOS and Android operating systems.

### **Intellectual Property Rights**

We develop and own significant intellectual property and believe that our intellectual property is fundamental to our biometric operation:

#### *Patents*

We own patented technologies and trade secrets developed or acquired by us.

In May 2005, the U.S. Patent & Trademark Office issued patent 6,895,104 for our Vector Segment fingerprint technology (VST), BIO-key's core biometric analysis and identification technology. With the payment of all maintenance fees, this patent will expire on March 4, 2023.

On October 3, 2006, we announced that our patent for a biometric authentication security framework had been granted by the U.S. Patent & Trademark Office. The patent No. 7,117,356 was issued to us for a biometric authentication security framework that enhances commercial and civil biometric use. Our authentication security framework protects privacy and security of cloud or network based authentications while also facilitates ease of use of biometric systems. The technology that this patent is based on is the foundation for the authentication security incorporated in our WEB-key® product line. WEB-key is a mature enterprise authentication solution that functions in a wide variety of application environments. The solution supports a variety of implementation alternatives including card technologies for "two-factor" authentication and also supports "single-factor" authentication. Partners and customers implementing our WEB-key software to provide convenient and secure user identity include a number of institutions including the Allscripts Healthcare Solutions, Computer Associates Site Minder, Oracle Access Manager and many other enterprise and solutions based systems. With the payment of all maintenance fees, this patent will expire on May 20, 2023.

On December 26, 2006, we were issued US patent No. 7,155,040 covering our unique image processing technology, which is critical for enhancing information used in the extraction of biometric minutiae. The issued patent protects a critical part of an innovative four-phase image enhancement process developed by us. With the payment of all maintenance fees, this patent will expire on January 29, 2025.

On April 15, 2008, we were issued US patent No. 7,359,553 covering our image enhancement and data extraction core algorithm components. The solution protected under this patent provides the capability to quickly and accurately transform a fingerprint image into a computer image that can be analyzed to determine the critical data elements. With the payment of all maintenance fees, this patent will expire on January 3, 2025.

On August 19, 2008, we were issued US patent No. 7,415,605 for our “Biometric Identification Network Security” method. The solution protected under this patent provides a defense against hackers and system attacks, while leveraging the industry standard Trusted Platform Module (TPM) specification for encryption key management. With the payment of all maintenance fees, this patent will expire on May 20, 2023.

On November 18, 2008, we were issued US patent No. 7,454,624 for our “Match Template Protection within a Biometric Security System” method. The solution protected under this patent limits the scope of enrollment templates usage and also eliminates the need for revocation or encryption processes, which can be expensive and time consuming. With the payment of all maintenance fees, this patent will expire on May 17, 2025.

On March 10, 2009, we were issued US patent No. 7,502,938 for our “Trusted Biometric Device” which covers a simple, yet secure method of protecting a user’s biometric information. It covers the transmission of information from the point the information is collected at the biometric reader until the data reaches the computer or device that is authenticating the user’s identity. With the payment of all maintenance fees, this patent will expire on October 25, 2025.

On May 26, 2009, we were issued US patent No. 7,539,331 for our “Image Identification System” method for improving the performance and reliability of image analysis within an image identification system. With the payment of all maintenance fees, this patent will expire on March 22, 2022.

On November 8, 2011, we were issued US Patent No 8,055,027 for our “Generation of Directional Information in the Context of Image Processing” method for image enhancement and processing. With the payment of all maintenance fees, this patent will expire on October 10, 2027.

On July 3, 2012, we were issued US Patent No 8,214,652 for our “Biometric Identification Network Security”, an expanded method of network and related network authentication security systems utilizing hardware based support for encryption and key management for authentication purposes. With the payment of all maintenance fees, this patent will expire on April 24, 2024.

We have also been granted parallel patents to the US Patent portfolio to certain of our patents in many foreign countries offering protection of our intellectual property rights around the world.

*Trademarks*

We have registered our trademarks “BIO-key”, “True User Identification”, “Intelligent Image Indexing” and “WEB-key” with the U.S. Patent & Trademark Office, as well as many foreign countries, protecting our company’s name and key technology offering names.

*Copyrights and trade secrets*

We take measures to ensure copyright and license protection for our software releases prior to distribution. When possible, the software is licensed in an attempt to ensure that only licensed and activated software functions to its full potential. We also take measures to protect the confidentiality of our trade secrets.

## Markets

### *Identity Management, User Authentication, Privilege Entitlement and Access Control*

Our products reduce risk of theft, fraud, loss and attack by limiting access to valuable assets, privileges, data, services, networks and places, to only authorized individuals. Conversely, our products enhance the monetary value and/or viability of privileged assets, places and services by ensuring only subscribers and otherwise entitled holders can enjoy full access to their privileges. In effect, our products replace traditional credentialing systems, which utilize a physical or electronic credential document to represent the holder's privilege entitlement, and access control systems that guard access to such privileges. Examples of such privileges include, but are not limited to: international travel and immigration privileges; employment ID, campus ID and corporate ID privileges; healthcare service privileges; citizen entitlement privileges such as Medicare, Medicaid and Social Security; and bank, credit account and financial transaction privileges such as checking accounts, debit and credit cards, payments, online services and subscription privileges. Examples of access points include doorways, gates, computers, point-of-sale terminals, smart-phones or web-portals and automobiles. In our opinion, the market for advanced user authentication, including fingerprint biometrics, is conceptually enormous, represented by virtually any doorway, gate, computer network or internet end-point like smart-phones, desktops and laptops PCs and tablets, and compounded by the number of individuals privileged to access something guarded by those access points. We believe the market opportunity for our products is a massive upgrade cycle of global privilege entitlement and access control systems.

Historically, our largest market has been access control within highly regulated industries like healthcare. However, we believe the mass adoption of advanced smart-phone and hand-held wireless devices have caused commercial demand for advanced user authentication to emerge as viable. The introduction of smart-phone capabilities, like mobile payments and credentialing, could effectively require biometric user authentication on mobile devices to reduce risks of identity theft, payment fraud other forms of fraud in the mobile or cellular based World Wide Web. As more services and payment functionalities, like mobile wallets and NFC, migrate to smart-phones, the value and potential risk associated with such systems should grow substantially and drive demand and mass adoption of advanced user authentication technologies, including fingerprint biometrics and our solutions.

We believe there is potential for significant market growth in three key areas:

Corporate network access control-corporate campuses, computer networks and applications.

Consumer mobile credentialing, including mobile payments-credit and payment card programs, data and application access and commercial loyalty programs.

Government services and highly regulated industry-Medicare, Medicaid, Social Security, Drivers Licenses, Campus and School ID, Passports/Visas.

## **Business Model**

We believe the most viable markets for our products involve various forms of computer network and Internet applications. The emergences of cloud computing and mobile computing are primary drivers of commercial and consumer adoption of advanced authentication applications, including our authentication capabilities. As the value of assets, services and transactions increases on such networks, we expect that security and user authentication demand will rise proportionately. We believe the nature of cloud and mobile computing requires technology interoperability across borders, jurisdictions and networks. Further, government and highly regulated service offerings must also interoperate across borders, jurisdictions and networks. In many cases, government and highly regulated service-related technologies are required to be interoperable and standards compliant. We have developed our technology and offerings to be software-based, standards compliant, universally interoperable, hardware and operating system agnostic, and scalable. Our technologies, products and platforms are designed to function on the Internet, in the cloud, in a traditional network environment, or stand-alone. We believe our model provides the strongest opportunity to penetrate the global biometric authentication market, leverage our partners' potentially large and resource rich sales channels, as well as produce the highest margin revenue.

We have built a two-tier sales channel to deliver our solutions. Channels include direct sales, integrator partners and VARs. We sell stand-alone software licenses for our products, as well as packaged configurations with "commercial-off-the-shelf" viable third-party hardware devices, like fingerprint readers and network technologies. We do not develop or produce proprietary hardware products. Our technologies also work with a variety of proprietary, sole-source technology offerings from third-party vendors. We believe our technologies can work within the constraints of any customer or partner system design. We are exploring a subscription or Software as a Service (SaaS) model for our software.



*Direct Sales, Licensing, Integrator and VAR Partnerships*

Our products are software based and we typically license our software to end users directly, or through integrator and VAR partners. Our primary sales and marketing focus is to integrate our software into the platform offerings of large technology infrastructure producers. We employ dedicated staff to develop relationships with end-users and integrator partners. We further employ technical support staff who help customers integrate our technology into their applications, as well as support new strategic development efforts.

We have formed strategic relationships with large Internet and network infrastructure providers, including IBM, Oracle, Microsoft, CA Technologies and Indigo, to provide enterprise-ready systems to large enterprise customers and stakeholders. We have also established partnerships with leading technology integrators, including MorphoTrak, McKesson, LexisNexis, Allscripts, Epic, Caradigm, Identimetrix and HealthCast.

On February 26, 2013, we entered into a strategic partnership with Interdigital Corporation to jointly develop and market biometric authentication solutions for the mobile credentialing & payments markets.

**Competition**

In addition to companies that provide existing commonplace methods of restricting access to facilities and logical access points such as pass cards, PIN numbers, passwords, locks and keys, there are numerous companies involved in the development, manufacturing and marketing of fingerprint biometrics products to commercial, government, law enforcement and prison markets. These companies include, but are not limited to, 3M (Cogent), NEC, and MorphoTrak.

The majority of sales for automated fingerprint identification products in the market to date have been deployed for government agencies, healthcare facilities and law enforcement applications. The consumer and commercial markets represent areas of significant growth potential for biometrics, led by the use of mobile devices.

The epidemic of security and data breaches reported over the past few years is one of the driving factors for identifying new methods of protecting valuable data. After attempting to create a more sophisticated password or more efficient token or PIN, it's become apparent that each of these methods is easily compromised and the downside risks are significant.

With respect to competing biometrics technologies, each has its strengths and weaknesses and none has emerged as a market leader:

*Fingerprint identification* is generally viewed as very accurate, inexpensive and non-intrusive;

*Palmvein scanning* is expensive, technique-sensitive, and offers mobility challenges;

*Iris scanning* is viewed as accurate, but the hardware is significantly more expensive; and

*Facial recognition* can have accuracy limitations and is typically highly dependent on ambient lighting conditions, angle of view, and other factors.

## **Research and Development**

We concentrate our research and development efforts on enhancing the functionality, reliability and integration of our current products as well as developing new and innovative products for biometrics. Although we believe that our identification technology is one of the most advanced and discriminating fingerprint technologies available today, the markets in which we compete are characterized by rapid technological change and evolving standards. In order to maintain our position in the market, we will continue to upgrade and refine our existing technologies.

On February 26, 2013, we announced that we entered into a Research and Development Collaboration Agreement, or the “R&D Collaboration”, with InterDigital Communications, Inc., a subsidiary of InterDigital, Inc., or “InterDigital”, a wireless research and development company, InterDigital is also the parent company of DRNC, which provided debt and equity financing to us in February 2013. The R&D Collaboration will target advanced cloud security and identity and access management solutions for the mobile market. The R&D Collaboration will bring together our innovative research and product development capabilities in fingerprint biometrics with InterDigital’s research efforts in developing identity and access management solutions for the mobile market.

During the fiscal years ended December 31, 2013 and 2012, we spent approximately \$1,344,000 and \$947,000, respectively, on our biometric segment's research, development and engineering. Our limited customer base during that time did not directly bear these costs, which were principally funded through outside sources of equity and debt financing.

### **Government Regulations**

We are not currently subject to direct regulation by any government agency, other than regulations generally applicable to businesses or related to specific project requirements. In the event of any international sales, we would be subject to various domestic and foreign laws regulating such exports and export activities.

### **Environmental Regulations**

As of the date of this prospectus, we have not incurred any material expenses relating to our compliance with federal, state, or local environmental laws and do not expect to incur any material expenses in the foreseeable future.

### **Employees and Consultants**

As of January 20, 2015, we employed 19 individuals on a full-time basis as follows – seven in engineering, customer support, research and development; three in finance and administration; and nine in sales and marketing. We also use the services of four consultants (full-time), who provide engineering and technical services, and one part-time contracts administrator.

