BIO KEY INTERNATIONAL INC
Form SB-2
October 29, 2004

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As filed with the Securities and Exchange Commission on October 29, 2004

Registration No. 333-

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM SB-2

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

BIO-key International, Inc.

(Exact name of registrant as specified in its charter)

Minnesota	**3577**	**41-1741861**
(State of incorporation)	*(Primary Standard Industrial Classification Code Number)*	*(I.R.S. Employer Identification No.)*

1285 Corporate Center Drive, Suite 175, Eagan, MN 55121, (651) 687-0414

(Address and telephone number of registrant's principal executive offices)

Michael W. DePasquale
Chief Executive Officer
BIO-key International, Inc., 1285 Corporate Center Drive, Suite 175, Eagan, MN 55121, (651) 687-0414
(Name, address and telephone number of agent for service)
Copy to:

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Approximate date of commencement of proposed sale to public: From time to time after this registration statement becomes effective.

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, as amended, or the Securities Act, check the following box. ý

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

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. o

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. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

Calculation of Registration Fee

Title of each class of securities to be registered	Number of units to be registered(1)	Proposed maximum aggregate offering price per unit(2)	Proposed maximum aggregate offering price(2)	Amount of registration fee
Common Stock, $.01 par value per share, issuable upon conversion of secured convertible term notes	4,338,105 shares(3)	$0.97	$4,207,962	$534
Common Stock, $.01 par value per share, issuable upon exercise of warrants	1,122,222 shares(4)	$0.97	$1,088,556	$138
Common Stock, $.01 par value per share, issuable upon conversion of subordinated convertible term notes	4,477,045 shares(5)	$0.97	$4,342,734	$550
Common Stock, $.01 par value per share, issuable upon exercise of warrants	1,059,553 shares(6)	$0.97	$1,027,767	$131

(1) Pursuant to Rule 416 under the Securities Act, this registration statement also covers an indeterminate number of additional shares of the registrant's common stock as may be issuable upon any stock split, stock dividend or similar transaction.

(2) Estimated pursuant to Rule 457(c) under the Securities Act solely for the purpose of calculating the registration fee, based upon the average of the high and low sale prices of the registrant's common stock as reported on the OTC Bulletin Board on October 26, 2004.

(3) Shares of the registrant's common stock issuable upon conversion of secured convertible term notes issued pursuant to a securities purchase agreement dated as of September 29, 2004.

(4) Shares of the registrant's common stock issuable upon the exercise of warrants issued pursuant to a securities purchase agreement dated as of September 29, 2004.

(5) Shares of the registrant's common stock issuable upon conversion of subordinated convertible term notes issued pursuant to a securities purchase agreement dated as of September 29, 2004.

(6) Shares of the registrant's common stock issuable upon the exercise of warrants issued pursuant to a securities purchase agreement dated as of September 29, 2004.

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.

Subject to completion, dated October 29, 2004

PROSPECTUS

10,996,925 Shares

BIO-key International, Inc.

Common Stock

We are registering up to 10,996,925 shares of our common stock for offer or sale by the selling security holders named in this prospectus. Of the shares being registered, 8,815,150 shares are issuable upon conversion of convertible term notes issued to certain of the selling security holders and 2,181,775 shares are issuable upon exercise of warrants issued to certain of the selling security holders. The selling security holders may offer or sell all or a portion of their shares publicly or through private transactions at prevailing market prices or at negotiated prices. We will not receive any proceeds from the shares being registered for offer and sale by the selling security holders. We will, however, receive proceeds from the exercise price of certain warrants held by the selling security holders to the extent that such warrants are exercised.

Investing in our common stock involves a high degree of risk.
See "Risk Factors" beginning on page 4.

Our common stock is traded on the OTC Bulletin Board under the symbol "BKYI." The last reported sale price of our common stock on October 26, 2004 was $0.97 per share.

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

, 2004

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You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information that is different. This prospectus may only be used where it is legal to sell these securities. The information in this prospectus may only be accurate on the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our common stock. Applicable rules of the Securities and Exchange Commission may require us to update this prospectus in the future.

PROSPECTUS SUMMARY

About BIO-key International, Inc.

BIO-key International, Inc. (the "Company," "BIO-key," "we" or "us") is in the business of delivering advanced identification solutions and information services to law enforcement departments, public safety agencies and other government and private sector customers. Our mobile wireless technology provides first responders with critical, reliable, real-time data and images from local, state, and national databases. More than 2,500 police, fire and emergency services departments in North America currently utilize the our solutions, making us a leading supplier of mobile and wireless solutions for public safety.

Our scalable biometric finger identification technology identifies and authenticates users of wireless and enterprise data to improve security, convenience and privacy as well as reducing identity theft. Biometrics is the science of analyzing specific human characteristics which are unique to an individual in order to identify a specific individual from a broader population. Our technology scans a person's fingerprint and identifies that person within seconds without using a password, key card, personal identification number or any other identifying data. Fingerprint analysis is an accurate and reliable method to distinguish one individual from another and is generally viewed as less intrusive than many other biometric identification methods. We believe our technology and products will have a broad range of applications relating to protecting access to information and assets in both electronic and physical environments, including:

Delivering mission critical centralized enterprise information to field personnel graphically and wirelessly through standard off-the-shelf hardware devices;

Securing access to logical networks and applications;

Securing access to buildings and restricted areas; and

Prevention of identity and data theft.

Our technology provides a reliable and secure user identification/authentication system for public and private computer networks. WEB-key is designed to secure access to proprietary information residing on remote servers which is transmitted via the Internet. It is compatible with Oracle server software and new security features in Microsoft's Internet Explorer Versions 5.5 SP2 and 6.0. Network authentication is typically accomplished by using passwords. Since passwords can be lost, transferred, stolen or forgotten, we believe our WEB-key biometric solution is a more secure method for verifying the identity of remote users and eliminates the substantial administrative costs associated with tracking and reissuing new passwords.

On March 30, 2004, we acquired Public Safety Group, Inc. ("PSG"), a privately held leader in wireless solutions for law enforcement and public safety markets. PSG's primary technology is a software solution that provides police officers and other security personnel instantaneous access to criminal, civil and private database information in a wireless environment. PocketCop© is a handheld application that allows law enforcement officers to access state and federal databases over the wireless network for PalmOS, Windows CE and PocketPC. With the use of a portable wireless handheld device and PocketCop© application software, an authorized user can access suspect information such as wanted status, warrant status, vehicle registration and driver license status. With our acquisition of PSG, we believe there is a substantial market opportunity to integrate our VST and WEB-key biometric technologies with the PSG mobile solution.

On September 30, 2004, we acquired the Mobile Government Division ("Aether Mobil Government") of Aether Systems, Inc. ("Aether"). Pursuant to the Asset Purchase Agreement dated as of August 16, 2004 by and among the Company, Aether, Cerulean Technology, Inc. and SunPro, Inc., we paid Aether a purchase price of $10,000,000 in cash, subject to post-closing adjustments to reflect changes in Aether Mobile Government's working capital and cash flows since June 30, 2004. In connection with this acquisition, we also issued a subordinated secured promissory note to Aether in the face amount of $6,884,588 (the "Aether Note"). The Aether Note evidences a contingent reimbursement obligation of the Company to Aether and a surety fee payable by the Company to Aether, in each case with respect to a letter of credit maintained by Aether for the Company's benefit in connection with the acquisition. Our obligations under the Aether Note are secured by a security interest granted to Aether in all or substantially all of our assets, subordinate to the security interests described in the "Convertible Debt Financing Transactions" section of this prospectus below.

Aether Mobile Government provides wireless data solutions for use by public safety organizations, primarily state and local police, fire and rescue and emergency medical services organizations, that enable such organizations to access law enforcement databases to validate identities and obtain suspect information. Its public safety solutions are integrated into fifty (50) different state databases, as well as local and federal databases, and its products deliver real-time information in seconds, without the need for human dispatchers or other resources.

Although biometric based solutions currently compete with more traditional security methods such as keys, cards, personal identification numbers and security personnel, biometric technology is becoming an acceptable approach to physical and logical security. Our current business plan is to:

- License our core technology "VST" to original equipment manufacturers, systems integrators and application developers to develop and market products and applications which can then be sold to end users;

- License WEB-key , our web-based biometric authentication solution; and

- Provide for "device independent" finger identification matching for virtually any application utilizing the latest advances in scanning technology.

- License our wireless software solutions for law enforcement and public safety markets.

We have evolved from a development stage company to a revenue generating company, but we have sustained substantial losses to date. We completed a private placement equity offering in March 2004 that resulted in approximately $12,000,000 in gross proceeds to the Company and a private placement convertible debt offering in September 2004 that resulted in approximately $10,000,000 in gross proceeds to the Company (a portion of which was used to finance the acquisition of Aether Mobile Government), and management believes that we now have sufficient funds to meet our working capital requirements for at least the next twenty-four (24) months. To the extent that we will require additional capital to support our operations, expand our marketing and sales efforts and to execute our business plan, we may need to obtain additional financing.

Our principal executive offices are located at 1285 Corporate Center Drive, Suite 175, Eagan, Minnesota 55121 and our telephone number is (651) 687-0414.

About the Offering

This prospectus covers the public resale of up to 10,996,925 shares of our common stock to be sold by the selling security holders identified herein. 4,338,105 shares of our common stock covered by this prospectus are issuable upon conversion of secured convertible term notes in the aggregate principal amount of $5,050,000, together with accrued interest and fees due thereon, issued to Laurus Master Fund, Ltd. and other institutional and accredited investors pursuant to a Securities Purchase Agreement dated as of September 29, 2004 (the "Senior Purchase Agreement") by and among the Company and such investors. 1,122,222 shares of our common stock covered by this prospectus are issuable upon exercise of warrants issued to the investors party to the Senior Purchase Agreement. 4,477,045 shares of our common stock covered by this prospectus are issuable upon conversion of subordinated convertible term notes in the aggregate principal amount of $4,768,000, together with accrued interest and fees due thereon, issued to The Shaar Fund Ltd. and other institutional and accredited investors pursuant to a Securities Purchase Agreement dated as of September 29, 2004 (the "Subordinated Purchase Agreement") by and among the Company and such investors. 1,059,553 shares of our common stock covered by this prospectus are issuable upon exercise of warrants issued to the investors party to the Subordinated Purchase Agreement.

RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the following information about certain of the risks of investing in our common stock, together with other information contained in this prospectus, before you decide to purchase our common stock.

Business and Financial Risks

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

From inception through December 31, 2003, we accumulated a deficit of approximately $27,676,000 and negative cash flow from operations of approximately $19,038,000. As of December 31, 2003, we had positive working capital of approximately $1,085,000, but a stockholders' deficit of approximately $9,136,000. Since our inception, we have focused almost exclusively on developing our core technology and have not generated any significant historical revenue. In order to generate revenue, we have developed a direct sales force and anticipate the need to retain additional sales, marketing and technical support personnel and incur substantial expenses. We cannot assure you that we will be able to secure these necessary resources, that a significant market for our technology will develop or that we will be able to achieve our targeted revenue.