### **Properties**

We do not own any real estate. We conduct operations from leased premises in Eagan, Minnesota (5,544 square feet), Wall, New Jersey (4,517 square feet) and North Billerica, Massachusetts (shared services center). We believe our current facilities are adequate for the foreseeable future.

### **Legal Proceedings**

In the normal course of business, we periodically become involved in litigation. We are not a party to any material pending litigation except as follows:

On or about March 13, 2014, LifeSouth Community Blood Centers, Inc. filed a lawsuit against us in the Superior Court of Monmouth County, New Jersey (MON-L-1042-14) alleging a breach of a license agreement and seeking return of all amounts paid under the license in the amount of \$718,500. We have denied all claims and asserted a counterclaim against LifeSouth for non-payment of support and maintenance service fees. Discovery has commenced and is proceeding.

**MANAGEMENT**

The following chart sets forth certain information about each of our directors and executive officers.

<u>Name</u>	<u>Age</u>	<u>Positions Held</u>
Michael W. DePasquale	60	Chairman of the Board of Directors and Chief Executive Officer
Charles P. Romeo (a) (c)	72	Director
John Schoenherr (b)	62	Director
Barbara Rivera (b)	63	Director
Thomas E. Bush, III (c)	62	Director
Thomas Gilley	54	Director
Cecilia Welch	55	Chief Financial Officer
Mira K. LaCous	53	Chief Technology Officer
Renat Zhdanov	52	Vice President, Chief Scientist
Scott Mahnken	55	Vice President of Marketing

(a) From April 2004 to February 2005, Mr. Romeo was employed by the Company.

(b) Audit Committee Member

(c) Compensation Committee Member

**Directors**

We believe that our board of directors should be composed of individuals with sophistication and experience in many substantive areas that impact our business. We believe that experience, qualifications, or skills in the following areas are most important: legal/regulatory and government affairs; accounting and finance; design, innovation and engineering; strategic planning; and human resources and development practices; and board practices of other corporations. These areas are in addition to the personal qualifications described in this section. We believe that our current board member possesses the professional and personal qualifications necessary for board service, and have highlighted particularly noteworthy attributes for this board member below. The principal occupation and business experience, for at least the past five years, of our current director is as follows:

*Michael W. DePasquale* has served as our Chief Executive Officer and a Director since January 3, 2003, and Chairman of the Board since January 29, 2014. He served as Co-Chief Executive Officer of the Company from July

2005 to August 2006. Mr. DePasquale brings more than 27 years of executive management, sales and marketing experience to the Company. Prior to joining us, Mr. DePasquale served as the President and Chief Executive Officer of Prism eSolutions, Inc., a Pennsylvania-based provider of professional consulting services and online solutions for ISO-9001/14000 certification for customers in manufacturing, healthcare and government markets, since February 2001. From December 1999 through December 2000, Mr. DePasquale served as Group Vice President for WRC Media, a New York-based distributor of supplemental education products and software. From January 1996 until December 1999, Mr. DePasquale served as Senior Vice President of Jostens Learning Corp., a California-based provider of multimedia curriculum. Prior to Jostens, Mr. DePasquale held sales and marketing management positions with McGraw-Hill and Digital Equipment Corporation. Mr. DePasquale earned a Bachelor of Science degree from the New Jersey Institute of Technology. He serves on the Board of Directors and as Treasurer of the International Biometrics and Identification Industry Association. Mr. DePasquale has extensive general management experience in the technology sector and has served as a Director for number of non-profit organizations and private companies.

*Charles P. Romeo* has served as a Director since February 28, 2005 and from January 29, 2003 to April 19, 2004. From April 2004 until February 2005, he served as our Vice President of Sales, Public Safety Division. From November 2005 to November 2007, Mr. Romeo served as the Vice President of Sales and Marketing for UNICOM, a Rhode Island systems integrator. From September 2002 until April 2004, Mr. Romeo was the President and Chief Executive Officer of FreedomBridge Technologies, Inc., a Rhode Island-based consulting firm to technology companies in the homeland security industry specializing in implementing direct and channel selling programs, strategic alliances and partnerships in the law enforcement market. Prior to founding FreedomBridge, Mr. Romeo had a 33 year sales and marketing management career with Digital Equipment Corporation, Compaq Computer Corporation and Hewlett Packard. During his career, Mr. Romeo served as Vice President of Service Sales for a \$500 million business unit, and Director of Public Sector Sales for a \$275 million division of Hewlett Packard. Mr. Romeo authored *The Sales Manager's Troubleshooter*, Prentice Hall 1998, which was named as one of the "top 10 must reads" by *Sales and Marketing Magazine*. Mr. Romeo earned a Bachelor of Science degree in Mathematics and Economics from the University of Massachusetts and an Executive MBA from Babson College. Mr. Romeo has significant sales and marketing management experience in the infrastructure and computer hardware and software industries.

*John Schoenherr* has served as a Director since December 30, 2004. Mr. Schoenherr served as Vice President of Corporate Performance Management for Oracle Corporation from 1995 through 2006. Prior to Oracle he served as Senior Vice President of Business Intelligence and Analytics at Information Resources, Inc. Mr. Schoenherr has over 25 years of experience in the area of business intelligence and strategic planning. His career includes a number of product development and management positions. Mr. Schoenherr has extensive product management and information services experience in both the large and small enterprise sectors.

*Barbara Rivera* has served as a Director of the Company since January 29, 2014. Ms. Rivera has served as President & General Manager of Experian Corporation's U.S. Public Sector Division since April 2012. Prior to Experian, Ms. Rivera worked for SAS Institute from 2009 through 2012. Ms. Rivera previously worked with firms including IBM, SAP and Oracle and also formed alliances with system integrators and consulting organizations that work in the public sector. Ms. Rivera has an impressive 25-year track record of developing and managing business with key federal, state and local organizations such as the Defense Department, the Department of Justice, the Department of Education, New York City and State as well as the Centers for Medicare and Medicaid Services. Ms. Rivera has particular knowledge and expertise in business development, technology security development, and executive management which strengthens the Board's collective qualifications, skills and experience.

*Thomas E. Bush, III* has served as a Director of the Company since January 29, 2014. Since 2009, Mr. Bush has provided business consulting services through his firm, Tom Bush Consulting. Prior to that, Mr. Bush served with the Federal Bureau of Investigation for over 33 years. Mr. Bush joined the FBI in September 1975, ultimately becoming the Director of the CJIS division, with over 2,500 employees and a budget of approximately one billion dollars. Mr. Bush is known for providing critical services in support of the criminal justice community, with two significant IT projects; Next Generation Identification and N-Dex, were awarded by CJIS with early increments delivered during his tenure at the FBI. He was the recipient of many awards during his tenure, most notably a Presidential Rank Award for Meritorious Service in 2007. Mr. Bush's extensive experience in law enforcement, security matters, and the use of biometric technologies in the government sector provides the Board with a unique perspective on security and public sector matters.

*Thomas Gilley* has served as a Director of the Company since January 29, 2014. Mr. Gilley is an entrepreneur, hands on technologist for mobile technologies, digital media, internet of things and social computing. Mr. Gilley served at Apple Computer, in the Advance Technology Group and Portable Products Group. Before and after Apple, Mr. Gilley founded several successful companies including PicoStar, a Silicon Valley incubator-technology investment company where he has been CEO since 1996. In New York City Mr. Gilley served as a strategic advisor, investor and technology company founder. Most recently, Mr. Gilley sold his on-demand web media company to Vignette and acted as CTO throughout the transaction and through the company's ultimate acquisition by OpenText. Mr. Gilley's substantial experience in starting, operating and financing technology companies provides the Board with a deep knowledge of the sales and development cycles applicable to growth businesses in the technology industry

## **Executive Officers**

*Cecilia Welch* has served as our Chief Financial Officer of the Company since December 21, 2009. Ms. Welch joined us in 2007 as our Corporate Controller. Prior to joining us, from January 2006 to December 2006, she was the Controller for Savaje Technologies (acquired by Sun Microsystems), a developer of advanced mobile telephone software. From October 2004 to January 2006, she was Controller for Crystal Systems, a manufacturer of sapphire crystals used for industrial, semiconductor, defense and medical applications. From December 1988 to July 2004, she was the Controller for ATN Microwave (acquired by Agilent Technologies), a manufacturer of automated test equipment. Ms. Welch has a Bachelor's degree in Accounting from Franklin Pierce University.

*Mira K. Lacous* has served as Chief Technology Officer of the Company since March 13, 2014. Prior to her appointment as Chief Technology Officer, she served as our Senior Vice President of Technology & Development since 2012, and as our Vice President of Technology and Development since 2000. Ms. LaCous has over 28 years of product/project management, solution architecture, software development, team leadership and customer relations experience with a background that includes successfully bringing numerous technologies to market, including automated voice response systems, automated building control systems, software piracy protection, intranet training materials and testing, page layout and design software, image scanning software and systems, biometric security, biometric algorithms and more. Ms. LaCous is also the author of six US patented technologies, multiple international patents, and other patent pending solutions. She has been an officer or director of two other companies; National Computer Systems (NCS), and TEL-Line Systems. Ms. LaCous has a Bachelor's in Computer Science from North Dakota State University. Ms. LaCous also served on the Board of Directors of the Minnesota Sinfonia, a not-for-profit arts and education organization, as well as its chairperson for two years.



*Renat Z. Zhdanov* has served as our Chief Scientist since November 2001. He has over fifteen years of academic experience in various fields of mathematics and physics; fifteen years of image processing, pattern recognition, and big data analysis algorithm development experience and more than ten years of software development experience ranging from database programming to statistical and analytical programming. Dr. Zhdanov is a recognized expert in mathematical physics and is the author of two books and more than 130 papers published in leading mathematics and physics journals. Before joining us, he worked as Chief Mathematician and Visiting Scientist in universities in Ukraine, Germany, Great Britain, Sweden and Spain. Dr. Zhdanov has two PhD degrees in Mathematical Physics and Differential Equations from the Institute of Mathematics in Kiev, Ukraine. He serves as the member of the Editorial Board of the “Journal of Applied Mathematics”.

*Scott Mahnken* has served as our Vice President of Marketing since February 2011. He brings over 20 years of marketing experience and success through strategic marketing and building dynamic relationships with channel partners. Prior to joining us, from August 2009 until February 2011, he was President of Edge Marketing, a leading marketing consulting firm in the dental and medical devices industries. From February 2008 until August 2009, Mr. Mahnken served as Director of Marketing at Milestone Scientific Inc., a manufacturer of computer controlled anesthetic delivery medical devices. From August 2002 until January 2008, he served as Director of Partnership Relations at ArcMesa Educators, an organization dedicated to providing accredited continuing education to medical and dental providers. Prior to ArcMesa, Mr. Mahnken held a number of marketing roles with the Lanmark Group a leading healthcare advertising agency. Mr. Mahnken is a graduate of the University of New Orleans, where he earned a Bachelor’s of Art degree in Marketing.

## EXECUTIVE COMPENSATION

The following table sets forth a summary of the compensation paid to or accrued by our chief executive officer (principal executive officer) and the two most highly compensated executive officers other than the principal executive officer, who were serving as executive officers at the end of December 31, 2014, for the fiscal years ended December 31, 2014 and 2013:

### SUMMARY COMPENSATION TABLE

Name	Fiscal	Salary	Option	All Other	Total
	Year	(\$)	Awards (\$)(1)	Compensation (\$)	(\$)
<b>Michael W. DePasquale</b> Chief Executive Officer	2014	250,000	82,300	739	333,039
	2013	257,815	148,800	739	407,354

<b>Mira K. LaCous</b>	2014	192,903	49,380	545	242,828
Chief Technology Officer (2)	2013	151,342	18,600	545	170,487
<b>Cecilia Welch</b>	2014	144,000	49,380	432	193,812
Chief Financial Officer	2013	140,754	22,320	427	163,501

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- (1) The aggregate grant date fair value of the option awards was estimated using the Black-Scholes option pricing model. The amount shown in this column represents the grant date fair value calculated under ASC 718.
- (2) Ms. LaCous was appointed as our Chief Technology Officer on March 31, 2014. Prior to her appointment as our Chief Technology Officer, she served as our Senior Vice President of Technology & Development.

## **Narrative Disclosure to Summary Compensation Table**

Compensation for BIO-key's executives is comprised of three main components: base salary, annual performance-based cash bonus and long-term equity awards. We do not target a specific weighting of these three components or use a prescribed formula to establish pay levels. Rather, the board of directors and compensation committee considers changes in the business, external market factors and our financial position each year when determining pay levels and allocating between long-term and current compensation for the named executive officers.

Cash compensation is comprised of base salary and an annual performance-based cash bonus opportunity. The committee generally seeks to set a named executive officer's targeted total cash compensation opportunity within a range that is the average of the applicable peer company and/or general industry compensation survey data, adjusted as appropriate for individual performance and internal pay equity and labor market conditions.

In setting cash compensation levels, we favor a balance in which base salaries are generally targeted at slightly below the peer average and a bonus opportunity that is targeted at slightly above the average. The committee believes that this higher emphasis on performance-based cash bonuses places an appropriate linkage between a named executive officer's pay, his or her individual performance and the achievement of specific business goals by placing a higher proportion of annual cash compensation at risk, thereby aligning executive opportunity with the interests of stockholders.

We include an equity component as part of our compensation package because we believe that equity-based compensation aligns the long-term interests of our named executive officers with those of stockholders.

These cash and equity compensation components of pay are supplemented by various benefit plans that provide health, life, accident, disability and severance benefits, most of which are the same as the benefits provided to all of our US based employees.

### ***Employment Agreements***

On March 26, 2010, we entered into an employment agreement, effective as of March 25, 2010, with Michael W. DePasquale to serve as the Chief Executive Officer of the Company until March 24, 2011. The agreement automatically renews for subsequent one-year terms, unless the employment relationship is terminated by either party, or modified in accordance with the terms and conditions of the Agreement. Under the Agreement, Mr. DePasquale will be paid an annual base salary of \$250,000, subject to adjustment by the Board or Compensation Committee. In

addition to the Base Salary, a “Performance Bonus” may be awarded to Mr. DePasquale on the basis of the Company achieving certain corporate and strategic performance goals, as determined by the Board in its sole discretion. 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. DePasquale 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. This agreement also contains a number of termination and change in control provisions as described in “Termination and Change in Control Arrangements” in this Item.

On November 20, 2013, we renewed our one-year employment agreement with Mira K. LaCous to serve as the Vice President of Technology & Development of the Company at an annual base salary of \$147,420, subject to adjustment by the Board or Compensation Committee. On March 13, 2014, in connection with her appointment as Chief Technology Officer, we amended and restated Ms. LaCous’ employment agreement to increase Ms. LaCous’ annual base salary to \$202,000. The employment agreement contains standard and customary confidentiality, technical invention 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. This agreement also contains a number of termination provisions as described in “Termination and Change in Control Arrangements” in this Item.

On May 15, 2013, we entered into an employment agreement with Cecilia Welch to serve as the Vice President and Chief Financial Officer of the Company until May, 2014. The agreement automatically renews for subsequent one-year terms, unless the employment relationship is terminated by either party, or modified in accordance with the terms and conditions of the agreement. The employment agreement contains standard and customary confidentiality, technical invention provisions, as well as a covenant not to compete which prohibits Ms. Welch 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. This agreement also contains a number of termination provisions as described in “Termination and Change in Control Arrangements” in this Item.

**Stock Option Grants**

In the event of any change in the outstanding shares of our common stock by reason of a stock dividend, stock split, combination of shares, recapitalization, merger, consolidation, transfer of assets, reorganization, conversion or what the board deems to be similar circumstances, the number and kind of shares subject to outstanding options, and the exercise price of such options shall be appropriately adjusted in a manner to be determined in the sole discretion of the board. Furthermore, these option agreements contain a change of control provision as described in “Termination Arrangements” in this Item.

**OUTSTANDING EQUITY AWARDS AT FISCAL YEAR END****DECEMBER 31, 2014**

The following table sets forth for each named executive officer, information regarding outstanding equity awards as at December 31, 2014:

Name	Option Awards		Option exercise price (\$)	Option expiration date
	Number of securities underlying unexercised options exercisable (#)	Number of securities underlying unexercised options unexercisable (#)		
Michael W. DePasquale	500,000	—	0.087	2/27/2016
	333,330	666,670	(1) 0.174	3/27/2020
	—	500,000	(2) 0.205	3/13/2021
Mira LaCous	75,000	—	0.180	8/13/2015
	340,000	—	0.460	1/7/2017
	75,000	—	0.140	5/11/2018
	41,666	83,334	(1) 0.174	3/27/2020

	—	300,000	(2)	0.205	3/13/2021
Cecilia Welch	150,000	—		0.140	5/11/2018
	49,999	100,001	(1)	0.174	3/27/2020
	—	300,000	(2)	0.205	3/13/2021

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(1) The options vest equally in three annual installments commencing March 27, 2013

(2) The options vest equally in three annual installments commencing March 13, 2014

### **Narrative Disclosure to Outstanding Equity Awards at Fiscal Year End Table**

The following are the material terms of each agreement, contract, plan or arrangement that provide for payments to one or more of our named executive officers at, following or pursuant to their resignation, retirement or termination, or in connection with a change in control of the Company.

#### ***Termination Arrangements***

Our employment agreement with Mr. DePasquale automatically renews for subsequent one-year terms, unless the employment relationship is terminated by either party, or modified in accordance with the terms and conditions of the Agreement. We may terminate the Agreement at any time with or without cause. In the event of termination by us without cause, we will continue to pay Mr. DePasquale his then current base salary for the greater of nine months from the date of such termination or the number of months remaining until the end of the term of the Agreement.

We may terminate our employment agreement with Ms. LaCous at any time with or without cause. In the event of termination by us without cause, we will continue to pay Ms. LaCous her then current base salary for nine months from the date of such termination.

Our employment agreement with Ms. Welch automatically renews for subsequent one-year terms, unless the employment relationship is terminated by either party, or modified in accordance with the terms and conditions of the Agreement. We may terminate our employment agreement with Ms. Welch at any time with or without cause. In the event of termination by us without cause, we will continue to pay Ms. Welch her then current base salary for the greater of six months from the date of such termination or the number of months remaining until the end of the term of the Agreement.

### *Change in Control Provisions*

The Company's 1999 Stock Option Plan and 2004 Stock Incentive Plan (the "1999 Plan" and together with the 2004 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" each Plan provides 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 all options issued under the 1999 Plan may be exercised. Thereafter, all options issued under the 1999 Plan which are neither assumed nor substituted in connection with such transaction, automatically expire unless otherwise determined by the Board. The 2004 Plan enables the Board to provide that all outstanding options be assumed, or equivalent options be substituted by the acquiring or succeeding corporation upon the occurrence of a "Reorganization Event" as defined. If such Reorganization Event also constitutes a Change In Control, then such assumed or substituted options shall be immediately exercisable in full. If the acquiring or succeeding corporation does not agree to assume, or substitute for such options, then the Board, upon written notice to the Participants, may provide that all unexercised options become exercisable in full as of a specified time prior to the Reorganization Event and terminate prior to the consummation of the Reorganization Event. Alternatively, if under the terms and conditions of the Reorganization Event, holders of common stock will receive a cash payment for their shares, then the Board may provide that all Participants receive a cash payment equal to the difference between the Acquisition Price and the Option Price multiplied by the number of options held by such Participants.

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

Our employment agreement with Mr. DePasquale contains a change in control provision that is triggered if Mr. DePasquale is not offered continued employment with us or any successor, or within five years following such Change of Control, we or any successor terminates Mr. DePasquale's employment without cause. If this occurs, then we will pay Mr. DePasquale his base salary and benefits earned but unpaid through the date of termination, and any prorated bonus earned during the then current bonus year, plus two times his then current base salary.



**DIRECTOR COMPENSATION FOR THE FISCAL YEAR ENDED****DECEMBER 31, 2014**

The following table sets forth for each director, information regarding their compensation for the year ended December 31, 2014:

Name(1)	Fees Earned or Paid in Cash	Option Awards	Total
	(\$)	(\$) (2)	(\$)
Thomas E. Bush, III	8,000	12,345	20,345
Thomas Gilley	8,000	12,345	20,345
Charles P. Romeo	8,000	12,345	20,345
John Schoenherr	8,000	12,345	20,345
Barbara Rivera	8,000	12,345	20,345

(1) Mr. DePasquale has been omitted from the above table because he does not receive any additional compensation for serving on our Board of Directors.

(2) The aggregate grant date fair value of the option awards was estimated using the Black-Scholes option pricing model. The amount shown in this column represents the grant date fair value calculated under ASC 718.

**Narrative Disclosure to Director Compensation Table**

The Company has adopted a policy to pay to each non-employee director \$3,000 per board meeting and \$1,000 per telephonic board meeting attended and to make an annual grant of options in the discretion of the Board upon recommendation of the Compensation Committee. In 2014, we granted to each of our non-employee directors an option to purchase 75,000 shares of common stock. The options vest in three equal annual installments and expire seven years after the date of grant.

We reimburse each of our non-employee directors for their reasonable expenses incurred in connection with attending meetings of the board of directors and related committees.

## SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth, as of January 20, 2015, information with respect to the securities holdings of all persons that we have reason to believe, pursuant to filings with the SEC, may be deemed the beneficial owner of more than 5% of our outstanding common stock. The following table also sets forth, as of such date, the beneficial ownership of our common stock by all executive officers and directors, individually and as a group.

The beneficial owners and amount of securities beneficially owned have been determined in accordance with Rule 13d-3 under the Exchange Act and, in accordance therewith, includes all shares of our common stock that may be acquired by such beneficial owners within 60 days of January 20, 2015 upon the exercise or conversion of any options, warrants or other convertible securities. Unless otherwise indicated, each person or entity named below has sole voting and investment power with respect to all common stock beneficially owned by that person or entity, subject to the matters set forth in the footnotes to the table below, and has an address of c/o BIO-Key International, Inc., 3349 Highway 138, Building A, Suite E, Wall, NJ 07719.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership (1)	Percentage of Class (1)
Michael W. DePasquale	1,049,996 (2)	*
Mira LaCous	631,666 (3)	*
Scott Mahnken	66,666 (4)	*
Cecilia Welch	299,999 (5)	*
Renat Zhdanov	236,666 (6)	*
John Schoenherr	240,596 (7)	*
Charles P. Romeo	174,286 (8)	*
Barbara Rivera	25,000 (9)	-
Thomas E. Bush III	25,000 (9)	-
Thomas Gilley	28,000 (9)	*
All officers and directors as a group (10 persons)	2,777,875 (10)	2.1 %

\* Less than 1%.



- The securities “beneficially owned” by an individual are determined in accordance with the definition of “beneficial ownership” set forth in the regulations promulgated under the Securities Exchange Act of 1934 and, accordingly, may include securities owned by or for, among others, the spouse and/or minor children of an individual and any
- (1) other relative who has the same home as such individual, as well as, other securities as to which the individual has or shares voting or investment power or which each person has the right to acquire within 60 days through the exercise of options or otherwise. Beneficial ownership may be disclaimed as to certain of the securities. This table has been prepared based on 132,002,317 shares of common stock outstanding as of January 20, 2015.
  - (2) Includes 999,996 issuable on exercise of options and 50,000 shares of common stock. Does not include 1,000,004 shares issuable upon exercise of options subject to vesting.
  - (3) Consists of 631,666 shares issuable upon exercise of options. Does not include 283,334 shares issuable upon exercise of options subject to vesting.
  - (4) Consists of 66,666 shares issuable upon exercise of options. Does not include 183,335 shares issuable upon exercise of options subject to vesting.
  - (5) Consists of 299,999 shares issuable upon exercise of options. Does not include 300,001 shares issuable upon exercise of options subject to vesting.
  - (6) Consists of 236,666 shares issuable upon exercise of options. Does not include 133,334 shares issuable upon exercise of options subject to vesting.
  - (7) Consists of 240,596 shares issuable upon exercise of options. Does not include 83,334 shares issuable upon exercise of options subject to vesting.
  - (8) Consists of 174,286 shares issuable upon exercise of options. Does not include 83,334 shares issuable upon exercise of options subject to vesting.
  - (9) Consists of 25,000 shares issuable upon exercise of options. Does not include 50,000 shares issuable upon exercise of options subject to vesting.
  - (10) Includes 2,699,875 shares issuable upon exercise of options. Does not include 2,072,226 shares issuable upon exercise of options subject to vesting.