Our technology has yet to gain widespread market acceptance and we do not know how large of a 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 generated any significant sales. Although recent security concerns relating to identification of individuals has increased interest in biometrics generally, it remains an undeveloped, evolving market. Biometric based solutions compete with more traditional security methods including keys, cards, personal identification numbers and security personnel. Acceptance of biometrics as an alternative to such traditional methods depends upon a number of factors including:

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

For these reasons, we are uncertain whether our 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 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 solution provides a higher level of security for information transmitted over the Internet than existing traditional methods, unless business and consumer markets embrace the use of a scanning device and believe the benefits of increased accuracy outweigh implementation costs, our solution will not gain market acceptance.

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

Although we have completed the development of our core 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 customers. Any such default or error in new or existing software or applications could cause delays in delivering our technology or require design modifications. These could adversely affect our competitive position and cause us to lose potential customers or opportunities. Since our technology is intended to be utilized to secure physical and electronic access, the effect of any such bugs or delays will likely have a detrimental impact on us. In addition, given that biometric technology generally, and our technology specifically, has 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.

While we have commenced a significant sales and marketing effort, we have only developed a limited distribution channel and may not have the resources or ability to sustain these efforts or generate any meaningful sales.

In order to generate revenue, 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.

We face intense competition and may not have the financial and human resources necessary to keep up with rapid technological changes which may result in our technology becoming obsolete.

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

We depend on our chairman of the board and chief executive officer and need additional marketing and technical personnel to successfully market our technology. We cannot assure you that we will be able to retain or attract such persons.

A loss of our current Chairman of the Board of Directors or Chief Executive Officer could severely and negatively impact our operations. We have an employment contract with Michael W. DePasquale, our Chief Executive Officer. Although the contract does not prevent him from resigning, it does contain confidentiality and non-compete clauses which are intended to prevent him from working for a competitor within one year after leaving our Company. We continue to retain additional 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 limited intellectual property protection for our core technology provides a meaningful competitive advantage or barrier to entry against our competitors.

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

We may need to obtain additional financing to execute our business plan 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 any significant revenue and have experienced substantial losses, including approximately $3,826,000 during 2003. We also have a stockholders' deficit as of December 31, 2003. In March 2004, we completed a private placement equity offering that resulted in approximately $12,000,000 in gross proceeds to the Company and a private placement convertible debt offering in September 2004 that resulted in approximately $10,000,000 in gross proceeds to the Company (a portion of which was used to finance the acquisition of Aether Mobile Government), and management now believes that we have sufficient funds to meet our working capital requirements for at least the next twenty-four (24) months. To the extent that we will require additional capital to support our operations, expand our marketing and sales efforts and to execute our business plan to substantially increase revenue, we may need to obtain additional financing through the issuance of debt or equity securities. We have not and cannot assure you that we will ever be able to secure any such financing on terms acceptable to us. If we cannot obtain such financing or generate such revenues, we may not be able to execute our business plan or continue operations.

We may not be able to successfully integrate recent acquisitions into our operations.

On September 30, 2004, we completed our transaction with Aether to purchase Aether Mobil Government based in Marlborough, Massachusetts, a provider of wireless data solutions for use by public safety organizations, as described further in the "Acquisition of Aether Mobile Government" section of this prospectus. The integration of Aether Mobile Government into our operations involves a number of risks, including:

- difficulty integrating operations and personnel;
- diversion of management attention;
- potential disruption of ongoing business;
- inability to retain key personnel;
- inability to successfully incorporate the acquired products and services into our product and service offerings and to develop new products and services; and
- impairment of relationships with employees, customers or vendors.

Failure to overcome these risks or any other problems encountered in connection with the acquisition of Aether Mobile Government could slow our growth or lower the quality of our services, which could reduce customer demand. The result could be an adverse effect on our financial results.

We may not achieve profitability with respect to our law enforcement and public safety division 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.

Our law enforcement and public safety division depends upon wireless networks owned and controlled by others.

If we do not have continued access to sufficient capacity on reliable networks, we may be unable to deliver services and our sales could decrease. Our ability to grow and achieve profitability partly depends on our ability to buy sufficient capacity on the networks of wireless carriers such as Verizon Wireless, Bell South Corporation, Metrocall, Motient and AT&T Wireless and on the reliability and security of their systems. All of our services are delivered using airtime purchased from third parties. We depend on these companies to provide uninterrupted and bug free service and would not be able to satisfy our customers' needs if they failed to provide the required capacity or needed level of service. In addition, our expenses would increase and our profitability could be materially adversely affected if wireless carriers were to increase the prices of their services. Our existing agreements with the wireless carriers generally have one-year terms. Some of these wireless carriers are, or could become, our competitors and if they compete with us they may refuse to provide us with their services.

New laws and regulations that impact our law enforcement and public safety division could increase our costs or reduce our opportunities to earn revenue.

We are not currently subject to direct regulation by the Federal Communications Commission or any other governmental agency, other than regulations applicable to businesses in general. However, in the future, we may become subject to regulation by the FCC or another regulatory agency. In addition, the wireless carriers who supply us airtime and certain of our hardware suppliers are subject to regulation by the FCC and regulations that affect them could increase our costs or reduce our ability to continue selling and supporting our services.

We granted a blanket security interest in all of our assets to the holders of our secured debt. If we are unable to make our required monthly payments on such debt, or any other event of default occurs, it could have a material adverse effect on our business and operations, and the debt holders may foreclose on our assets.

As part of our recent secured convertible debt financing transactions, we granted to Laurus Master Fund, Ltd. and another holder of such secured debt a blanket security interest in all of our assets, including assets of our subsidiary. See the "Convertible Debt Financing Transactions" section of this prospectus. In the event we default in payment on such debt, or any other event of default occurs under the relevant financing documents, 120% of the outstanding principal amount of the secured notes, plus accrued interest and fees will accelerate and be due and payable in full. See the "Convertible Debt Financing Transactions" section of this prospectus for a list of such potential events of default.

The cash required to pay such accelerated amounts on the secured notes following an event of default would most likely come out of our working capital. As we rely on our working capital for our day to day operations, such a default could have a material adverse effect on our business, operating results, or financial condition to such extent that we are forced to restructure, file for bankruptcy, sell assets or cease operations. In addition, upon an event of default, the holder of the secured debt could foreclose on our assets or exercise any other remedies available to them. If our assets were foreclosed upon, we were forced to file for bankruptcy or cease operations, stockholders may not receive any proceeds from disposition of our assets and may lose their entire investment in our stock.

Our obligations under our recently issued debt securities may adversely affect our ability to enter into potential significant transactions with other parties.

As a result of our recent debt financing transactions with Laurus Master Fund, Ltd., The Shaar Fund, Ltd. and other institutional and accredited investors, we incurred significant repayment obligations and we agreed to certain restrictive covenants. In particular, for so long as 25% of the aggregate principal amount of the convertible term notes remains outstanding, we will need the consent of the holders of such notes before we can take certain actions, including the following:

- pay any dividends;
- merge, effect a material reorganization, liquidate or dissolve;
- materially change the scope of our business; or
- create, incur or assume any debt (other than certain trade debt, equipment financings and debt for the purchase of assets in the ordinary course of business).

Accordingly, unless we obtain the noteholders' consent, we may not be able to enter into certain transactions. In addition, in connection with any potential significant transaction (such as a merger, sale of substantially all our assets, joint venture, or similar transaction), it is likely that we would have to pay off such debt obligations and have the applicable security interests released. Although we have the right at any time to prepay our debt obligations, we can only do so upon payment of 110% of the then principal balance, plus all other amounts owing under the notes. See the "Convertible Debt Financing Transactions" section of this prospectus. Based on an aggregate principal balance of $10 million, a complete prepayment would require a cash payment of $11 million. These provisions could have the practical effect of increasing the costs of any potential significant transaction, and restrict our ability to enter into any such transaction.

Our obligations to the holders of our outstanding preferred stock may further affect our ability to enter into potential significant transactions with other parties.

We will need to obtain the consent of the holders of a majority of the then outstanding shares of our Series C preferred stock before we can take certain actions, including the following:

- a sale or other disposition of any material assets;
- an acquisition of a material amount of assets;
- engaging in a merger, reorganization or consolidation; or
- incur or guaranty any indebtedness in excess of $50,000.

Accordingly, unless we obtain such consent, we may not be able to enter into certain transactions.

Risks Related To Our Common Stock

We have issued a substantial number of securities convertible into shares of our common stock which will result in substantial dilution to the ownership interests of our existing shareholders.

As of October 28, 2004, approximately 34,113,323 shares of our common stock were reserved for issuance upon exercise or conversion of the following securities:

- 8,946,933 shares upon conversion of outstanding convertible term notes;
- 14,737,915 shares upon exercise of outstanding stock options and warrants;
- 804,208 shares upon exercise of options available for future grant under our existing option plans; and
- 9,624,267 shares or more upon conversion of our outstanding shares of Series C convertible preferred 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 shareholders.

A substantial number of our convertible securities are convertible into shares of common stock at a conversion price of $.75 per share. Most of these shares are eligible for public resale. The trading price of our common stock and our ability to raise additional financing may be adversely effected by the influx into the market of such a substantial number of shares.

Our outstanding convertible preferred stock is convertible into 9,624,267 shares of common stock at a per share conversion price of $.75 which is substantially less than the current trading price of our shares. Although many of the shares issuable upon conversion of our convertible preferred stock are eligible for public resale under Securities and Exchange Commission Rule 144, we have agreed to file a registration statement to cover the public resale of all of these shares. This significant increase in the number of shares available for public sale may have a negative impact on the trading price of our shares and substantially dilute the ownership interests of our existing shareholders. In the event that our stock trades below $.75 per share, in order to raise additional financing we would likely be required to issue additional shares of common stock or securities convertible into common stock at a purchase or conversion price, as applicable, of less than $.75 per share. Any issuance of shares at a purchase price of less than $.75 per share would reduce the conversion price of our Series C preferred shares to such lower price. This would require us to issue additional shares upon conversion of our Series C preferred shares and further dilute the ownership interests of our existing shareholders. To the extent these factors are viewed negatively by the market, it may provide an incentive for persons to execute short sales of our common stock that could adversely affect the trading price of our common stock.

Applicable Securities and Exchange Commission rules governing the trading of "penny stocks" limits the trading and liquidity of our common stock which may affect the trading price of our common stock.

Our common stock currently trades on the OTC Bulletin Board. Because our common stock continues to trade below $5.00 per share, our common stock is considered a "penny stock" and is subject to Securities and Exchange Commission 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 do not intend to pay dividends in the foreseeable future.

We have never declared or paid a dividend on our common stock. In addition, the terms of our outstanding Series C preferred shares preclude us from declaring or paying a dividend on our common stock unless a dividend is also declared or paid, as applicable, on our Series C preferred shares. We intend to retain earnings, if any, for use in the operation and expansion of our business and, therefore, do not anticipate paying any dividends on our common stock in the foreseeable future.

The trading price of our common stock may be volatile.

The trading price of our shares has from time to time fluctuated widely and in the future may be subject to similar fluctuations. The trading price may be affected by a number of factors including the risk factors set forth in this 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. Although we believe that approximately fifteen (15) registered broker dealers currently make a market in our common stock, we cannot assure you that any of these firms will continue to serve as market makers or have the financial capability to stabilize or support our common stock. A reduction in the number of market makers or the financial capability of any of these market makers could also result in a decrease in the trading volume of, and price of, our shares. In recent years, broad stock market indices, in general, and the securities of technology companies, in particular, have experienced substantial price fluctuations. Such broad market fluctuations may adversely affect the future trading price of our common stock.

Minnesota anti-takeover law and certain provisions of our articles of incorporation may discourage attempts to effect a change in control of our company, which may adversely affect the value of our common stock.

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

The selling security holders intend to sell their shares of common stock in the market, which sales may cause our stock price to decline.

The selling stockholders named in this prospectus intend to sell in the public market 10,996,925 shares of our common stock being registered in this offering. That means that up to 10,996,925 shares may be sold pursuant to this registration statement. Such sales may cause our stock price to decline. Our officers and directors and those shareholders who are significant shareholders as defined by the Securities and Exchange Commission will continue to be subject to the provisions of various insider trading and Rule 144 regulations.

FORWARD-LOOKING STATEMENTS

This prospectus contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. All statements other than statements of historical facts contained 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. Although we believe that our plans, intentions and expectations reflected in the forward-looking statements are reasonable, we cannot be sure that they will be achieved. Actual results may differ materially due to a number of factors. Many of these factors are set forth in the "RISK FACTORS" section of this prospectus. Actual results may differ materially from the forward-looking statements contained in this prospectus. These factors are not intended to represent a complete list of the general or specific factors that may affect us. It should be recognized that other factors, including general economic factors and business strategies, may be significant, presently or in the future. Except as required by law, we undertake no obligation to update any forward-looking statement, whether as a result of new information, future events or otherwise.

USE OF PROCEEDS

The shares are being registered hereunder for resale by the selling security holders. We will not receive any proceeds from the sale of the shares by the selling security holders. We will receive the proceeds from the exercise price of certain warrants held by the selling security holders to the extent that such warrants are exercised. We expect to use the proceeds of any such sales for general working capital purposes.

MARKET FOR OUR COMMON STOCK AND RELATED STOCKHOLDER MATTERS

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

	High	Low
2004:		
Quarter ended September 30, 2004	$ 1.43	$ 0.60
Quarter ended June 30, 2004	$ 3.00	$ 1.26
Quarter ended March 31, 2004	$ 1.85	$ 1.03
2003:		
Quarter ended December 31, 2003	$ 1.40	$ 0.53
Quarter ended September 30, 2003	$ 0.59	$ 0.38
Quarter ended June 30, 2003	$ 0.64	$ 0.30
Quarter ended March 31, 2003	$ 0.73	$ 0.35
2002:		
Quarter ended December 31, 2002	$ 0.74	$ 0.33
Quarter ended September 30, 2002	$ 0.50	$ 0.26
Quarter ended June 30, 2002	$ 0.75	$ 0.38
Quarter ended March 31, 2002	$ 1.20	$ 0.61

The last price of our common stock as reported on the OTC Bulletin Board on October 26, 2004 was $0.97 per share.

Holders

As of October 25, 2004 the number of stockholders of record of our common stock was 220. Based on broker inquiry conducted in connection with the distribution of proxy solicitation materials in connection with the Company's special meeting of shareholders on August 16, 2004, we believe that there are approximately 3,500 beneficial owners of its common stock.

Dividends

We have not paid any cash dividends to date, and have no intention of paying any cash dividends on our common stock in the foreseeable future. The terms of our outstanding Series C preferred shares preclude us from declaring or paying a dividend on our common stock unless a dividend is also declared or paid, as applicable, on our Series C preferred shares. The declaration and payment of dividends is also subject to the discretion of our Board of Directors and certain limitations imposed under the Minnesota Business Corporation Act. 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.

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" and elsewhere in this prospectus. The following should be read in conjunction with our audited financial statements included elsewhere herein.

Overview

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

We develop and market proprietary fingerprint identification biometric technology and software solutions. We pioneered the development of automated, finger identification technology that can be used without the aid of non-automated methods of identification such as a personal identification, password, token, smart card, ID card, credit card, passport, driver license or other form of possession or knowledge based identification. This advanced BIO-key identification technology improves both the accuracy and speed of finger-based biometrics and is the only finger identification algorithm that has been certified by the International Computer Security Association (ICSA).

Since our inception in 1993, we have spent substantial time and effort in completing the development of what we believe is the most discriminating and effective finger biometric technology available. During the past two years, our focus has shifted to marketing and licensing this technology. We have built a direct sales force of professionals with substantial experience in selling technology solutions to government and corporate customers. We expect to continue to add additional qualified personnel in 2004.

During 2003 and the first two quarters of 2004, we entered into a number of licensing and development agreements. Certain of these arrangements have resulted in our technology being used in commercial applications on a run time basis and we are beginning to generate recurring revenue. We will continue to focus a substantial amount of resources on our sales and marketing efforts and expect revenues to increase substantially during 2004. Our primary objective in 2004 is to generate revenue and increase the recognition, use and acceptance of our technology in the market. To accomplish this, all sales efforts are focused on moving evaluation and development relationships to run time license arrangements as quickly as possible. We continue to see increases in qualified leads resulting in evaluation licenses and run time licenses. Our biggest challenge is obtaining financial and human resources to pursue and follow up on all opportunities available to us.

Although recent security concerns relating to the identification of individuals has increased interest in biometrics generally, it has yet to gain widespread commercial acceptance. We continue to see increasing acceptance of biometric technology, however, and believe the market for our technology is large enough for us to become a successful revenue generating company. Continued concerns regarding security and increased corporate spending on technology are key external conditions which may affect our ability to execute our business plan.

On March 30, 2004, we acquired all of the outstanding capital stock of PSG, a privately-held provider of wireless solutions for law enforcement and public safety markets based in Winter Park, Florida, in exchange for an aggregate of 2,422,108 shares of our common stock, $500,000 in cash, and our assumption of $600,000 in aggregate net liabilities of PSG. The acquisition was completed pursuant to the terms of an agreement and plan of merger by and among the Company, BIO-Key Acquisition Corp., a wholly-owned subsidiary of the Company, PSG and all of the shareholders of PSG. As a result of this transaction, PSG became a wholly-owned subsidiary of the Company and now constitutes a division of our business specializing in the law enforcement and public safety markets.

On March 31, 2004, we completed a private placement equity offering that resulted in approximately $12,000,000 in gross proceeds to the Company. Based on available cash resources, existing funding obligations and projected revenue, we believe our existing financial resources will now be sufficient to sustain operations for at least the next twenty-four (24) months. Our long-term viability and growth will depend upon the successful commercialization of our technologies and our ability to obtain adequate financing, among other matters, as to which there can be no assurances.

As more fully described in our Proxy Statement filed on July 21, 2004 with the Securities and Exchange Commission, we are actively pursuing strategic acquisitions that are expected to be accretive to operating results. To enable us to respond rapidly to acquisition opportunities, and to meet other future needs that could arise, we have obtained shareholder approval to raise the number of shares of common stock that we are authorized to issue from 60 million to 85 million. In that regard, on September 30, 2004, we completed our previously announced acquisition of Aether Mobile Government from Aether. Pursuant to the Asset Purchase Agreement dated as of August 16, 2004 by and among the Company, Aether, Cerulean Technology, Inc. and SunPro, Inc., the Company paid Aether a purchase price of $10,000,000 in cash, subject to post-closing adjustments to reflect changes in Aether Mobile Government's working capital and cash flows since June 30, 2004. In connection with this acquisition, the Company issued a subordinated secured promissory note to Aether in the face amount of $6,884,588 (the "Aether Note"). The Aether Note evidences a contingent reimbursement obligation of the Company to Aether and a surety fee payable by the Company to Aether, in each case with respect to a letter of credit maintained by Aether for the Company's benefit in connection with the acquisition. The Company's obligations under the Aether Note are secured by a security interest granted to Aether in all or substantially all of the Company's assets, subordinate to the security interest described in the "Convertible Debt Financing Transactions" section of this prospectus below.

Aether Mobile Government provides wireless data solutions for use by public safety organizations, primarily state and local police, fire and rescue and emergency medical services organizations, that enable such organizations to access law enforcement databases to validate identities and obtain suspect information. Its public safety solutions are integrated into fifty (50) different state databases, as well as local and federal databases, and its products deliver real-time information in seconds, without the need for human dispatchers or other resources.

On September 29, 2004, we entered into a securities purchase agreement with certain institutional and accredited investors. Under this agreement, the Company issued secured convertible term notes in the aggregate principal amount of $5,050,000, convertible into common stock of the Company in certain circumstances at $1.35 per share, and issued warrants to purchase an aggregate of 1,122,222 shares of our common stock at an exercise price of $1.55 per share. The Company's obligations under these financing documents are secured by a security interest in all or substantially all of the Company's assets. Also on September 29, 2004, we entered into a separate securities purchase agreement with existing shareholders of the Company and other accredited investors. Under this agreement, the Company issued unsecured convertible term notes in the aggregate principal amount of $4,768,000, convertible into common stock of the Company in certain circumstances at $1.35 per share, and issued warrants to purchase an aggregate of 1,059,553 shares of our common stock at an exercise price of $1.55 per share. The proceeds from each of these transactions were used in part to finance a portion of the Company's acquisition of Aether Mobile Government and will be used in part for working capital purposes.

Results of Operations

On March 30, 2004, we completed the acquisition of PSG, which now operates as our Law Enforcement and Public Safety division. The discussion below regarding our results of operations for the three and six months ended June 30, 2004 reflects the combined operations of our historic biometric technology licensing business and our new Law Enforcement and Public Safety division, whereas the corresponding periods in 2003 include only the operations of our historic biometric business. In order to present the following discussion in a manner to provide a more meaningful comparison between the two periods, where possible, we have quantified the material changes in our results of operations which are attributable to the operations of each of our businesses.

Three Months and Six Months Ended June 30, 2004 As Compared To Three Months and Six Months Ended June 30, 2003

Revenue:

We generated revenue of approximately $519,000 during the three month period ended June 30, 2004 as compared to approximately $13,000 during the corresponding period in 2003. Of this amount, approximately $128,000 was generated by our biometric technology business, representing an approximate $115,000 increase over the corresponding period in 2003. This increase was due to an increased number of licensing arrangements, some of which have moved from evaluation to recurring run time licenses. PSG, our law enforcement and public safety division which we acquired on March 30, 2004, accounted for approximately $391,000 of the remaining revenue during the three month period ended June 30, 2004.

We generated revenue of approximately $831,000 during the six month period ended June 30, 2004 as compared to approximately $41,000 during the corresponding period in 2003. Of this amount, approximately $253,000 was generated by our biometric technology business, representing an approximate $212,000 increase over the corresponding period in 2003. This increase was due to an increased number of licensing arrangements, some of which have moved from evaluation to recurring run time licenses. Our law enforcement and public safety division accounted for approximately $578,000 of the remaining revenue during the six month period ended June 30, 2004.

Consolidated revenue during the six month period ended June 30, 2004 consisted of approximately $580,000 from license fees, approximately $120,000 from product sales and approximately $131,000 from technical support services. We expect to continue to generate a majority of our revenue form license fees and the balance from technical support and product sales. As our evaluation customers move to run time licensing arrangements, we expect technical support fees to comprise a larger percentage of our consolidated revenue and provide increased recurring monthly revenue. We continue to expand our sales and marketing departments and expect to continue to add customers and increase revenue during 2004 in both our biometric and public safety divisions. We expect the majority of our consolidated revenue through the remainder of 2004 to continue to be generated by our public safety division.