## **EQUITY COMPENSATION PLAN INFORMATION**

The following table sets forth, as of December 31, 2014, information with respect to securities authorized for issuance under equity compensation plans.

	<b>Number of securities to be issued upon exercise of outstanding options, warrants and rights</b>	<b>Weighted-average exercise price of outstanding options, warrants and rights</b>	<b>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</b>
	<b>(a)</b>	<b>(b)</b>	<b>(c)</b>
Equity compensation plans approved by security holders	—	—	—
Equity compensation plans not approved by security holders	4,736,679	\$ 0.17	29,395
Total	4,736,679	\$ 0.17	29,395

## **CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS**

### **Employment Arrangements**

The Company has entered into employment agreements with Michael W. DePasquale, Cecilia Welch and Mira LaCous. See **“EXECUTIVE COMPENSATION—Employment Agreements.”**

### **Consulting Arrangement with Thomas J. Colatosti**

In connection with his appointment to the Board of Directors in September 2002, and as acting Chief Financial Officer from November 2008 to December 2009, we had entered into a number of consulting arrangements with Thomas Colatosti. Under the most recent arrangement, which was entered into on January 12, 2010, Mr. Colatosti provided services to the Company and its subsidiaries and affiliates for the two-year term ended December 31, 2011 at a rate of \$5,000 per month. At December 31, 2013 and December 31, 2012, we owe to Mr. Colatosti an aggregate of \$50,000 for consulting services rendered.



### **Repayment of Note Payable to Thomas J. Colatosti**

Effective as of December 31, 2010, we entered into a Securities Exchange Agreement with Thomas J. Colatosti, pursuant to which Mr. Colatosti agreed to exchange all of his outstanding shares of Series D Convertible Preferred Stock, including all accrued and unpaid dividends thereon, and the 7% Convertible Promissory Notes dated as of December 28, 2009 issued to Mr. Colatosti in the original principal amount of \$64,878 for a new non-convertible 7% Secured Promissory Note in the original principal amount of \$350,804. The 7% Secured Promissory Note was due on December 31, 2012. Pursuant to a Note Amendment and Extension Agreement effective as of December 31, 2012, the maturity date of the 7% Convertible Promissory Note was extended to March 31, 2013. In February 2013, we repaid the outstanding principal balance and accrued interest under this note from the proceeds of our February 2013 private offering with InterDigital.

### **Director Independence**

The Board applies the definition of independent director as set forth in NASDAQ Stock Market Rule 5605 (a)(2), as well as Rule 10A-3 under the Securities Exchange Act of 1934, as amended.

In accordance with this guidance, the Board considers Mr. Schoenherr, Mr. Romeo, Ms. Rivera, Mr. Bush and Mr. Gilley, to be independent. Mr. Schoenherr and Ms. Rivera are the members of the Company's Audit Committee, while Mr. Schoenherr, Mr. Romeo, and Mr. Bush are the members of the Company's Compensation Committee.

### **DESCRIPTION OF SECURITIES**

*The following summary of our capital stock, our certificate of incorporation, our bylaws and the DGCL is intended as a summary only and is subject to and qualified in its entirety by reference to our certificate of incorporation and bylaws, and the applicable provisions of the DGCL.*

#### **Common Stock**

We are authorized to issue 170,000,000 shares of common stock, \$.0001 par value per share, of which 132,002,317 shares were outstanding on the date of this prospectus. Holders of shares of our common stock are entitled to one vote per share on all matters submitted to a vote of the stockholders and are not entitled to cumulative voting rights. Our

shares of our common stock do not carry any preemptive, conversion or subscription rights, and there are no sinking fund or redemption provisions applicable to the shares of our common stock. Holders of our common stock are entitled to receive dividends and other distributions in cash, stock or property as may be declared by our Board of Directors from time to time out of our assets or funds legally available for dividends or other distributions, subject to dividend or distribution preferences that may be applicable to any then outstanding shares of preferred stock. In the event of our voluntary or involuntary liquidation, dissolution or winding up, holders of shares of our common stock are entitled to share ratably in the assets legally available for distribution to stockholders after payment of all debts and other liabilities and satisfaction of the liquidation preference, if any, granted to the holders of any preferred stock then outstanding. All outstanding shares of our common stock are fully paid and nonassessable.

## **Preferred Stock**

We are authorized to issue 5,000,000 shares of preferred stock, \$.0001 par value per share, of which no shares are outstanding on the date of this prospectus. Our certificate of incorporation authorizes our Board of Directors to establish one or more series of preferred stock (including convertible preferred stock). Unless required by law, the authorized shares of preferred stock will be available for issuance without further action by you. Our Board of Directors is able to determine, with respect to any series of preferred stock, the powers (including voting powers), preferences and relative, participating, optional or other special rights, and the qualifications, limitations or restrictions thereof, including, without limitation:

the designation of the series;

the number of shares of the series, which our Board of Directors may, except where otherwise provided in the preferred stock designation, increase (but not above the total number of authorized shares of the class) or decrease (but not below the number of shares then outstanding);

whether dividends, if any, will be cumulative or non-cumulative and the dividend rate of the series;



the dates at which dividends, if any, will be payable;

the redemption rights and price or prices, if any, for shares of the series;

the terms and amounts of any sinking fund provided for the purchase or redemption of shares of the series;

the amounts payable on shares of the series in the event of any voluntary or involuntary liquidation, dissolution or winding-up of our affairs;

whether the shares of the series will be convertible into shares of any other class or series, or any other security, of the Company or any other corporation, and, if so, the specification of the other class or series or other security, the conversion price or prices or rate or rates, any rate adjustments, the date or dates as of which the shares will be convertible and all other terms and conditions upon which the conversion may be made;

restrictions on the issuance of shares of the same series or of any other class or series; and

the voting rights, if any, of the holders of the series.

We could issue a series of preferred stock that could, depending on the terms of the series, impede or discourage an acquisition attempt or other transaction that some, or a majority, of the holders of our common stock might believe to be in their best interests or in which the holders of our common stock might receive a premium for your common stock over the market price of the common stock. Additionally, the issuance of preferred stock may adversely affect the holders of our common stock by restricting dividends on the common stock, diluting the voting power of the common stock or subordinating the liquidation rights of the common stock. As a result of these or other factors, the issuance of preferred stock could have an adverse impact on the market price of our common stock.

#### **Anti-Takeover Effects of Certain Provisions of Our Certificate of Incorporation, Our Bylaws and the DGCL**

The following provisions of our certificate of incorporation, our bylaws and the DGCL may discourage takeover attempts of us that may be considered by some stockholders to be in their best interest. The effect of such provisions could delay or frustrate a merger, tender offer or proxy contest, the removal of incumbent directors, or the assumption of control by stockholders, even if such proposed actions would be beneficial to our stockholders. Such effect could cause the market price of our common stock to decrease or could cause temporary fluctuations in the market price of our common stock that otherwise would not have resulted from actual or rumored takeover attempts.

*Authorized but Unissued Capital Stock*

Delaware law does not require stockholder approval for any issuance of authorized shares. Additional shares that may be used in the future may be used for a variety of corporate purposes, including future public offerings, to raise additional capital, to facilitate acquisitions and employee benefit plans.

Our Board of Directors may generally issue preferred shares on terms calculated to discourage, delay or prevent a change of control or the removal of our management. Moreover, our authorized but unissued shares of preferred stock will be available for future issuances without stockholder approval and could be utilized for a variety of corporate purposes.

One of the effects of the existence of unissued and unreserved common stock or preferred stock may be to enable our Board of Directors to issue shares to persons friendly to current management, which issuance could render more difficult or discourage an attempt to obtain control of the Company by means of a merger, tender offer, proxy contest or otherwise, and thereby protect the continuity of our management and possibly deprive our stockholders of opportunities to sell their shares of common stock at prices higher than prevailing market prices.

### *Special Meetings of Stockholders*

Our bylaws provide that special meetings of our stockholders may be called only by our Board of Directors. This provision may have the effect of deferring, delaying or discouraging hostile takeovers, or changes in control or management of the Company.

### *Director Vacancies*

Our certificate of incorporation provides that any vacancies in our Board of Directors, however occurring, will be filled by a majority of the remaining members of the Board of Directors, even if less than a quorum. This provision may discourage a third party from making a tender offer or otherwise attempting to obtain control of us because the provision effectively limits stockholder election of Directors to annual and special meetings of the stockholders.

### *Requirements for Advance Notification of Director Nominations and Stockholder Proposals*

Our bylaws establish advance notice procedures with respect to stockholder proposals and the nomination of candidates for election as directors, other than nominations made by or at the direction of the Board of Directors or a committee of the Board of Directors. In order for any matter to be “properly brought” before a meeting, a stockholder will have to comply with advance notice requirements and provide us with certain information. Generally, to be timely, a stockholder’s notice must be received at our principal executive offices not less than 60 days nor more than 90 days prior to the first anniversary date of the immediately preceding annual meeting of stockholders. Our bylaws also specify requirements as to the form and content of a stockholder’s notice. These provisions may defer, delay or discourage a potential acquirer from conducting a solicitation of proxies to elect the acquirer’s own slate of directors or otherwise attempting to influence or obtain control of the Company.

### *No Cumulative Voting*

Under Delaware law, the right to vote cumulatively does not exist unless the certificate of incorporation specifically authorizes cumulative voting. Our certificate of incorporation does not authorize cumulative voting. Therefore, stockholders holding a majority in voting power of the shares of our stock entitled to vote generally in the election of directors will be able to elect all our directors.

**MARKET FOR COMMON EQUITY  
AND RELATED STOCKHOLDER MATTERS**

**Market Information**

Our common stock currently trades on the OTCQB under the symbol "BKYY". The following table sets forth the range of high and low bid prices for shares of our common stock on the OTCQB for the periods indicated, as reported by the OTCQB. Quotations represent inter-dealer prices, without retail mark-up, markdown or commission, and may not represent actual transactions.

<b>2015:</b>	<b>High</b>	<b>Low</b>
Quarter ended March 31, 2015 (through January 16, 2015)	\$ 0.11	\$ 0.07

	<b>High</b>	<b>Low</b>
<b>2014:</b>		
Quarter ended December 31, 2014	\$ 0.14	\$ 0.08
Quarter ended September 30, 2014	0.25	0.10
Quarter ended June 30, 2014	0.30	0.22
Quarter ended March 31, 2014	0.28	0.14

<b>2013:</b>	<b>High</b>	<b>Low</b>
Quarter ended December 31, 2013	\$0.24	\$0.15
Quarter ended September 30, 2013	0.39	0.24
Quarter ended June 30, 2013	0.40	0.16
Quarter ended March 31, 2013	0.19	0.09

The last reported trading price of our common stock as reported on the OTCQB on January 16, 2015 was \$0.10 per share.

## **Holders**

As of January 16, 2015, the number of stockholders of record of our common stock was 166.

## **Dividends**

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

## **Transfer Agent**

The transfer agent for our common stock is Broadridge Corporate Issuer Solutions, Inc., 1717 Arch Street, Suite 1300, Philadelphia, Pennsylvania 19103.

## **THE OFFERING**

This prospectus covers the public sale of 27,912,496 shares of common stock to be sold by the selling security holders identified in this prospectus, consisting of:

15,949,997 shares of common stock; and  
11,962,499 shares of common stock underlying warrants with an exercise price of \$0.15 per share, which expire five years after the date of grant.

This prospectus also covers any additional shares of our common stock that we may issue or that may be issuable by reason of any stock split, stock dividend or similar transaction involving our common stock.

The selling security holders may sell the shares covered by this prospectus through public or private transactions at prevailing market prices or at privately negotiated prices. We will not receive any proceeds from this offering.

Set forth below is the private offering that we conducted in November 2014, which form the basis of the shares of common stock being registered for resale hereby.

*November 2014 Private Offering of Common Stock and Warrants to Private Investors*

In November 2014, we issued to certain private investors 15,949,997 shares of common stock and warrants to purchase an additional 23,924,997 shares of common stock for aggregate gross proceeds of \$1,595,000. In addition, for each share purchased in this offering, the investors surrendered to us for cancellation a warrant to acquire one share of our common stock which we previously issued in a private placement transaction in November, 2013. This resulted in the cancellation of warrants to purchase an aggregate of 15,949,997 shares of common stock. The public resale of these shares was included in an effective registration statement we previously filed with the Securities and Exchange Commission.