Costs and Other Expenses

Cost of Products and Services Sold. Cost of products and services sold were approximately $95,000 during the three month period ended June 30, 2004 as compared to approximately $3,000 during the corresponding period in 2003. Of this amount, approximately $31,000 was attributed to sales by our biometric technology business, representing an approximate $28,000 increase from the corresponding period. Approximately $64,000 of the remaining cost of products sold, was attributed to our law enforcement and public safety division. As our revenue and customer base continues to grow, we expect these costs to continue to increase. Most initial sales by our law enforcement and public safety division involve the sale of a PDA, and most initial sales by our biometrics business involve the sale of a scanner. We expect cost of products on a consolidated basis to continue to increase and be split approximately equally between our public safety and biometric technology businesses. Although we generate a margin on such sales, our future earnings, if any, will depend primarily upon licensing and technical support fees.

Cost of products and services sold were approximately $101,000 during the six month period ended June 30, 2004 as compared to approximately $6,000 during the corresponding period in 2003. Of this amount, approximately $37,000 was attributed to sales by our biometric technology business, representing an approximate $31,000 increase from the corresponding period. Approximately $64,000 of the remaining cost of products sold, was attributed to our law enforcement and public safety division.

Selling, general and administrative expenses. Selling, general and administrative expenses increased approximately $877,000 to approximately $1,346,000 during the three months ended June 30, 2004 as compared to approximately $469,000 during the corresponding period in 2003. Of this amount, approximately $878,000 was incurred by our biometric technology business, representing approximately a $409,000 increase over the corresponding period in 2003. Approximately $468,000 of the remaining selling, general and administrative expenses were incurred by our law enforcement and public safety division.

Of the approximately $877,000 increase in selling, general and administrative expenses during the three months ended June 30, 2004, approximately $312,000 was related to increased sales and marketing activity, approximately $169,000 was related to an increase in general administrative costs, approximately $106,000 was related to an increase in costs for administrative personnel, and approximately $290,000 was related to an increase in professional services incurred in connection with additional SEC filings and the audit of PSG. Although we continue to closely monitor expenses, we retained 5 additional employees in connection with our recent acquisition of PSG, and have expanded both our direct sales force, marketing and technology support departments. We expect continued increases in these functions during 2004 as we continue to focus on generating additional revenue and supporting our growing customer base. Accordingly, we expect selling, general and administrative expenses to continue to increase during 2004.

Selling, general and administrative expenses increased approximately $1,130,000 to approximately $2,167,000 during the six months ended June 30, 2004 as compared to approximately $1,037,000 for the corresponding period in 2003. Of this amount, approximately $1,699,000 was incurred by our biometric technology business, representing an approximate $662,000 increase over the corresponding period in 2003. The remaining increase approximately $468,000 was incurred by our law enforcement and public safety division.

Of the approximate $1,130,000 increase in selling, general and administrative expenses during the six months period ended June 30, 2004, approximately $257,000 was due to an increase in sales and marketing costs as we continue to focus substantial resources to generating revenue, approximately $141,000 was due to an increase in executive personnel costs, approximately $356,000 was due to an increase in general administrative costs and approximately $376,000 was related to an increase in professional services incurred in connection with additional SEC filings and the audit of PSG.

Research and Development. Research, development and engineering expenses increased approximately $98,000 to approximately $352,000 during the three months ended June 30, 2004 as compared to approximately $254,000 during the corresponding period in 2003. Of this amount, approximately $276,000 was incurred by our biometric technology business, representing an approximate $22,000 increase over the corresponding period in 2003. The remaining increase of approximately $76,000 was incurred by our law enforcement and public safety division. Of the approximate $98,000 increase in research, development and engineering expenses approximately $60,000 was related to an increase in general development expense, and approximately $38,000 related to an increase in personnel costs. Having completed the development of our core technology, research and development expenses in 2004 will consist of enhancing existing software and reacting to customer feedback. We expect research and development costs to stabilize during 2004 and be incurred primarily by our biometrics business.

Research, development and engineering expenses increased approximately $140,000 to approximately $615,000 during the six months ended June 30, 2004 as compared to approximately $475,000 during the corresponding period in 2003. Of this amount, approximately $539,000 was incurred by our biometric technology business, representing an approximate $64,000 increase over the corresponding period in 2003. Approximately $76,000 of the remaining increase was incurred by our law enforcement and public safety division. Of the approximate $140,000 increase in research, development and engineering expenses approximately $35,000 was related to an increase in general development expense, and approximately $105,000 related to an increase in personnel costs.

Interest Expense. Interest expense was approximately $1,000 and $137,000 during the three and six month periods ended June 30, 2004, respectively, as compared to approximately $303,000 and $594,000 during the corresponding periods in 2003, respectively. Substantially all of the interest expense was incurred by our biometric technology business. The decrease in interest expense during the three and six months ended June 30, 2004 was due to the decrease in long-term obligations. As of the date of this prospectus, all term indebtedness has been converted into equity.

Year Ended December 31, 2003 As Compared To Year Ended December 31, 2002:

Revenues

We generated revenues of approximately $524,000 during 2003 as compared to approximately $155,000 during 2002. Our 2003 revenues consisted of approximately $411,000 from license fees and approximately $113,000 from products and services as compared to approximately $131,000 from license fees and approximately $24,000 from sales of products and services during 2002. We expect ninety percent (90%) of our future revenues to be generated from license fees and the balance from product sales. We expect revenues to continue to increase during 2004, as we enter into new licensing arrangements and our existing arrangements lead to recurring run time licenses.

Costs and Other Expenses

Selling, general and administrative expenses. Selling, general and administrative expenses increased approximately $192,000 to approximately $2,118,000 during 2003 as compared to approximately $1,926,000 in 2002. Of the increase, approximately $182,000 was related to increased sales and marketing activity, approximately $137,000 was related to an increase in general administrative costs, approximately $266,000 was related to an increase in costs for administrative personnel, and approximately $76,000 was related to an increase in professional services. These amounts were offset by a decrease in marketing consulting costs of approximately $469,000 in 2003. Although we continue to closely monitor expenses, we expect marketing, sales and technical support expenses to increase in 2004 as we continue to focus on generating revenue and supporting our growing customer base. Accordingly, we expect selling, general and administrative expenses to increase during 2004.

Research and Development. Research, development and engineering expenses decreased approximately $47,000 to approximately $1,037,000 in 2003 as compared to approximately $1,084,000 in 2002. Of the decrease, approximately $58,000 was related to a decrease in general development expense, and approximately $44,000 was related to a decrease for services of outside programming sub-contractors. This was offset by an approximate $55,000 increase in personnel costs. Having completed the development of our core technology, research and development expenses in 2004 will consist of enhancing existing software and reacting to customer feedback. We expect research and development costs to stabilize during 2004.

Interest Expense. Interest expense decreased approximately $53,000 to approximately $1,110,000 in 2003 as compared to approximately $1,163,000 in 2002. The decrease was due to a net decrease during 2003 of the amortization of discounts applicable to convertible debt issued during 2001 arising from the warrants issued with such convertible debt and the beneficial conversion features of such debt. We recently converted $6.5 million of long term debt and accrued interest into convertible preferred stock. Unless we are required to raise any necessary financing through issuance of debt securities, we expect interest expenses to decrease substantially in 2004.

Net Operating Loss Carryforwards

As of December 31, 2003, we had federal and Minnesota net operating loss carryforwards of approximately $24,504,000 and $12,406,000, respectively. Such carryforwards expire between 2011 and 2023 and will be limited in the future due to a change in ownership of the Company as defined in the Internal Revenue Code.

Liquidity and Capital Resources

Net cash used in operating activities during the six months ended June 30, 2004 was approximately $2,307,000 compared to approximately $1,307,000 during the six months ended June 30, 2003. The primary use of cash for both years was to fund the net losses. Net cash used in investing activities for the six months ended June 30, 2004 was approximately $6,541,000 compared to net cash used in investing activities of approximately $8,000 for the corresponding period in 2003 and consisted primarily of $5,887,500 invested in government bonds, $498,937 invested in the acquisition of PSG, $50,000 invested in Classifeye, and $79,089 invested in capital equipment additions. Net cash provided by financing activities during the six months ended June 30, 2004 was approximately $11,673,000 compared to approximately $1,553,000 in the corresponding period in 2003 and consisted primarily of $11,249,000 from sales of our common stock and approximately $1,000,000 from long term borrowings. These amounts were offset approximately $400,000 for a note repayment, approximately $100,000 for repurchasing warrants, approximately 44,000 in repayment of advances from a shareholder, and approximately $32,000 for other items.

Working capital increased approximately $3,161,000 during the six months ended June 30, 2004 to approximately $4,246,000 compared to approximately $1,085,000 as of December 31, 2003. This increase was due to an approximate $11,249,000 increase in cash as a result of the completion of our recent private placements of our equity securities. This amount was offset by the purchase of approximately $5,888,000 of marketable debt securities classified as held-to-maturity securities. Pursuant to an available credit facility, we can access an amount equal to up to 90% of the current market value of such marketable debt securities at a cost of funds equal to or less then the effective interest earned on such securities.

Since January 7, 1993 (date of inception), our capital needs have been principally met through proceeds from the sale of equity and debt securities. We do not currently maintain a line of credit or term loan with any commercial bank or other financial institution except as described in the immediate preceding paragraph.

On October 31, 2003, we entered into an amendment to the January 27, 2003 note purchase agreement with The Shaar Fund Ltd. ("Investor") to provide up to $2,500,000 of additional financing pursuant to the terms of a secured promissory note (the "Secured Note"). Of this amount, $600,000 was advanced at closing and $1,900,000 was funded between December 3, 2003 and March 29, 2004. The Secured Note was due October 1, 2005, secured by substantially all of our assets including our intellectual property, accrued interest at the rate of 7% per annum payable on maturity, and may be prepaid without penalty. The principal amount and accrued interest was convertible at the option of the Investor into either shares of our common stock at a conversion price of $.75 per share or shares of our Series C preferred stock (the "Series C Shares") at a conversion price of $100 per share. The Secured Note also provided that in the event we completed a private placement of our equity securities resulting in gross proceeds in excess of $5,000,000 on or before June 30, 2004, some or all of the principal and accrued interest shall, at the option of the Investor, be either converted into such equity securities at a conversion price equal to the sale price of such securities or repaid in cash. Upon the closing of our recent private placement equity offering, the Investor elected to convert $347,500 of the principal amount of the Secured Note into shares of our common stock and warrants to purchase shares of our common stock, each issued to the Investor in connection with such private placement.

Pursuant to a recapitalization transaction completed on March 3, 2004, all existing promissory notes payable to the Investor, other than the Secured Note, together with all accrued and unpaid interest due thereon (approximately $6,500,000) were cancelled and converted into 65,000 Series C Shares. Series C Shares are convertible into common stock at a conversion price of $.75 per share. In the event that the average closing bid price of our common stock is less than $1.00 per share for thirty (30) consecutive days at any time after March 3, 2007, we will be required to redeem the Series C Shares at a redemption price of $100 per share plus all accrued and unpaid dividends due thereon. In connection with the recapitalization transaction, the Investor sold $375,000 of the principal amount of the Secured Note to Thomas J. Colatosti, our Chairman of the Board of Directors.

On March 30, 2004, the Investor elected to convert $1,827,463 of principal and accrued interest due under the Secured Note into 18,275 Series C Shares. Also on March 30, 2004, the Investor elected to exchange all of the issued and outstanding shares of our series B preferred stock and accrued and unpaid dividends thereon and all accrued and unpaid interest on such dividends into 5,257 additional Series C Shares. On April 29, 2004, Mr. Colatosti elected to convert $375,000 of the principal amount of the Secured Note into 3,750 Series C Shares. As a result of these conversions, as of the date of this report, we have no outstanding indebtedness other than as described in the "Convertible Debt Financing Transactions" section of this prospectus and current liabilities.

Between April 7, 2004 and June 21, 2004, we issued an aggregate of 2,237,198 shares of common stock upon conversion of 16,600 shares of the Company's Series C 7% Convertible Preferred Stock and $17,898 of dividends due theron to the Shaar Fund.

On March 31, 2004, we entered into a securities purchase agreement with certain institutional and accredited investors pursuant to which we issued and sold an aggregate of 8,888,928 shares of our common stock and warrants (the "Warrants") to purchase an aggregate of 4,444,464 shares of our common stock. The investors paid an aggregate purchase price of $1.35 for each share of common stock and Warrant to purchase 0.5 of a share of common stock, resulting in gross proceeds to of approximately $12,000,000.

On March 30, 2004, we completed the acquisition of PSG in exchange for an aggregate of 2,416,108 shares of our common stock, $500,000 in cash, and our assumption of $600,000 in net liabilities of PSG. Any liability or obligation of PSG in excess of such $600,000 limitation will be solely the responsibility of the former shareholders of PSG. In connection with this acquisition, we also issued 6,000 shares of our common stock to Harward Investments, Inc. ("Harward") pursuant to an arrangement involving the discharge of certain outstanding debt obligations of PSG to Harward as of March 30, 2004.

Additional earnout consideration, determined as a proportion of qualified revenues, as defined, attained by the acquired business during fiscal years 2004 and 2005, may be paid to the former shareholders of PSG. During 2004, earnout consideration, if any, will be paid at the following rates: Five percent (5%) of all 2004 Qualifying Revenue less than $2 million, less the Accounts Receivable Holdback; as defined; Ten percent (10%) of all 2004 Qualifying Revenue equal to or greater than $2 million but less than $4 million; Twenty percent (20%) of all 2004 Qualifying Revenue equal to or greater than $4 million but less than $7 million; and Thirty percent (30%) of all 2004 Qualifying

Revenue equal to or greater than $7 million. During 2005, earnout consideration, if any, will be paid at the following rates: Ten percent (10%) of all 2005 Qualifying Revenue equal to or greater than $7 million but less than $10 million; and Twenty percent (20%) of all 2005 Qualifying Revenue equal to or greater than $10 million. We will make payments of such additional consideration on the last day of the month following each month in which the acquired business achieves specified revenue milestones during fiscal years 2004 and 2005. Such payments will be made in cash, unless the aggregate amount of earnout consideration exceeds sixty percent (60%) of the aggregate consideration we paid in the merger transaction. Any such excess amounts will be paid in shares of our common stock priced as of two (2) days prior to the date on which any earnout payment becomes due.

We have announced our intention to actively pursue strategic acquisitions that are expected to be accretive to operating results. We believe that an active acquisition strategy is timely because (i) companies with synergistic technology and/or market channels can combine to respond to the need in the homeland security market for complete technology solutions and to create operating efficiencies and (ii) there are many companies in the technology sector that have over-invested in the development stage and now lack sufficient financial resources to invest in the sales and marketing capabilities necessary for growth. To enable us to respond rapidly to acquisition opportunities, and to meet other future needs that could arise, we obtained shareholder approval to increase the number of shares we are authorized to issue from 60 million to 85 million. While some of these newly authorized shares could be used as currency for acquisitions, we may raise the additional capital required for acquisitions through the issuance of convertible instruments that would not be immediately convertible into common stock.

On September 30, 2004, we completed our acquisition of Aether Mobil Government. Pursuant to the Asset Purchase Agreement dated as of August 16, 2004 by and among the Company, Aether, Cerulean Technology, Inc. and SunPro, Inc., the Company paid Aether a purchase price of $10,000,000 in cash, subject to post-closing adjustments to reflect changes in Aether Mobile Government's working capital since June 30, 2004. In connection with this acquisition, the Company issued a Subordinated Secured Promissory Note to Aether in the face amount of $6,884,588 (the "Aether Note"). The Aether Note evidences a contingent reimbursement obligation of the Company to Aether and a surety fee payable by the Company to Aether, in each case with respect to a letter of credit maintained by Aether for the Company's benefit in connection with the acquisition. The Company's obligations under the Aether Note are secured by a security interest granted to Aether in all or substantially all of the Company's assets, subordinate to the security interest described in the "Convertible Debt Financing Transactions" section of this prospectus below.

On September 29, 2004, we entered into a Securities Purchase Agreement (the "Senior Purchase Agreement") with Laurus Master Fund, Ltd. ("Laurus") and certain other institutional and accredited investors (together with Laurus, the "Senior Investors"). Under the Senior Purchase Agreement, the Company issued secured convertible term notes (the "Senior Convertible Notes") in the aggregate principal amount of $5,050,000, convertible into common stock of the Company in certain circumstances at $1.35 per share, and issued warrants (the "Senior Warrants") to purchase an aggregate of 1,122,222 shares of our common stock at an exercise price of $1.55 per share. The proceeds from this transaction were used to finance in part the Company's acquisition of Aether Mobile Government. The Company's obligations under the Senior Purchase Agreement, the Senior Convertible Notes and the Senior Warrants are secured by a security interest in all or substantially all of the Company's assets.

Also on September 29, 2004, we entered into a Securities Purchase Agreement (the "Subordinated Purchase Agreement") with the Investor and other existing shareholders of the Company and accredited investors (collectively, the "Subordinated Investors"). Under the Subordinated Purchase Agreement, the Company issued unsecured convertible term notes (the "Subordinated Convertible Notes") in the aggregate principal amount of $4,768,000, convertible into common stock of the Company in certain circumstances at $1.35 per share, and issued warrants (the "Subordinated

Warrants") to purchase an aggregate of 1,059,553 shares of our common stock at an exercise price of $1.55 per share. The proceeds from this transaction were used in part to finance a portion of the Company's acquisition of Aether Mobile Government and will be used in part for working capital purposes. Please see the "Convertible Debt Financing Transactions" section of this prospectus for a more complete description of the transactions consummated in connection with the Senior Purchase Agreement and the Subordinated Purchase Agreement.

Our future liquidity and capital requirements will depend upon numerous factors, including:

- our ability to license our technology to original equipment manufacturers, systems integrators and application developers;
- our ability to successfully integrate PSG's and Aether Mobile Government's technology and customer relationships into our current business plan;
- the costs and timing of product development efforts and the success of these efforts;
- our ability to maintain and grow quality customer base; and
- biometric technology market developments.

As of the date of this prospectus, we had cash resources of approximately $3,200,000 and no debt other than as described in the "Convertible Debt Financing Transactions" section of this prospectus and current liabilities. We currently require approximately $400,000 per month to conduct our operations. During the first two quarters of 2004, we generated approximately $831,000 of revenue and expect to continue to generate increasing revenue from existing and new relationships during 2004.

We now believe our current cash resources and anticipated cash flow from current operations will enable us to maintain operations at current levels for at least the next twenty-four (24) months. We may need to obtain additional funding to (i) conduct the sales, marketing and technical support necessary to execute our plan to substantially grow operations, increase revenue and serve a significant customer base; and (ii) pursue our acquisition strategy. While anticipated revenues are expected to defray operating expenses and reduce the need for additional financing, they are not expected to be sufficient for us to significantly expand operations. To the extent that we would require such additional funding, no assurance can be given that any form of additional financing will be available on terms acceptable to us, that adequate financing will be obtained to meet our needs, or that such financing would not be dilutive to existing stockholders. If available financing is insufficient or unavailable or we fail to continue to generate meaningful revenue, we may be required to further reduce operating expenses, delay the expansion of operations, or be unable to pursue merger or acquisition candidates.

DESCRIPTION OF THE BUSINESS

Overview

The Company was formed in 1993 and is in the business of delivering advanced identification solutions and information services to law enforcement departments, public safety agencies and other government and private sector customers. Our mobile wireless technology provides first responders with critical, reliable, real-time data and images from local, state, and national databases. More than 2,500 police, fire and emergency services departments in North America currently utilize the our solutions, making us a leading supplier of mobile and wireless solutions for public safety. Our scalable biometric finger identification technology identifies and authenticates users of wireless and enterprise data to improve security, convenience and privacy as well as reducing identity theft. Biometric technology, the science of analyzing specific human characteristics which are unique to each individual in order to identify a specific person from a broader population, is an emerging technology. Fingerprint analysis is an accurate and reliable method to distinguish one individual from another and is viewed as less intrusive than many other biometric identification methods. As a result, fingerprint analysis has gained the most widespread use for biometric identification. Biometric technology represents a novel and accurate approach to identity verification and authentication which is now being used in limited applications and is gaining acceptance in the government, commercial and consumer markets.

We have pioneered the development of high performance automated finger identification technology that can be used without the aid of non-automated methods of identification such as a personal identification number (PIN), password, token, smart card, ID card, credit card, passport, driver license or other form of possession based or knowledge based identification.

Our advanced BIO-key identification technology improves both the accuracy and speed of finger-based biometrics and is the only finger identification algorithm that has been certified by the International Computer Security Association. Our proprietary biometric technology scans a person's fingerprint and identifies a person, typically within a few seconds, without the use of any other identifying data. We believe our fingerprint identification technology will have a broad range of possible applications relating to information security and access control, including:

- Securing Internet sites and electronic transactions
- Securing access to logical networks and applications
- Securing access to buildings and restricted areas
- Securing mobile devices such as cell phones and PDA's

In addition to these technologies, on March 30, 2004, we acquired Public Safety Group, Inc. ("PSG"), a privately held leader in wireless solutions for law enforcement and public safety markets. PSG's primary technology, PocketCop©, is a software solution that provides police officers and other security personnel instantaneous access to important criminal, civil and private database information in a wireless environment. PocketCop© is the first and only copyrighted handheld application that allows law enforcement officers to access state and federal databases over the wireless network for PalmOS, Windows CE and PocketPC. With the use of a portable wireless handheld device and PocketCop© application software, an authorized user can access suspect information such as wanted status, warrant status, vehicle registration and driver license status. PSG has deployed its technology in numerous police departments in the United States, including the statewide deployment for the Massachusetts State Police and has developed a number of important strategic marketing partnerships including Hewlett Packard.

On September 30, 2004, we completed a transaction with Aether Systems, Inc. to purchase its Mobil Government division ("Aether Mobil Government"). Aether Mobile Government provides wireless data solutions for use by public safety organizations, primarily state and local police, fire and rescue and emergency medical services organizations. Its public safety solutions are integrated into fifty (50) different state databases, as well as local and federal databases, and its products deliver real-time information in seconds, without the need for human dispatchers or other resources. Together with PSG, Aether Mobile Government now comprises the Law Enforcement and Public Safety Division of our business.