The warrants have a term of five years and an exercise price of \$0.15 per share. Warrants to purchase 11,962,499 shares of common stock are immediately exercisable and the resale of the shares underlying these warrants are included in this prospectus. The remaining warrants to purchase 11,962,498 shares of common stock will become exercisable upon the completion of a 1-for-2 reverse split of our common stock, or such other action that provides us with additional authorized and unissued shares of common stock sufficient to reserve for the issuance of the remaining shares underlying the warrants. If within 90 days of the closing there are not sufficient shares available and reserved for the exercise of all of the warrants, we are required to issue to each Investor additional warrants to purchase 0.25 shares for each share purchased by such investor in this offering. If within 180 days of the closing there are not sufficient shares reserved for exercise of all of the warrants, the exercise price of the warrants will be automatically reduced to 2/3 of the exercise price in effect immediately prior to such reduction. The foregoing issuance and exercise price adjustment will only be made for investors that voted in favor of any action proposed to our stockholders that, if adopted, would have provided us with sufficient authorized and unissued shares to reserve for the exercise of all of the warrants.

The warrants have customary anti-dilution protections including a “full ratchet” anti-dilution adjustment provision. In addition, if at any time between now and the two year anniversary of the date in which the registration statement of which this prospectus forms a part becomes effective, we sell or issue shares of common stock or securities that are convertible into common stock at a price lower than \$0.10 per share, we will be required to issue additional shares of common stock for no additional consideration.

The warrants are exercisable on a cashless basis if at any time there is no effective registration statement covering the resale of the shares of common stock underlying the warrants.

## **SELLING SECURITY HOLDERS**

The selling security holders identified in the following table are offering for resale 27,912,496 shares of our common stock. All of the securities were previously issued to the selling security holders in private placement transactions described above under the section entitled “**The Offering**”.

The following table sets forth as of January 20, 2015:

The name of each selling security holder and any material relationship between us and such selling security holder based upon information currently available to us;

The number of shares owned issued in our November 2014 private placement;

The number of shares owned beneficially by each selling security holder before the offering;

The percentage ownership of each selling security holder prior to the offering;

The number of shares offered hereunder by each selling security holder;

The number of shares owned beneficially by each selling security holder after the offering; and

The percentage ownership of each selling security holder after the offering.



The information presented in this table has been calculated based on the assumption that all options and warrants will be exercised prior to completion of the offering, that all shares offered hereby will be sold, and that no other shares of our common stock will be acquired or disposed of by the selling security holder prior to the termination of this offering. The beneficial ownership set forth below has been determined in accordance with Rule 13d-3 under the Exchange Act based on 132,002,317 shares of our common stock outstanding on January 20, 2015. Except as indicated by footnote, and subject to applicable community property laws, we believe that the beneficial owners of the common stock listed below have sole voting power and investments power with respect to their shares. None of the selling security holders are affiliated with a broker-dealer registered under the Exchange Act of 1934, as amended.

Name of Selling Security Holder	Number of		Beneficial Ownership		Maximum		Beneficial Ownership	
	Issued and	Shares	of	of	Number of	of	of	of
	Issuable		Selling Security		Shares	Selling Security		
	from the		Holders Prior		Offered	Holders		
	November		to the Offering <sup>(2)</sup>		Hereby <sup>(3)</sup>	After the Offering		
	2014							
	Offering <sup>(1)</sup>							
		Number	Percent			Number <sup>(4)</sup>	Percent	
AIGH Investment Partners LLC <sup>(5)</sup>	1,000,000	1,100,000 <sup>(6)</sup>	1.06 %		700,000	400,000	*	
AIGH Investment Partners LP <sup>(7)</sup>	12,500,000	6,650,000 <sup>(8)</sup>	4.99 %		8,750,000	400,000	*	
Dougherty Absolute Equity Fund LLC <sup>(9)</sup>	3,500,000	3,850,000 <sup>(10)</sup>	3.65 %		2,450,000	1,400,000	1.06 %	
Jeffrey Jacobson <sup>(11)</sup>	83,333	91,666 <sup>(12)</sup>	*		58,333	33,333	*	
Leap Tide Partners L.P. <sup>(13)</sup>	1,250,000	5,708,334 <sup>(14)</sup>	4.24 %		875,000	4,833,334 <sup>(15)</sup>	3.60 %	
Hershel Berkowitz	250,000	275,000 <sup>(16)</sup>	*		175,000	100,000	*	
E. Terry Skone TTEE Terry Skone Rev Trust u/a dtd 11/30/2005	500,000	550,000 <sup>(17)</sup>	*		350,000	200,000	*	
Paul and Nancy Seel Joint Account WROS	500,000	550,000 <sup>(17)</sup>	*		350,000	200,000	*	
Stephanie L. Russo	500,000	550,000 <sup>(17)</sup>	*		350,000	200,000	*	
Richard A. Hoel	250,000	275,000 <sup>(16)</sup>	*		175,000	100,000	*	
Dorothy J. Hoel	500,000	550,000 <sup>(17)</sup>	*		350,000	200,000	*	
Janet & Donald Voight Trustees FBO Janet M. Voight Trust u/a dtd 8/28/96 <sup>(18)</sup>	250,000	275,000 <sup>(16)</sup>	*		175,000	100,000	*	
David & Carole Brown Trustees FBO David & Carole Brown Revocable	500,000	550,000 <sup>(16)</sup>	*		350,000	200,000	*	

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Trust u/a dtd 10/23/97								
Gary A. Bergren	750,000	825,000	(19)	*	525,000	300,000		*
William H. Baxter trustee FBO William								
H. Baxter Revocable Trust u/a dtd	500,000	550,000	(17)	*	350,000	200,000		*
7/3/96								
Robert G. Allison	1,000,000	1,100,000 <sup>(20)</sup>		1.06	%	700,000	400,000	*
Alice Ann Corporation <sup>(21)</sup>	750,000	825,000	(19)	*	525,000	300,000		*
Frances A. Gonyea	750,000	825,000	(19)	*	525,000	300,000		*
Wyatts Torch Equity Partners, LP	4,166,668	4,583,335 <sup>(22)</sup>		4.34	%	2,916,668	1,666,667	1.26
Iroquois Master Fund Ltd. <sup>(23)</sup>	833,325	916,665	(24)	*	583,328	333,337	(25)	-
Joseph P. Sullivan <sup>(26)</sup>	500,000	550,000	(17)	*	350,000	200,000		*
The Hewlett Fund <sup>(27)</sup>	2,375,000	2,045,833 <sup>(28)</sup>		1.54	%	1,662,500	383,333	(29)
Alpha Capital Anstalt <sup>(30)</sup>	6,666,668	4,666,668 <sup>(31)</sup>		4.90	%	4,666,668	-0-	-

\* Represents less than one percent (1%) of our outstanding shares.

(1) Reflects the total number of shares of common stock issued or issuable to each selling security holder from the November 2014 private placement, without regard to contractual restrictions on the exercise of the warrants as described in footnote (2) below. All of the foregoing securities are being offered for resale by this prospectus

(other than warrants to purchase 11,962,498 shares of common stock, which are not being offered for resale by this prospectus).

- (2) To our knowledge, none of the shares of common stock or warrants issued to the selling security holders in the November 2014 private placement have been sold or otherwise transferred prior to the date of this prospectus in transactions exempt from the registration requirements of the Securities Act. The warrants issued in the November 2014 private placement provide that a selling security holder may not exercise

its warrants  
to the extent  
(but only to  
the extent)  
such selling  
security  
holder or any  
of its  
affiliates  
would  
beneficially  
own a  
number of  
shares of our  
common  
stock which  
would exceed  
4.99%. As a  
result, the  
number of  
shares of  
common  
stock  
reflected in  
this column  
as  
beneficially  
owned by  
each selling  
security  
holder  
includes (a)  
the number  
of  
outstanding  
shares of  
common  
stock issued  
to such  
selling  
security  
holder, and  
(b) the  
number of  
shares of  
common  
stock  
underlying  
the warrants  
issued to  
such selling

security  
holder that  
such selling  
security  
holder has  
the right to  
acquire  
without it or  
any of its  
affiliates  
beneficially  
owning more  
than 4.99%  
of our  
currently  
outstanding  
common  
stock, based  
on  
132,002,317  
outstanding  
shares of our  
common  
stock as of  
January 20,  
2015.

Includes all shares of common stock issued and issuable as of the date of this prospectus to the selling security holders in connection with the November 2014 private placement, including all

(3) shares underlying the currently exercisable warrants issued therein as of the date of this prospectus, without regard to contractual restrictions on the exercise of the warrants as described in footnote (2) above.

(4) Assumes that (i) all of the shares of common stock to be registered by the registration statement of which this prospectus is a part, including all shares of common stock issued and outstanding and all shares of common stock

issuable upon exercise of the currently exercisable warrants, are sold in this offering and (ii) the selling security holders do not acquire additional shares of our common stock after the date of this prospectus and prior to completion of this offering.

Orin Hirschman is the president of AIGH Investment Partners LLC  
(5) and has sole voting and dispositive power with respect to the shares.

Includes 300,000 shares issuable upon exercise of warrants held by AIGH Investment Partners LLC.  
(6) Does not include 3,750,000 shares issuable upon exercise of warrants held by AIGH Investment Partners LP.

(7) Orin Hirschman is the general

partner of AIGH Investment Partners LP and has sole voting and dispositive power with respect to the shares.

- (8) Includes 1,650,000 shares issuable upon exercise of warrants. Does not include 800,000 shares held by AIGH Investment Partners LLC. Also does not include 400,000 shares issuable upon exercise of warrants held by AIGH Investment Partners LLC. The number of shares reflected in this table as beneficially owned excludes 2,500,000 shares of our common stock issuable upon exercise of warrants held by this selling security holder because such warrants contain a blocker provision as described in footnote (2), under which the holder thereof does not have the right to exercise the



warrants to the extent (but only to the extent) that such exercise would result in beneficial ownership by the holder thereof or any of its affiliates of more than 4.99% of our common stock.

(9) Jeffrey D. Jacobson is the Senior Vice President of Dougherty Absolute Equity Fund LLC and has sole voting and dispositive power with respect to the shares.

(10) Includes 1,050,000 shares issuable upon exercise of warrants.

(11) Jeffrey D. Jacobson is a Senior Vice President at Dougherty & Company, LLC

(12) Includes 25,000 shares issuable upon exercise of warrants. Does not include securities owned by Dougherty Absolute Equity Fund LLC.

Jan Loeb as partner and manager of Leap Tide Partners L.P.  
(13) has sole voting and dispositive power with respect to the shares.

Includes 2,541,667  
(14) shares issuable upon exercise of warrants.

Includes 2,166,667  
(15) shares issuable upon exercise of warrants.

Includes 75,000  
(16) shares issuable upon exercise of warrants.

Includes 150,000 shares  
(17) issuable upon exercise of warrants.

T. Jay Salmen as president of Sun Investments, LLC  
(18) has sole voting and dispositive power with respect to the shares.

(19) Includes 225,000

shares  
issuable  
upon  
exercise of  
warrants.

(20) Includes 300,000 shares issuable upon exercise of warrants.

(21) Richard C. Perkins, executive vice president of Perkins Capital Management, the investment advisor, agent and attorney-in-fact of Alice Ann Corporation, has sole voting and dispositive power with respect to the shares.

(22) Includes 1,250,001 shares issuable upon exercise of warrants.

(23) Iroquois Capital Management L.L.C. is the investment manager of Iroquois Master Fund, Ltd. Iroquois Capital Management has voting control and investment discretion over securities held by Iroquois Master Fund. As managing members of Iroquois Capital, Joshua Silverman and Richard Abbe make voting and investment decisions on behalf of Iroquois Capital in its capacity as investment manager to Iroquois Master Fund. As a result of the foregoing, Mr. Silverman and Mr. Abbe may be deemed to have beneficial ownership (as determined under Section 13(d) of the Securities Exchange Act of 1934, as amended) of the securities held by IMF.

(24) Includes 583,335 shares issuable upon exercise of warrants.