Our current business plan is to:

- License our core technology "VST" to original equipment manufacturers, systems integrators and application developers to develop products and applications which utilize our core technology.
- License WEB-key , our web-based biometric authentication solution.
- Provide for "device independent" finger identification matching for virtually any application utilizing the latest advances in scanning technology.
- License our wireless software solutions for law enforcement and public safety markets.

We actively market and sell our technology principally to biometric system integrators and value added resellers focused on the security and logical access markets. A number of our customers have begun to deploy our technology on a run-time basis which is generating recurring quarterly revenues. After years of technology and product development, we have evolved from a development stage company to a revenue generating company.

Market Overview

Recent concerns relating to Homeland Security and the need for identification of individuals has resulted in an increased interest in biometrics. Biometric based solutions currently compete with more traditional security methods such as keys, cards, personal identification numbers and security personnel, as well as competing biometric technologies including voice, face, iris and hand geometry. The market for business-to-business and business-to-consumer transactions is substantial and continues to grow. Such transactions are subject to fraud resulting in unauthorized individuals gaining access to confidential information. Identity theft is one of the most pressing issues facing corporations today. We believe our biometric technology provides a more reliable method for confirming the identity of persons in local or remote locations than existing traditional methods.

Additionally, law enforcement and public safety are large and growing markets. The ability to quickly and accurately collect data from a variety of database sources and formats and deliver it to first responders opens a new framework to bring real time intelligence to security officers deployed in the field. With our acquisition of PSG, we believe there is a substantial market opportunity to integrate our VST and WEB-key biometric technologies with the PSG mobile solution.

Biometric technology is becoming an acceptable approach to physical and logical security. Acceptance of biometrics as an alternative to traditional security methods depends upon a number of factors including:

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

Commercial markets have been slow to accept biometrics as a viable alternative to current security methods. As a result, the primary competition for biometric technology has been the traditional security methods described above. With respect to competing biometrics, each has its strength and weaknesses and none has emerged as a market leader. Fingerprint identification is generally viewed as inexpensive

and non-intrusive. Iris scanning is viewed as accurate, but also as inconvenient to use and expensive. Facial recognition has recently received substantial attention, however, it suffers from accuracy limitations. In summary, the market for biometric technology is evolving.

We market and sell our wireless data solutions primarily to state and local law enforcement agencies throughout the United Sates. We are establishing a strong customer base and expect continued growth in this division particularly in the current environment of heightened security concerns. We believe there is a substantial market opportunity to integrate our VST and WEB-key biometric technologies with the PSG mobile solution and the Aether Mobile Government solution. The integration will provide us with the ability to offer a unique wireless solution and the opportunity to provide a meaningful upgrade to all existing customers of PSG and Aether Mobile Government. We expect to complete the integration of the PSG-related technologies during the third quarter of 2004, and will continue to integrate the Aether Mobile Government-related technologies over the course of the next several quarters.

Technology

We have developed proprietary fingerprint identification technology consisting of:

- VST (Vector Segment Technology), our patent pending core algorithm which creates a mathematical representation of a fingerprint based on its particular characteristics.

- Software which translates and standardizes the image of the fingerprint for computer analysis ("Biometric Solution").

- SDK (Developers Tool Kit), a biometric application development tool which facilitates integration of our technology for vertical market applications.

Utilizing these technologies, we continue to develop identification products and software solutions which are designed to assure that only individuals comprising an approved fingerprint in an online or embedded database are allowed access to an application through real time authentication.

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

De-coupling of Technologies. Over the years we have modified our core Vector Segment Technology by de-coupling the core identification algorithm from the reader technology. Our finger identification technology is hardware independent and can be integrated with virtually any finger reading devise. Enrollments or capture of an individual's biometric identification can be done on one type of scanner and looked-up or identified for a match on another type of scanner. This capability is unique in the biometric market and allows our software to be used and integrated with almost any finger scanning hardware.

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

Current Offerings

The following is a description of the status of each of our current offerings.

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

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

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

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

WEB-key is an Internet ready three-tiered Internet application architecture software security solution. We license WEB-key as an integrated solution of our VST algorithm for securing e-commerce, e-business, and web-based transaction applications. All WEB-key communication is triple-encrypted to prevent secure information from being intercepted over the Internet. Using WEB-key 's browser plug-in, users enroll finger identification at a WEB-key enabled Web site from their own PC.

After enrollment, WEB-key requests finger identification every time a user begins a secure session. WEB-key 's interface guides users through the few steps necessary to gain an accurate finger identification. The entire identification process takes less time than typing a user ID and password.

The Web based server authentication application is an integrated solution involving the distribution of readers and the licensing of client and server based software to provide for reliable and cost effective user authentication in connection with the processing of transactions over the Internet. This solution is intended to secure other Internet applications such as restricting access to specific Web pages, specific information contained on a Web-site or specific applications. We believe we have the opportunity to be the first supplier of a reliable electronic identification and authorization solution which operates effectively without the aid of a personal identification number or password supplied by the user.

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

WEB-key consists of three basic components:

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

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

WEB-key provides a reliable and secure user authentication solution. WEB-key takes advantage of new security features in Microsoft's Internet Explorer versions 5.5 SP2 and 6.0, in addition to 1024 bit enhanced encryption capabilities integrated with public/private key pairs. WEB-key has also been integrated with Oracle9iRAC and 10g which offers advanced speed, scalability, and reliance to WEB-key 's database tier. Additional tools and software based on VST technology are under development.

We do not currently manufacture any hardware and do not intend to in the future. We rely on OEMs, systems integrators and other licensees of our software to supply the necessary hardware, including optical readers. We have relationships with hardware manufacturers which enable us to supply readers as an integrated solution when necessary. Our technology includes proprietary open architecture communication software which allows virtually any reader to be integrated with our technology. Our software has been integrated with readers manufactured by Polaroid, Authentec, Ethentica, CrossMatch, ST Micro, Secugen, Fujitsu, TesTec, Silex, StarTek, Targus, and other independent manufactures.

PocketCop©. PocketCop© is a software solution that provides police officers and other security personnel instantaneous access to important criminal, civil and private database information in a wireless environment. PocketCop© is the first and only copyrighted handheld application that allows law enforcement officers to access state and federal databases over the wireless network for PalmOS, Windows CE and PocketPC. With the use of a portable wireless handheld device and PocketCop© application software, an authorized user can access suspect information such as wanted status, warrant status, vehicle registration and driver license status. The highest available encryption methods are implemented to provide secured transactions between the handheld device and the local agency's server meeting and exceeding state and federal certification standards.

Aether Mobile Government. On September 30, 2004, we completed our acquisition of Aether Mobil Government. Aether Mobile Government provides wireless data solutions for use by public safety organizations, primarily state and local police, fire and rescue and emergency medical services organizations, that enable such organizations to access law enforcement databases to validate identities and obtain suspect information. Its public safety solutions are integrated into fifty (50) different state databases, as well as local and federal databases, and its products deliver real-time information in seconds, without the need for human dispatchers or other resources. Upon completing the purchase of Aether Mobile Government, we acquired its principal products, which are:

- The PacketCluster® family of products, which are open, standards-based wireless information software products that provide police officers in the field with direct access to motor vehicle and warrant information and other critical information;

- The handheld version of PacketCluster® Patrol (called PocketBlue), which is a handheld application for mobile law enforcement that is part of a fully integrated mobile data system, providing criminal database queries, secure messaging and alarm capabilities for all connected mobile users;

- PacketWriter , which is a mobile field reporting solution that allows for mobile data collection, data sharing with PacketCluster® and work-flow management;

- The FireRMS family of products for fire and rescue companies, which are compliant incident reporting products specifically developed to cut report completion time for front-line emergency response personnel; and

- Handheld applications for fire and rescue companies (PocketFD and PocketCluster Rescue), which allow fire services personnel to wirelessly access and update records in the field and extends computer aided dispatch, fire records management systems and other in-house data sources to a mobile environment.

Potential Market

The growth of electronic fingerprint identification will be driven by the need for secure access to private applications and proprietary databases residing on both private and public network infrastructures. The scope of these opportunities include:

- corporations that increasingly rely upon the exchange and distribution of proprietary information among staff using intranet or other private networks

- business-to-business e-commerce among trading partners which share confidential information on a secure basis

- business-to-consumer e-commerce where the e-commerce service provider wants to restrict access to paying subscribers

- Government Regulations such as HIPPA and Gramm Leach Bliley which are forcing the secure management of user identities

- Application software providers that require secure access to applications such as Single Sign On, HR, ERP, Point of Sale, Check Cashing, and Medical Records

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

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

We believe that our law enforcement and public safety division is well-positioned to help government agencies address certain aspects of ongoing homeland security concerns. The estimated potential includes nearly one million officers, supported by hundreds of thousands of vehicles across 18,000 agencies in the United States alone. Additionally the market opportunity for fire departments and EMS services is approximately 31,000 agencies and 75,000 vehicles. The Company's strategic partnerships with HP, Oracle, ChoicePoint, AutoDesk and Netegrity will extend the market reach of the combined companies after our anticipated acquisition of Aether Mobile Government.

Marketing and Distribution

Our marketing and distribution efforts consist of:

- Developing strategic alliances with technology leaders such as Oracle, Netegrity, Hewlett Packard, Autodesk and others
- Promoting biometric technology and our offerings through industry trade shows, public speaking engagements, press activities and partner marketing programs
- Directing licensing efforts to, among others, original equipment manufacturers ("OEMs"), application developers and system integrators.
- Building a reseller, integrator, partner network and a direct sales team

Direct Selling Efforts. Our current selling efforts are conducted primarily through our expanded direct sales organization. Our sales team consists of our vice president of sales, three area sales directors, a business integration manager to support sales efforts with partners, ISV's, OEM's and the indirect channel, and a senior sales support representative to support all direct and indirect sales campaigns.

Strategic Alliances and Partnerships. We attend and actively participate in various product conferences and conventions in the technology and security industries to generate market awareness of biometric technology generally, and our offerings specifically. During the past year, we have strengthened our alliance with Oracle having been recognized as Certified Partner in the Oracle Partner Network. We support the Oracle e-business suite of applications and provide the biometric enabler for the Oracle Single Sign on product. We are a development partner with Oracle which provides the underlying database used for true user identification and "on demand" alias checking. As a development partner, we participate in Oracle Trade Shows such as Oracle Open World and Oracle Apps World.

We have formed alliances with other industry leaders. We are a Premier Partner of Netegrity, a leader in the identity management, whose Identity technology is used by over 800 corporate accounts with over 2.5 million users. We have developed a biometric interface allowing users of Netegrity to enhance the traditional methods of user identification, which we intend to aggressively market through the Netegrity Partner and Integrator Network. We are also working with Choicepoint, a leader in civil identification and background checks, to thwart identity theft in the commercial marketplace. One solution being deployed is a check cashing application where individuals would use fingerprint biometrics to truly verify that they are the individual carrying the credentials and authorized to conduct the transaction. Other solutions utilizing the strength of Choicepoint products and services are currently being developed.