(25) Consists of shares issuable upon exercise of warrants.

(26) Joseph Sullivan is a Senior Vice President at Dougherty & Company, LLC. Securities reflected as beneficially owned by Mr. Sullivan in this table do not include securities owned by Dougherty Absolute Equity Fund LLC.

(27) Martin Chopp is the general partner of The Hewlett Fund and has sole voting and dispositive power with respect to the shares.

(28) Includes 1,095,833 shares issuable upon exercise of warrants.

(29) Consists of shares issuable upon exercise of warrants.

(30) Konrad Ackermann is the director of Alpha Capital Anstalt and has sole voting and dispositive power with respect to the shares.

(31) Includes 2,000,001 shares issuable upon exercise of warrants.

## USE OF PROCEEDS

We will not receive any proceeds from the sale of common stock by the selling security holders. We will, however, receive proceeds upon the exercise of any warrants held by the selling security holders. If such warrants are exercised in full (unless exercised on a cashless basis), we would receive gross cash proceeds of approximately \$1,794,375. Any such proceeds are currently expected to be used for working capital and general corporate purposes. No assurances can be given that any of the warrants will be exercised.

**PLAN OF DISTRIBUTION**

Each selling security holder of the common stock and any of their pledgees, assignees and successors-in-interest may, from time to time, sell any or all of their shares of common stock on the OTCQB or any other stock exchange, market or trading facility on which the shares are traded or in private transactions. These sales may be at fixed or negotiated prices. A selling security holder may use any one or more of the following methods when selling shares:

ordinary brokerage transactions and transactions in which the broker-dealer solicits purchasers;

block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;

purchases by a broker-dealer as principal and resale by the broker-dealer for its account;

an exchange distribution in accordance with the rules of the applicable exchange;

privately negotiated transactions;

settlement of short sales entered into after selling security holders the effective date of the registration statement of which this prospectus is a part;

broker-dealers may agree to sell a specified number of such shares at a stipulated price per share;

through the writing or settlement of options or other hedging transactions, whether through an options exchange or otherwise;

a combination of any such methods of sale; or

any other method permitted pursuant to applicable law.

The selling security holders may also sell shares under Rule 144 under the Securities Act of 1933, as amended (the “Securities Act”), if available, rather than under this prospectus.

Broker-dealers engaged by the selling security holders may arrange for other brokers-dealers to participate in sales. Broker-dealers may receive commissions or discounts from the selling security holders (or, if any broker-dealer acts as agent for the purchaser of shares, from the purchaser) in amounts to be negotiated, but, except as set forth in a supplement to this prospectus, in the case of an agency transaction not in excess of a customary brokerage commission in compliance with FINRA Rule 2440; and in the case of a principal transaction a markup or markdown in compliance with FINRA IM-2440.

In connection with the sale of the common stock or interests therein, the selling security holders may enter into hedging transactions with broker-dealers or other financial institutions, which may in turn engage in short sales of the common stock in the course of hedging the positions they assume. The selling security holders may also sell shares of the common stock short and deliver these securities to close out their short positions, or loan or pledge the common stock to broker-dealers that in turn may sell these securities. The selling security holders may also enter into option or other transactions with broker-dealers or other financial institutions or the creation of one or more derivative securities which require the delivery to such broker-dealer or other financial institution of shares offered by this prospectus, which shares such broker-dealer or other financial institution may resell pursuant to this prospectus (as supplemented or amended to reflect such transaction).

The selling security holders and any broker-dealers or agents that are involved in selling the shares may be deemed to be “underwriters” within the meaning of the Securities Act in connection with such sales. In such event, any commissions received by such broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act. Each selling security holder has informed us that it does not have any written or oral agreement or understanding, directly or indirectly, with any

person to distribute the common stock. In no event shall any broker-dealer receive fees, commissions and markups which, in the aggregate, would exceed eight percent (8%).

We are required to pay certain fees and expenses incurred by us incident to the registration of the shares. We have agreed to indemnify the selling security holders against certain losses, claims, damages and liabilities, including liabilities under the Securities Act.

Because selling security holders may be deemed to be “underwriters” within the meaning of the Securities Act, they will be subject to the prospectus delivery requirements of the Securities Act, including Rule 172 thereunder. In addition, any securities covered by this prospectus which qualify for sale pursuant to Rule 144 under the Securities Act may be sold under Rule 144 rather than under this prospectus. There is no underwriter or coordinating broker acting in connection with the proposed sale of the resale shares by the selling security holders.

We agreed to keep this prospectus effective until the earlier of (i) the date on which the shares may be resold by the selling security holders without registration and without the requirement to be in compliance with Rule 144(c)(1) under the Securities Act and otherwise without volume or manner of sale restrictions pursuant to Rule 144 or (ii) all of the shares have been sold pursuant to this prospectus or Rule 144 under the Securities Act. The resale shares will be sold only through registered or licensed brokers or dealers if required under applicable state securities laws. In addition, in certain states, the resale shares may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirement is available and is complied with.

Under applicable rules and regulations under the Securities Exchange Act of 1934, as amended, any person engaged in the distribution of the resale shares may not simultaneously engage in market making activities with respect to the common stock for the applicable restricted period, as defined in Regulation M, prior to the commencement of the distribution. In addition, the selling security holders will be subject to applicable provisions of the Securities Exchange Act of 1934, as amended, and the rules and regulations thereunder, including Regulation M, which may limit the timing of purchases and sales of shares of the common stock by the selling security holders or any other person. We will make copies of this prospectus available to the selling security holders and have informed them of the need to deliver a copy of this prospectus to each purchaser at or prior to the time of the sale (including by compliance with Rule 172 under the Securities Act).

## **LEGAL MATTERS**

The validity of the shares of common stock offered hereby has been passed upon for us by Fox Rothschild LLP, 997 Lenox Drive, Building 3, Lawrenceville, NJ 08648.

## **EXPERTS**

The audited consolidated balance sheets at December 31, 2013 and 2012 and the audited consolidated statements of operations, stockholders' (deficit) equity and cash flows for the years ended December 31, 2013 and 2012 have been audited by Rotenberg Meril Solomon Bertiger & Guttilla, P.C., our independent registered public accounting firm. We have included these financial statements in this registration statement in reliance upon the reports of such firm given their authority as experts in accounting and auditing.

## **ABOUT THIS PROSPECTUS**

This prospectus is part of a registration statement that we filed with the SEC. You should rely only on the information provided in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. The selling security holders are offering to sell, and seeking offers to buy, shares of common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of common stock. Applicable SEC rules may require us to update this prospectus in the future.

## **WHERE YOU CAN FIND MORE INFORMATION**



We file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any report, statement or other information that we file with the SEC at the SEC Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. You may obtain further information on the operation of the Public Reference room by calling the SEC at 1-800-SEC-0330. Our SEC filings are also available to the public at the SEC's website at [www.sec.gov](http://www.sec.gov), as well as our website at [www.bio-key.com](http://www.bio-key.com). Information contained on our website does not constitute a part of this prospectus.

This prospectus is part of a registration statement that we filed with the SEC. This prospectus and any accompanying prospectus supplement do not contain all of the information included in the registration statement, and certain statements contained in this prospectus and any accompanying prospectus supplement about the provisions or contents of any contract, agreement or any other document referred to herein are not necessarily complete. For each of these contracts, agreements or documents filed as an exhibit to the registration statement, we refer you to the actual exhibit for a more complete description of the matters involved. In addition, we have omitted certain parts of the registration statement in accordance with the rules and regulations of the SEC. To obtain all of the information that we filed with the SEC in connection herewith, we refer you to the registration statement, including its exhibits and schedules. You should assume that the information contained in this prospectus and any accompanying prospectus supplement is accurate only as of the date appearing on the front of the prospectus or prospectus supplement, as applicable.

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**BIO-KEY INTERNATIONAL, INC. AND SUBSIDIARY****CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>September 30,  2014 (Unaudited)</b>	<b>December 31,  2013</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$167,179	\$2,023,349
Accounts receivable, net of allowance for doubtful accounts of \$20,526 at September 30, 2014 and December 31, 2013	631,574	284,025
Due from factor	21,708	2,449
Inventory	12,025	9,376
Prepaid expenses and other	80,586	73,482
Total current assets	913,072	2,392,681
Equipment and leasehold improvements, net	104,510	125,062
Deposits and other assets	8,712	8,712
Intangible assets—less accumulated amortization	164,745	174,950
Total non-current assets	277,967	308,724
<b>TOTAL ASSETS</b>	<b>\$1,191,039</b>	<b>\$2,701,405</b>
<b>LIABILITIES</b>		
Accounts payable	\$457,278	\$540,912
Accrued liabilities	482,537	338,321
Deferred revenue	431,103	528,160
Total current liabilities	1,370,918	1,407,393
Warrant liabilities	83,327	243,077
<b>TOTAL LIABILITIES</b>	<b>1,454,245</b>	<b>1,650,470</b>
Commitments and contingencies		
<b>STOCKHOLDERS' (DEFICIT) EQUITY:</b>		
Common stock — authorized, 170,000,000 shares; \$.0001 par value issued and outstanding; 116,052,320 at September 30, 2014 and 115,842,315 as of December 31, 2013	11,605	11,584
Additional paid-in capital	55,972,787	55,909,923
Accumulated deficit	(56,247,598)	(54,870,572)
<b>TOTAL STOCKHOLDERS' (DEFICIT) EQUITY</b>	<b>(263,206 )</b>	<b>1,050,935</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' (DEFICIT) EQUITY</b>	<b>\$1,191,039</b>	<b>\$2,701,405</b>

The accompanying notes to the condensed consolidated financial statements are an integral part of these statements.

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**BIO-KEY INTERNATIONAL, INC. AND SUBSIDIARY****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30, 2014</b>	<b>2013</b>	<b>September 30, 2014</b>	<b>2013</b>
Revenues				
Services	\$496,127	\$246,760	\$1,027,069	\$781,172
License fees and other	787,720	184,816	2,027,089	877,304
	1,283,847	431,576	3,054,158	1,658,476
Costs and other expenses				
Cost of services	144,224	47,531	296,504	116,395
Cost of license fees and other	99,730	55,439	225,925	199,353
	243,954	102,970	522,429	315,748
Gross Profit	1,039,893	328,606	2,531,729	1,342,728
Operating Expenses				
Selling, general and administrative	989,521	740,725	2,741,665	2,054,110
Research, development and engineering	324,992	353,583	1,282,536	902,558
	1,314,513	1,094,308	4,024,201	2,956,668
Operating loss	(274,620 )	(765,702 )	(1,492,472 )	(1,613,940 )
Other income (expense)				
Interest income (expense)	2	(13,942 )	5	(36,113 )
Gain on derivative liabilities	223,892	-	117,153	-
Income taxes	(800 )	(2,910 )	(1,712 )	(2,910 )
	223,094	(16,852 )	115,446	(39,023 )
Net loss	\$(51,526 )	\$(782,554 )	\$(1,377,026 )	\$(1,652,963 )
<b>Basic and Diluted Loss per Common Share</b>	<b>\$(0.00 )</b>	<b>\$(0.01 )</b>	<b>\$(0.01 )</b>	<b>\$(0.02 )</b>
<b>Weighted Average Shares Outstanding:</b>				
Basic and Diluted	116,052,320	89,844,062	115,978,126	86,194,591

The accompanying notes to the condensed consolidated financial statements are an integral part of these statements.