We also have established, through PSG, a strategic marketing partnership with Hewlett Packard to provide PSG's technology to the Massachusetts State Police on a statewide basis.

Public and Private Sector. The events of September 11, 2001 have heightened the need for securing data dissemination throughout and between government agencies and automating the positive identification of personnel. We believe our finger identification technology coupled with the capabilities of our wireless data solutions and our alliance partners are the most advanced solutions capable of meeting these needs. In this regard, we were recently awarded a contract to ensure the secure access, transmission and retrieval of critical government and public sector information. We are also working with the National Sheriff's Association and the Pegasus Research Foundation to provide biometric authentication for secure sharing of critical data to Sheriff's offices and first responders across the country. We expect the initial rollout to grow from the initial 220 Sheriff's locations.

Licensing. We target both Internet infrastructure companies and large portal providers as licensees of our WEB-key solution. On the Internet infrastructure side, we seek to partner with Internet server manufacturers, providers of database and data warehouse engine software, horizontally positioned application engines, firewall solution providers and peripheral equipment manufacturers. On the portal side, we are targeting financial service providers such as credit and debit card authorization and issuing institutions, Internet retailers, business-to-business application service providers (ASPs) and corporate intranets. During 2003, we commenced a direct selling effort of WEB-key and VST and entered into license agreements with OEMs and system integrators to develop applications for distribution to their respective customers. We expect to continue to generate revenue during the remainder of 2004 from existing and new customer relationships.

We are also addressing the security needs of application providers in the following vertical markets:

- Government: Northup Grumann has deployed a pilot within the Department of Defense to cross credential visitors and contractors to certain military bases using our technology.

- Education: Educational Biometrics has incorporated our technology to enable school children to pay for school lunch programs and checkout library books using their fingerprints. VST technology enabled Educational Biometrics to easily enroll these children and reduce the time students spend in lunch line and administrative costs of managing passwords and collecting payments.

- Healthcare: Biometric Technologies, a licensee in South Africa, is utilizing our technology to minimize fraud for health service providers. The integration of our biometric solution to truly identify individuals presenting insurance cards will reduce losses due to identity fraud.

Financial: We are working with several partners focusing on financial applications such as check cashing, point of sale systems and employee trusted identification cards, as well as customer facing applications over the internet.

Competition

The markets for our products and technologies are developing and are characterized by intense competition and rapid technological change. No assurance can be given that our competitors will not develop new or enhanced technologies that will offer superior price, performance or function features or render our products or technologies obsolete.

In addition to existing commonplace methods of restricting access to facilities such as pass cards, PIN numbers, passwords, locks and keys, there are numerous companies involved in the development, manufacture and marketing of fingerprint biometrics products to government, law enforcement and prison markets. These companies include, but are not limited to, PRINTRAK International, IDENTIX, and Bioscript.

Most current automated fingerprint identification product sales have been for government and law enforcement applications, which are typically priced higher than our products and licensing arrangements. Although most companies targeting consumer application markets have completed the development of their products, biometric products and technologies have not been widely accepted in the commercial markets. Most companies competing for commercial opportunities are in the business of selling scanning devices and tie their algorithm to a specific device. We have created a "device independent" algorithm that provides for flexibility in choosing the correct device, optical or tactile sense to fit the application served.

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

Our current and potential competitors for the products and services we currently offer through our Law Enforcement and Public Safety division, and those products that we plan to offer in the future, include mobile and/or wireless software companies such as Sybase, Inc., Motorola, Inc., Qualcomm, Inc., Minor Planet Systems USA Inc., and Terrion. Some of our existing and potential competitors have substantially greater financial, technical, marketing and distribution resources than we do. Furthermore, these competitors may be able to adopt more aggressive pricing policies and offer customers more attractive terms than we can.

Intellectual Property Rights

Our technology consists of knowledge and information relating to computer software and methods, which is used to create an automated process of capturing, processing, analysis and matching of a fingerprint for authorization purposes. Matching can be performed against existing databases or individual samples. We have patent application claims on our algorithm technologies, called Vector Segment Technology, our authentication solutions security framework, called WEB-key , our trusted device communication methodologies, and our secure template processes. There can be no assurance that any patents will be issued, or that, if issued, we will have the resources to protect any such issued patent infringement. Although we believe that its technology does not infringe upon patents held by others, no assurance can be given that such infringements do not exist.

Our technology consists of software. We take measures to ensure copyright and license protection for our software releases prior to distribution. Where possible, the software is licensed in an attempt to ensure that only licensed and activated software functions to its full potential. This provides a mechanism to combat cloning of products.

We believe we have developed common law trademark rights in the terms SACman , SACcat , SACremote , BIO-key , True User Identification , WEB-key and PocketCop and have filed federal trademark applications. We do not claim any additional trademarks at this time. Pursuant to our purchase of Aether Mobile Government as described above, we have acquired the following additional trademarks that have been registered or published with or allowed by the Unites States Patent and Trademark Office: PacketWriter , PacketCluster®, PacketCluster® Patrol , Cerulean and Cerulean Design.

Research and Development

During fiscal years ended December 31, 2002 and 2003, we spent approximately $1,085,000 and approximately $1,037,000, respectively, on research and development. Our limited customer base did not directly bear these costs, which were principally funded through outside sources of equity and debt financing.

Although we believe that our identification technology is one of the most advanced and discriminating fingerprint technologies available on the market 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. During 2004, our research and development effort will be focused on the continued evolution of our Web based authentication solution, furthering the VST algorithm, SDK and Web-key. Our goal is to provide a full identification solution enabling the identification of individuals with a single finger scan, to a population of 1,000,000 prints on a standard Oracle platform in less than five seconds.

Government Regulation

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

Environmental Regulation

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

Employees and Consultants

We currently employ one hundred fifteen (115) individuals on a full-time basis; seventy-one (71) in engineering, research and development, eleven (11) in finance and administration and thirty-three (33) in sales and marketing. We also utilize four (4) consultants who provide engineering and technical services and one (1) who provides financial consulting services. We anticipate retaining additional sales and marketing personnel within the next twelve (12) months to execute our business plan.

DESCRIPTION OF PROPERTY

We do not own any real estate. We conduct operations from the following leased premises:

Approximately 6,000 square feet of space located at 1285 Corporate Center Drive, Suite 175, Eagan, Minnesota, which is leased under a four-year lease, which terminates in August 2007 and currently provides for monthly rent of $2,842.

Approximately 376 square feet of office space located at 105 East Robinson Street, Suite 540, Orlando, Florida, which currently provides for a monthly rent of $535.

Approximately 2180 square feet of office space located at Allaire Office Park, Highway 138, Building D, Wall Township, New Jersey, which lease terminates in August 2009 and currently provides for monthly rent of $3,905.

Approximately 38,390 square feet of space located at 300 Nickerson Road, Marlborough, Massachusetts, which lease terminates in August 2008 and currently provides for monthly rent of $95,975.

LEGAL PROCEEDINGS

Except as disclosed below, we are not a party to any material pending legal proceeding nor are we aware of any proceeding contemplated by any governmental authority involving the Company. In June 2003, PSG was named as a defendant in a civil action initiated in the Superior Court Department in Hampden County, Commonwealth of Massachusetts by The Vince Group, Inc. ("TVG"). The case has since been removed to the United States District Court for the District of Massachusetts at the request of the parties. The complaint claims that PSG is obligated to pay a percentage of certain of its revenues to TVG in consideration for a strategic business introduction allegedly made by an agent of TVG. PSG has denied the allegations and filed an answer in the litigation, and as of the date of this prospectus, the outcome of the litigation is pending. The claim is for an unspecified amount including actual damages, interest, and attorney's fees. Management believes that the claim is without merit and will be settled out of court for an amount that will not have a material adverse affect on our business, financial condition or operating results. In addition, the merger agreement pursuant to which we acquired PSG provides that any liability or payment obligation arising from this litigation will be solely the responsibility of the former shareholders of PSG.

MANAGEMENT

Directors and Executive Officers

The following sets forth certain information regarding each of the directors and executive officers of the Company.

Name	Age	Positions Held
Thomas J. Colatosti	56	Chairman of the Board of Directors
Michael W. DePasquale	49	Chief Executive Officer and Director
Gary E. Wendt	62	Chief Financial Officer and Director
Jeffrey J. May	44	Director
Richard E. Gaddy	60	Director
Kenneth S. Souza	50	Senior Vice President and Chief Technology Officer
Randy Fodero	45	Vice President of Sales and Marketing

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

THOMAS J. COLATOSTI has served as a Director of the Company since September 2002 and as Chairman of the Board since January 3, 2003. Mr. Colatosti currently serves as the Chief Executive Officer of American Security Ventures, a Lexington, Massachusetts based consulting firm he founded which specializes in providing strategic management consulting services to emerging and developing companies in the homeland security industry. From 1997 through June 2002, Mr. Colatosti served as the Chief Executive Officer of Viisage Technology, Inc., a publicly traded biometric technology company focusing on biometric face-recognition technology and delivering highly secure identification documents and systems. Between 1995 and 1997, Mr. Colatosti served as President and Chief Executive Officer of CIS Corporation, a higher education industry leader that designed and implemented integrated and flexible systems solutions to manage entire university administrative operations. Prior to CIS, Mr. Colatosti had a 20-year career with Digital Equipment Corporation. His most recent responsibility was Vice President and General Manager, Northeast Area, where he was responsible for a business unit with annual revenues of more than $1.2 billion and 3,000 people. Mr. Colatosti is an active industry security spokesperson testifying before Congressional Committees and advising the White House and other Federal security agencies on homeland security issues. Mr. Colatosti earned a Bachelor of Science degree in Management and Finance as well as a Masters degree in Business Administration from Suffolk University.

MICHAEL W. DePASQUALE has served as the Chief Executive Officer and a Director of the Company since January 3, 2003. Mr. DePasquale brings more than 20 years of executive management, sales and marketing experience to the Company. Prior to joining the Company, 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 multi media curriculum. Prior to Jostes, 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.

GARY E. WENDT has served as Chief Financial Officer and Director of the Company since its inception in 1993. As previously disclosed, Mr. Wendt will retire as Chief Financial Officer and Director of the Company as of November 1, to be succeeded by Harlan Plumley. From 1993 to 1994, Mr. Wendt was Treasurer and Chief Financial Officer of Esprit Technologies, Inc., a computer manufacturer which produced high speed PCs marketed primarily to government and industry in the Midwestern United States. Mr. Wendt attended Metropolitan State University, North Hennepin Community College, and the Academy of Accountancy where he was certified in public accounting.

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

RICHARD E. GADDY has served as a Director of the Company since October 13, 2004. Mr. Gaddy serves as Vice President, Public Sector South for Unisys Corporation. Mr. Gaddy is a 33-year veteran of the computer and information technology industry. His career with Unisys includes a number of sales and business management positions.

KENNETH S. SOUZA has served as Senior Vice President and Chief Technology Officer of the Company since October 4, 2004. Prior to joining the Company, Mr. Souza was Vice President of Industry Solutions for EMC Corporation. Prior to joining EMC, he was Vice President for e-Commerce Enterprise Systems Solutions for Compaq Computer Corporation. His 25-year technology and market career includes serving in a number of executive positions with Digital Equipment Corporation including Vice President Worldwide Solutions Services and Training, and Director of Workstations Marketing. In the early 1980's, Mr. Souza held technical sales management positions with Hewlett Packard and Burroughs. Mr. Souza also held executive positions with a venture funded MRP software company.