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**BIO-KEY INTERNATIONAL, INC. AND SUBSIDIARY****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	<b>Nine Months Ended</b>	
	<b>September 30,</b>	<b>2013</b>
	<b>2014</b>	<b>2013</b>
<b>CASH FLOW FROM OPERATING ACTIVITIES:</b>		
Net loss	\$(1,377,026)	\$(1,652,963)
<b>Adjustments to reconcile net loss to cash used for operating activities:</b>		
Depreciation	29,905	18,351
Amortization		
Intangible assets	10,205	8,453
Deferred costs	-	11,776
Gain on derivative liabilities	(117,153 )	-
Share-based compensation	170,282	62,272
Other	6	-
<b>Change in assets and liabilities:</b>		
Accounts receivable	(347,549 )	508,933
Due from factor	(19,259 )	179,994
Inventory	(2,649 )	(1,494 )
Prepaid expenses and other	(7,104 )	(22,644 )
Accounts payable	(83,634 )	(489,453 )
Accrued liabilities	144,216	(181,172 )
Deferred revenue	(97,057 )	(206,505 )
Net cash used for operating activities	(1,696,817)	(1,764,452)
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(9,353 )	(23,446 )
Net cash used for investing activities	(9,353 )	(23,446 )
<b>CASH FLOW FROM FINANCING ACTIVITIES:</b>		
Repurchase of outstanding warrants	(150,000 )	-
Issuance of common stock	-	1,952,693
Repayment of notes payable – related party	-	(321,428 )
Proceeds from issuance of Note Payable	-	497,307
Costs to issue common stock	-	(142,133 )
Financing costs for Note Payable	-	(57,202 )
Net cash (used for) provided by financing activities	(150,000 )	1,929,237
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(1,856,170)</b>	<b>141,339</b>
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	<b>2,023,349</b>	<b>83,989</b>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$167,179</b>	<b>\$225,328</b>

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**BIO-KEY INTERNATIONAL, INC. AND SUBSIDIARY**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(Unaudited)**

**SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION**

	<b>Nine Months Ended September  30, 2014</b>
Cash paid for:	
Interest	\$- \$11,991
Noncash Investing and Financing Activities:	
Issuance of warrants for deferred financing costs and equity raise	\$- \$89,637

The accompanying notes to the condensed consolidated financial statements are an integral part of these statements.

**BIO-KEY INTERNATIONAL, INC. AND SUBSIDIARY**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

September 30, 2014 (Unaudited)

1. BASIS OF PRESENTATION

The accompanying unaudited interim condensed consolidated financial statements include the accounts of BIO-key International, Inc. and its wholly-owned subsidiary (collectively, the “Company”) and are stated in conformity with accounting principles generally accepted in the United States of America, pursuant to the rules and regulations of the Securities and Exchange Commission (the “SEC”). The operating results for interim periods are not necessarily indicative of results that may be expected for any other interim period or for the full year. Pursuant to such rules and regulations, certain financial information and footnote disclosures normally included in the financial statements have been condensed or omitted. Significant intercompany accounts and transactions have been eliminated in consolidation.

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all necessary adjustments, consisting only of those of a recurring nature, and disclosures to present fairly the Company’s financial position and the results of its operations and cash flows for the periods presented. The balance sheet at December 31, 2013 was derived from the audited financial statements, but does not include all of the disclosures required by accounting principles generally accepted in the United States of America. These unaudited interim condensed consolidated financial statements should be read in conjunction with the financial statements and the related notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2013 (the “Form 10-K”), filed with the SEC on March 31, 2014.

*Recently Issued Accounting Pronouncements*

Effective January 1, 2014, the Company prospectively adopted Accounting Standards Update (“ASU”) No. 2013-11, “Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists” (“ASU 2013-11”). ASU 2013-11 is expected to reduce diversity in practice by providing guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity would settle at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The adoption of ASU 2013-11 did not have a material effect on its consolidated financial statements.

In May 2014, ASU No. 2014-09, "Revenue from Contracts with Customers" was issued. The comprehensive new standard will supersede existing revenue recognition guidance and require revenue to be recognized when promised goods or services are transferred to customers in amounts that reflect the consideration to which the Company expects to be entitled in exchange for those goods or services. The guidance will also require that certain contract costs incurred to obtain or fulfill a contract, such as sales commissions, be capitalized as an asset and amortized as revenue is recognized. Adoption of the new rules could affect the timing of both revenue recognition and the incurrence of contract costs for certain transactions. The guidance permits two implementation approaches, one requiring retrospective application of the new standard with restatement of prior years and one requiring prospective application of the new standard with disclosure of results under old standards. The new standard is effective for reporting periods beginning after December 15, 2016 and early adoption is not permitted. For the Company, the new standard will be effective January 1, 2017. The Company is currently evaluating the impact of adoption and the implementation approach to be used.

In June 2014, ASU 2014-12, “Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period” (“ASU No. 2014-12”) was issued. ASU No. 2014-12 requires that a performance target that affects vesting and that could be achieved after the requisite service period is treated as a performance condition. An entity should recognize compensation cost in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the periods for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. ASU 2014-12 becomes effective for interim and annual periods beginning on or after December 15, 2015. Early adoption is permitted. The Company is currently evaluating the effects of adopting ASU 2014-12 on its consolidated financial statements but the adoption is not expected to have a significant impact on the Company’s consolidated financial statements.

In June 2014, ASU 2014-15, “Presentation of Financial Statements – Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern” (“ASU No. 2014-15”) was issued. Before the issuance of ASU 2014-15, there was no guidance in U.S. GAAP about management’s responsibility to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern or to provide related footnote disclosures. This guidance is expected to reduce the diversity in the timing and content of footnote disclosures. ASU 2014-15 requires management to assess an entity’s ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards as specified in the guidance. ASU 2014-15 becomes effective for the annual period ending after December 15, 2016 and for annual and interim periods thereafter. Early adoption is permitted. The Company is currently evaluating the effects of adopting ASU 2014-15 on its consolidated financial statements but the adoption is not expected to have a significant impact on the Company’s consolidated financial statements.

Management does not believe that any other recently issued, but not yet effective, accounting standard if currently adopted would have a material effect on the accompanying consolidated financial statements.

## 2. GOING CONCERN

The Company has incurred significant losses to date and at September 30, 2014, had an accumulated deficit of approximately \$56 million. In addition, broad commercial acceptance of the Company’s technology is critical to the Company’s success and ability to generate future revenues. At September 30, 2014, the Company’s total cash and cash equivalents were approximately \$167,000, as compared to approximately \$2,023,000 at December 31, 2013. On November 13, 2014, the Company issued to certain private investors 14,316,664 shares of common stock and warrants to purchase an additional 21,474,997 shares of common stock for aggregate net proceeds of \$1,376,166. (See Note 10 – Subsequent Events)

The Company has financed itself in the past through access to the capital markets by issuing secured and convertible debt securities, convertible preferred stock, common stock, and through factoring receivables. The Company currently requires approximately \$475,000 per month to conduct operations, a monthly amount that it has been unable to achieve consistently through revenue generation.

If the Company is unable to generate sufficient revenue to meet its goals, it will need to obtain additional third-party financing to (i) conduct the sales, marketing and technical support necessary to execute its plan to substantially grow operations, increase revenue, and serve a significant customer base; and (ii) provide working capital. 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 by the Company in order to meet its needs, or that such financing would not be dilutive to existing shareholders.

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern, and assumes continuity of operations, realization of assets and the satisfaction of liabilities and commitments in the normal course of business. The matters described in the preceding paragraphs raise substantial doubt about the Company's ability to continue as a going concern. Recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon the Company's ability to meet its financing requirements on a continuing basis, and become profitable in its future operations. The accompanying consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

## 3. SHARE BASED COMPENSATION

The following table presents share-based compensation expenses for continuing operations included in the Company's unaudited interim condensed consolidated statements of operations:

	<b>Three Months Ended September 30, 2014</b>	<b>Three Months Ended September 30, 2013</b>
Selling, general and administrative	\$ 32,700	\$ 19,294
Research, development and engineering	5,364	2,961
	<b>\$ 38,064</b>	<b>\$ 22,255</b>
	<b>Nine Months Ended September 30, 2014</b>	<b>Nine Months Ended September 30, 2013</b>
Selling, general and administrative	\$ 144,616	\$ 50,571
Research, development and engineering	25,666	11,701
	<b>\$ 170,282</b>	<b>\$ 62,272</b>

## 4. EARNINGS (LOSS) PER SHARE COMMON STOCK ("EPS")

The Company's basic EPS is calculated using net income (loss) and the weighted-average number of shares outstanding during the reporting period. Diluted EPS includes the effect from potential issuance of common stock, such as stock issuable pursuant to the exercise of stock options and warrants.

The following table summarizes the options and warrants which were excluded from the diluted per share calculation even though the exercise prices were less than the average market price of the common shares because the effect of including these potential shares was antidilutive due to the net losses for the three and nine month periods ended September 30:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Stock Options	728,298	2,802,392	1,429,391	2,027,713
Warrants	-	817,072	-	174,477
Total	728,298	3,619,464	1,429,391	2,202,190

Items excluded from the diluted per share calculation because the exercise price was greater than the average market price of the common shares:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Stock options	6,195,001	410,000	3,480,000	410,000
Warrants	30,369,129	3,500,006	30,369,129	11,750,006
Total	36,564,130	3,910,006	33,849,129	12,160,006

## 5. STOCKHOLDERS' DEFICIT

### Derivative Liabilities

In connection with the issuances of equity instruments or debt, the Company may issue options or warrants to purchase common stock. In certain circumstances, these options or warrants may be classified as liabilities, rather than as equity. In addition, the equity instrument or debt may contain embedded derivative instruments, such as conversion options or listing requirements, which in certain circumstances may be required to be bifurcated from the associated host instrument and accounted for separately as a derivative liability instrument. The Company accounts for derivative liability instruments under the provisions of FASB ASC 815, "Derivatives and Hedging."

### Securities Purchase Agreements dated October 25, 2013 and November 8, 2013

The Company issued common stock (the "Shares") and warrants (the "Warrants") pursuant to a series of Private Investors Securities Purchase Agreements (the "PI SPA") on October 25, 2013 and November 8, 2013. Each unit had a purchase price of \$0.15 and consisted of one Share and one Warrant. The Warrants are immediately exercisable at an exercise price of \$0.25 per share, have a term of three years, and were exercisable on a cashless basis if at any time following the nine month anniversary of the issuance date, there was not an effective registration statement covering the public resale of the shares of Common Stock underlying the Warrants. The Shares and shares of common stock underlying the Warrants were subject to a registration rights agreement. The Company filed a registration statement on November 22, 2013 and such registration was declared effective on December 31, 2013.



Investors in the PI SPA had certain anti-dilution rights which required the Company to issue additional shares of common stock to the investors if within the nine months following November 8, 2013, the Company, sold or issued any common stock or common stock equivalents (other than sales or issuances to directors, officers, employees or independent contractors in the ordinary course of business for compensation purposes and stock splits and stock dividends payable in respect of the Company's common stock) having a purchase, exercise or conversion price per share of less than \$0.15.

Based on an evaluation as discussed in FASB ASC 815-15, "Embedded Derivatives" and FASB ASC 815-40-15, "Contracts in Entity's Own Equity - Scope and Scope Exceptions," the Company determined that the anti-dilution features in the common stock issued were not considered indexed to its own stock because neither the occurrence of a sale of equity securities by the issuer at market nor the issuance of another equity contract with a lower strike price is an input to the fair value of a fixed-for-fixed option or forward on equity shares. As such, the anti-dilution features should be bifurcated from the common stock and accounted for as a derivative liability.

The Company did not value the derivative liability. One of the key determinants of the Company's decision to not value the derivative liability was the high likelihood that a future financing would not occur that would trigger the down round feature. Whether a future equity financing would occur would be determined by the cash needs of the Company and management's willingness to trigger the down round feature. The Company's reasons were as follows:

1. The Company's cash position.
2. The stock price of the Company's common stock.
3. The unavailability of enough authorized shares to complete a large offering.

The anti-dilution feature expired on August 8, 2014, and no equity financing events occurred during the period of the anti-dilution right.

Pursuant to a placement agency letter agreement, the Company paid the placement agent cash commissions equal to 8% of the gross proceeds of the offering, reimbursed the placement agent for its reasonable out of pocket expenses, and issued to the placement agent warrants (the "Placement Agent Warrants") to purchase an aggregate of 1,971,786 shares of common stock. The Placement Agent Warrants have substantially the same terms as the Warrants issued to the investors, except the Placement Agent Warrants are immediately exercisable on a cashless basis.

The cashless exercise features contained in the Placement Agent Warrants are considered to be derivatives and the Company recorded a warrant liability on the condensed consolidated balance sheet. The Company recorded the warrant liabilities equal to their estimated fair value in 2013. The Company is required to mark-to-market the warrant liability at the end of each reporting period. For the three months ended September 30, 2014, the Company recorded a gain on the change in fair value of the cashless exercise feature of \$223,892. For the nine months ended September 30, 2014, the Company recorded a net gain on the change in fair value of the cashless exercise feature of \$123,380. At September 30, 2014 and December 31, 2013, the fair value of the cashless exercise feature was \$83,327 and \$206,707, respectively.

### Warrants

On August 15, 2013, the Company issued a warrant to purchase 300,000 shares of the Company's common stock to an independent contractor. On March 11, 2014, the warrant was exercised on a cashless basis resulting in the issuance of 153,659 shares of common stock.

The cashless exercise feature contained in the warrant was considered to be a derivative and the Company recorded a warrant liability on the condensed consolidated balance sheet. The Company recorded the warrant liability equal to its estimated fair value. The Company was required to mark-to-market the warrant liabilities at the end of each reporting period. As the warrant was exercised, the Company marked-to-market the warrant on the day before the exercise and such value was then transferred to additional paid-in capital. For the nine months ended September 30, 2014, the Company recorded a loss on the change in fair value of the cashless exercise feature of \$6,211. \$42,581, the value of the cashless exercise feature as of March 10, 2014, was transferred to additional paid-in capital. The fair value of the cashless exercise feature was \$36,370 as of December 31, 2013.

On January 27, 2014, the Company repurchased a warrant for the purchase of 8,000,000 shares of common stock from the Shaar Fund Ltd. at a purchase price of \$150,000. The warrant was exercisable at a strike price of \$0.30 per share through December 31, 2015.

Issuances and Exercise of Stock Options

During the three and nine months ended September 30, 2014, the Company granted 0 and 3,420,000 stock options, respectively. The options are exercisable for a term of seven years and vest in equal installments over a three-year period commencing on the date of grant. 2,970,000 of the options are exercisable at \$0.205 per share and 350,000 of the options are exercisable at \$0.17 per share.

During the nine months ended September 30, 2014, the Company issued 56,346 shares of common stock for the cashless exercise of stock options.

6. SEGMENT INFORMATION

The Company has determined that its continuing operations are one discrete segment consisting of biometric products. Geographically, North American sales accounted for approximately 81% and 97% of the Company's total sales for the three months ended September 30, 2014 and 2013, respectively, and were approximately 91% and 97% of the Company's total sales for the nine months ended September 30, 2014 and 2013, respectively.

## 7. FAIR VALUES OF FINANCIAL INSTRUMENTS

Cash and cash equivalents, accounts and notes receivable, accounts payable, accrued liabilities, and notes payable, are carried at, or approximate, fair value because of their short-term nature.

The fair value of the warrant liabilities were measured using the following assumptions:

Risk-free interest rate	0.60	%
Expected term	2.07 – 2.11	
Expected dividends	0	
Volatility of stock price	94.7% - 98.6	%

The warrant liabilities are considered Level 3 liabilities on the fair value hierarchy as the determination of fair value includes various assumptions about of future activities and the Company's stock prices and historical volatility as inputs.

Compensatory Warrant	
Fair value at January 1, 2014	\$36,370
Loss on derivative	6,211
Transfer to additional paid-in-capital	(42,581 )
Value at September 30, 2014	-

Warrant issued under PI SPA	
Fair value at January 1, 2014	206,707
Gain on derivative	(123,380)
Value at September 30, 2014	83,327
Balance, September 30, 2014	\$83,327

## 8. MAJOR CUSTOMERS AND ACCOUNTS RECEIVABLE

The Company had certain customers whose revenue individually represented 10% or more of the Company's total revenue, or whose accounts receivable balances individually represented 10% or more of the Company's total accounts receivable, as follows:

For the three months ended September 30, 2014 and 2013, three customers accounted for 58% and two customers accounted for 43% of revenue, respectively. For the nine months ended September 30, 2014 and 2013, four customers accounted for 71% and three customers accounted for 47% of revenue, respectively.

At September 30, 2014, three customers accounted for 70% of accounts receivable. At December 31, 2013, one customer accounted for 50% of accounts receivable.

## 9. CONTINGENCY

On or about March 13, 2014, LifeSouth Community Blood Centers, Inc. (“LifeSouth”) filed a lawsuit against the Company in the Superior Court of Monmouth County, New Jersey based on an alleged breach of a license agreement seeking return of all amounts paid under the license in the amount of \$718,500. The Company has denied all claims and asserted a counterclaim against LifeSouth for non-payment of support and maintenance service fees. Discovery has commenced and is proceeding.

## 10. SUBSEQUENT EVENTS

On November 13, 2014, the Company raised additional working capital of \$1,431,666 through the issuance of 14,316,664 shares of common stock and warrants to purchase an additional 21,474,997 shares of common stock in a private placement transaction. As part of the transaction, the investors surrendered to the Company for cancellation, previously issued warrants to acquire shares of common stock. In connection with the transaction, the Company is obligated to effect a 1-for-2 reverse split of its common stock and register the public resale of both the shares of common stock issued and the shares underlying the warrants. Warrants to purchase 50% of the shares are immediately exercisable and the balance are exercisable upon completion of the 1-for-2 reverse split of our outstanding shares. The warrants have a term of five years and are exercisable at \$0.15 per share, subject to “full ratchet” anti-dilution adjustment. In addition, if at any time within two years after the effective date of the registration statement the Company issues shares of common stock at a price lower than \$0.10 per share, it will be required to issue additional shares of common stock. In connection with the transaction described above, the Company expects to incur estimated costs of \$55,500, which will be offset against additional paid-in capital.

## **Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

BIO-key International, Inc.

North Billerica, MA

We have audited the accompanying consolidated balance sheets of BIO-key International, Inc. and Subsidiary (the "Company") as of December 31, 2013 and 2012, and the related consolidated statements of operations, stockholders' equity (deficit) and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated 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 audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management as well as evaluating the overall consolidated financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of BIO-key International, Inc. and Subsidiary as of December 31, 2013 and 2012, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As disclosed in the consolidated financial statements, the Company has suffered substantial net losses in recent years, has an accumulated deficit at December 31, 2013 and is dependent on debt and equity financing to fund its operations, all of which raise substantial doubt about the Company's ability to continue as a going concern. Management's plans regarding these matters are disclosed in Note A. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Rotenberg Meril Solomon Bertiger & Guttilla,P.C.

ROTENBERG MERIL SOLOMON BERTIGER &  
GUTTILLA, P.C.

Saddle Brook, New Jersey

March 31, 2014

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

	<b>December 31</b>	
	<b>2013</b>	<b>2012</b>
<b>ASSETS</b>		
Cash and cash equivalents	\$2,023,349	\$83,989
Accounts receivable, net	284,025	604,784
Due from factor	2,449	189,904
Inventory	9,376	4,186
Prepaid expenses and other	73,482	25,088
Total current assets	2,392,681	907,951
Equipment and leasehold improvements, net	125,062	24,267
Deposits and other assets	8,712	8,712
Intangible assets—less accumulated amortization	174,950	195,911
Total non-current assets	308,724	228,890
<b>TOTAL ASSETS</b>	<b>\$2,701,405</b>	<b>\$1,136,841</b>
<b>LIABILITIES</b>		
Accounts payable	\$540,912	\$931,276
Accrued liabilities	338,321	593,599
Deferred revenue	528,160	508,520
Note payable – related party	-	321,428
Total current liabilities	1,407,393	2,354,823
Warrant liabilities	243,077	-
<b>TOTAL LIABILITIES</b>	<b>1,650,470</b>	<b>2,354,823</b>
Commitments		
<b>STOCKHOLDERS' EQUITY (DEFICIT)</b>		
Common stock — authorized, 170,000,000 shares; issued and outstanding; 115,842,315 and 78,155,413 of \$.0001 par value at December 31, 2013 and December 31, 2012, respectively	11,584	7,815
Additional paid-in capital	55,909,923	51,062,624
Accumulated deficit	(54,870,572)	(52,288,421)
<b>TOTAL STOCKHOLDERS' EQUITY (DEFICIT)</b>	<b>1,050,935</b>	<b>(1,217,982 )</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)</b>	<b>\$2,701,405</b>	<b>\$1,136,841</b>

The accompanying notes are an integral part of these statements.



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**BIO-key International, Inc. and Subsidiary****CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>Years ended December</b>	
	<b>31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Revenues</b>		
Services	\$988,003	\$1,094,731
License fees and other	997,973	2,741,162
	1,985,976	3,835,893
<b>Costs and other expenses</b>		
Cost of services	145,702	221,027
Cost of license fees and other	241,326	350,706
	387,028	571,733
Gross Profit	1,598,948	3,264,160
<b>Operating expenses</b>		
Selling, general and administrative	2,776,559	2,288,903
Research, development and engineering	1,344,070	947,371
	4,120,629	3,236,274
<b>Operating (loss) income</b>	(2,521,681 )	27,886
<b>Other income (deductions)</b>		
Interest income	7	7
Interest expense	(136,484 )	(24,626 )
Gain on derivative liabilities	78,812	-
Income taxes	(2,805 )	-
	(60,470 )	(24,619 )
Net (loss) income	\$(2,582,151 )	\$3,267
<b>Basic and Diluted (Loss) Income per Common Share:</b>	\$(0.03 )	\$0.00
<b>Weighted Average Shares Outstanding:</b>		
Basic and Diluted	91,791,690	78,155,413

The accompanying notes are an integral part of these statements.



## BIO-key International, Inc. and Subsidiary

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)

	Common Stock		Additional	Accumulated	
	Shares	Amount	Contributed	Deficit	Total
<b>Balance as of December 31, 2011</b>	<b>78,155,413</b>	<b>\$7,815</b>	<b>\$51,012,782</b>	<b>\$(52,291,688 )</b>	<b>\$(1,271,091)</b>
Share-based compensation	—	—	49,842	—	49,842
Net income	—	—	—	3,267	3,267
<b>Balance as of December 31, 2012</b>	<b>78,155,413</b>	<b>\$7,815</b>	<b>\$51,062,624</b>	<b>\$(52,288,421 )</b>	<b>\$(1,217,982)</b>
Issuance of common stock and warrants pursuant to security purchase agreements	37,174,277	3,718	5,646,076	—	5,649,794
Issuance of common stock pursuant to anti-dilution rights	412,067	41	(41 )	—	—
Issuance of common stock in exchange for options exercised	100,558	10	(10 )	—	—
Derivative liabilities associated with security purchase agreements	---	---	(346,214 )	---	(346,214 )
Stock issuance costs	—	—	(648,116 )	—	(648,116 )
Share-based compensation	—	—	81,642	—	81,642
Reclassification of derivative liability	---	----	113,962	---	113,962
Net loss	—	—	—	(2,582,151 )	(2,582,151)
<b>Balance as of December 31, 2013</b>	<b>115,842,315</b>	<b>\$11,584</b>	<b>\$55,909,923</b>	<b>\$(54,870,572 )</b>	<b>\$1,050,935</b>

The accompanying notes are an integral part of these statements.

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

	<b>Years ended December</b>	
	<b>31,</b>	
	<b>2013</b>	<b>2012</b>
<b>CASH FLOW FROM OPERATING ACTIVITIES:</b>		
Net (loss) income	\$(2,582,151)	\$3,267
<b>Adjustments to reconcile net (loss) income to cash (used for) provided by operating activities:</b>		
Allowance for doubtful accounts	-	(377,000)
Depreciation	28,618	28,603
Amortization:		
Intangible assets	20,961	11,269
Deferred costs	107,203	-
Share-based compensation	81,642	49,842
Gain on derivative liabilities	(78,812 )	-
<b>Change in assets and liabilities:</b>		
Accounts receivable trade	320,759	359,562
Due from factor	187,455	(189,904)
Inventory	(5,190 )	4,051
Prepaid expenses and other	(48,394 )	33,833
Accounts payable	(480,364 )	243,835
Accrued liabilities	(255,278 )	(82,234 )
Deferred revenue	19,640	(19,572 )
Net cash (used for) provided by operating activities	(2,683,911)	65,552
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(129,413 )	-
Net cash used for investing activities	(129,413 )	-
<b>CASH FLOW FROM FINANCING ACTIVITIES:</b>		
Issuances of common stock	5,649,793	-
Repayment of notes payable – related party	(321,428 )	(25,000 )
Proceeds from issuance of Note Payable	497,307	-
Repayment of Note Payable	(497,307 )	-
Costs to issue common stock and Note Payable	(575,681)	