RANDY FODERO has served as the Vice President of Sales and Marketing since July 18, 2003 and as a member of the Company's sales organization since March 2003. Mr. Fodero brings more than 20 years of successful executive and sales management experience to the Company. Prior to joining the Company, Mr. Fodero served as director of Global Accounts from Veritas Software from February 2002 until January 2003. Between 1999 and February 2002, Mr. Fodero served in executive sales capacities with both companies in the enterprise software industry, including Agile Software. From 1998 to 1999, Mr. Fodero served as Regional Vice President of Sales for Memco Software, a leading provider of information security software to Fortune 1000 companies, where he was instrumental in increasing sales and enhancing shareholder value in connection with the sale of Memco to Platinum Technology. From 1990 through 1998, Mr. Fodero served as Vice President of Sales of AT&T CommVault Systems, where he grew sales from startup to over $36 million and participated in a management buyout.

Directors' Terms of Office

Mr. Wendt was initially elected to serve as a director in 1993, and was re-elected in 2004. Mr. May was initially elected to serve as a director in 2001, and was re-elected in 2004. Mr. Colatosti was initially elected to serve as a director in 2002, and was re-elected in 2004. Mr. DePasquale was initially elected as a director in 2003, and was re-elected in 2004. Mr. Gaddy was initially elected as a director in 2004. Each such director was elected to serve until the Company's next annual meeting or until his successor is duly elected and qualified in accordance with the By-laws of the Company.

EXECUTIVE COMPENSATION

The following table sets forth a summary of the compensation paid to or accrued by our Chief Executive Officer and all of our other executive officers whose compensation exceeded $100,000 during fiscal year 2003 (the "named executive officers") for each of the fiscal years ended December 31, 2001, 2002 and 2003:

Summary Compensation Table

					Long-Term Compensation			
	Annual Compensation				Awards		Payouts	
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
Name and Principal Position	Fiscal Year	Salary ($)	Bonus ($)	Other Annual Compensation ($)	Restricted Stock Award ($)	Securities Underlying Options/ SARs($)	LTIP Payouts ($)	All Other Compensation ($)
Michael W. DePasquale(1) Chief Executive Officer	2003	148,943	25,000			1,080,000		
Randy Fodero(2) Vice President Sales and Marketing	2003	111,837				600,000		

(1) Mr. DePasquale became employed as our Chief Executive Officer on January 3, 2003.

(2) Mr. Fodero became an executive officer of the Company on July 18, 2003.

Option Grants in Year Ended December 31, 2003

The following table sets forth all options granted during the year ended December 31, 2003 to each of the named executive officers:

	Number of Securities Underlying Options Granted	Percent of Total Options Granted to Employees in Fiscal Year	Exercise Price ($/Share)	Expiration Date
Michael W. DePasquale	580,000(1)	23.8%	$ 0.53	January 2, 2010
Michael W. DePasquale	500,000(2)	20.5%	$ 1.32	December 10, 2010
Randy Fodero	300,000(3)	12.3%	$ 0.39	March 9, 2006
Randy Fodero	300,000(4)	12.3%	$ 1.32	December 10, 2010

(1) Options vested in eight (8) quarterly installments commencing April 1, 2003.

(2) Options vest in two (2) equal annual installments on January 3, 2004 and 2005.

(3) Options vest in eleven (11) quarterly installments commencing June 10, 2003.

(4) Options vest in three (3) equal annual installments on January 3, 2005, 2006 and 2007.

**Aggregated Option Exercises in the Year Ended December 31, 2003
and Fiscal Year-End Option Value**

The following table sets forth for each named executive officer, information regarding stock options exercised by such officer during the year ended December 31, 2003, together with the number and value of stock options held at December 31, 2003, each on an aggregated basis:

Name	Number of Shares Acquired on Exercise	Value Realized	Number of Unexercised Options at Fiscal Year-End Exercisable/Unexercisable(#)	Value of Unexercised In-the-Money Options at Fiscal Year-End Exercisable/Unexercisable($)(1)
Michael W. DePasquale			217,500/862,500	143,550/239,250
Randy Fodero			81,816/518,184	65,452/174,547

(1)
The last sales price of the Company's common stock as reported on the OTC Bulletin Board on December 31, 2003 was $1.19.

Compensation of Directors

Directors who are also officers of the Company receive no additional compensation for serving on the Board of Directors, other than reimbursement of reasonable expenses incurred in attending meetings. The Company's 1996 stock incentive plan provides for the grant of options to purchase 50,000 shares of common stock to each non-employee director upon first being elected or appointed to the Board of Directors. Since 2001, the Company has executed a policy of granting options to purchase 200,000 shares of common stock to each non-employee director upon first being elected or appointed to the Board of Directors. In December 2003, we adopted a policy of issuing options to purchase 50,000 shares of common stock to each non-employee director on an annual basis.

Employment Agreements

Michael W. DePasquale

On January 3, 2003, the Company entered into a two-year employment agreement with Michael W. DePasquale to serve as the Chief Executive Officer of the Company at an annual base salary of $150,000 subject to adjustment by the Board of Directors. The employment agreement provided for a quarterly performance bonus during 2003 of $37,500 per calendar quarter payable upon the Company achieving gross revenue of: $300,000, $400,000, $650,000 and $900,000 during the first, second, third and fourth calendar quarters of 2003, respectively. The employment agreement also provides for an annual bonus of options to purchase up to 500,000 shares of Company common stock payable at the discretion of the Board of Directors.

The base salary has been adjusted to $216,000 for 2004. The quarterly performance bonus benchmarks for 2004 have also been adjusted to provide for payment of the $37,500 quarterly bonus upon achieving gross revenue of: $500,000, $750,000, $1,000,000 and $1,250,000 during the first, second, third and fourth calendar quarters of 2004, respectively. Additional performance bonuses of $50,000 upon achieving annual gross revenue of at least $4,000,000 and $50,000 upon the Company reporting operating profit during 2004 have also been included for 2004.

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. The agreement may be terminated by the Company at any time with or without cause. In the event of termination without cause, Mr. DePasquale shall continue to be paid his then current base salary for the greater of six (6) months from the date of such termination or the number of months remaining until the end of the term of the employment agreement.

Harlan Plumley

In connection with his pending appointment as Chief Financial Officer of the Company as of November 1, 2004, we entered into a one (1) year employment agreement with Harlan Plumley. The employment agreement provides for an annual base salary of $190,000 and a performance bonus payable at the sole discretion of the Company. Unless terminated at least 30 days prior to the end of the term, the employment agreement automatically renews for successive one year terms. In the event that Mr. Plumley is terminated without cause, Mr. Plumley will receive severance payment equal to his base salary for the greater of 6 months and that number of months prior to the end of the term. The employment agreement contains standard and customary confidentiality, non-compete and work made for hire provisions.

Upon execution of the employment agreement, we issued Mr. Plumley a stock option to purchase 200,000 shares of our common stock at an exercise price of $1.05 per share, the last sale price of our common stock as reported on the OTC Bulletin Board on the date of grant. The option has a term of seven (7) years and vests in three equal annual installments commencing on September 15, 2005.

Kenneth S. Souza

In connection with his appointment as Senior Vice President and Chief Technology Officer of the Company on October 4, 2004, we entered into a one (1) year employment agreement with Kenneth S. Souza. The employment agreement provides for an annual base salary of $200,000 and a performance bonus in the amount of up to $76,000 payable upon achievement of certain performance criteria. Unless notice of non-renewal is provided to Mr. Souza at least two months prior to the end of the term, the employment agreement automatically renews for successive one year terms. In the event that Mr. Souza is terminated without cause, Mr. Souza will receive severance payment equal to his base salary for the greater of 6 months and that number of months remaining until the end of the term. The employment agreement contains standard and customary confidentiality, non-compete and work made for hire provisions.

Upon execution of the employment agreement, we issued Mr. Souza a stock option to purchase 300,000 shares of our common stock at an exercise price of $1.11 per share, the last sale price of our common stock as reported on the OTC Bulletin Board on the date of grant. The option has a term of seven (7) years and vests in three equal annual installments commencing on October 4, 2005.

Change in Control Provisions

The Company's 1996 Stock Option Plan (as amended to date, the "1996 Plan") and 1999 Stock Option Plan (the "1999 Plan" and together with the 1996 Plan, the "Plans")) each 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 fifty percent (50%) of the combined voting power of the surviving corporation's outstanding securities; (iv) the incumbent directors cease to constitute at least a majority of the Board of Directors; or (v) a change in control of the Company which would otherwise be reportable under Section 13 or 15(d) of the Exchange Act.

In the event of a "Change In Control" both Plans provide for the immediate vesting of all options issued thereunder. The 1999 Plan provides for the Company to deliver written notice to each optionee under the 1999 Plan fifteen (15) days prior to the occurrence of a Change In Control during which 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 1996 Plan provides for all options to remain exercisable for the remainder of their respective terms and permits the Company to make a cash payment to any or all optionees equal to the difference between the exercise price of any or all such options and the fair market value of the Company's common stock immediately prior to the Change In Control.

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

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Employment Arrangements

The Company has entered into the employment agreements described above in the "EXECUTIVE COMPENSATION Employment Agreements" section of this prospectus.

Options Granted to Executive Officers and Directors

During 2002, the Company issued options to purchase 200,000 shares of common stock to Thomas J. Colatosti upon his appointment as a director of the Company. During 2003, the Company issued options to purchase an aggregate of 2,180,000 shares of common stock to its officers and directors. The options were issued at exercise prices equal to the last sales price of the Company's common stock as reported on the OTC Bulletin Board on the date of grant, have terms of three (3) to seven (7) years, and vest over a one to three year period.

Consulting Arrangement with Thomas J. Colatosti

In connection with his appointment to the Board of Directors in September 2002, the Company entered into a consulting arrangement with Thomas J. Colatosti. Under the arrangement, the Company paid Mr. Colatosti $4,000 per month through December 2003 and issued him options to purchase 150,000 shares of common stock at an exercise price of $.33 per share, the closing price of the Company's common stock on the date of grant. In December 2003, a committee of independent directors renewed this arrangement through December 31, 2004. The committee also issued options to Mr. Colatosti to purchase 150,000 shares of common stock at an exercise price of $1.32 per share, the closing price of the Company's common stock on the date of grant, for serving as Chairman. Mr. Colatosti has substantial experience in the biometric industry and in addition to his role as the Chairman of the Board of Directors of the Company, provides extensive service to the Company in the areas of strategic planning and corporate finance.

In March 2004, Mr. Colatosti entered into a three-year consulting arrangement with The Shaar Fund Ltd., a principal creditor of the Company. Under the terms of the arrangement, The Shaar Fund transferred $375,000 principal amount of our secured convertible notes due October 1, 2005 to Mr. Colatosti. On April 29, 2004, Mr. Colatosti elected to convert the $375,000 principal amount of such note into 3,750 Series C Shares.

Consulting Agreement with Jeffry R. Brown

In connection with Jeffry R. Brown's resignation as the Chief Executive Officer and Chairman of the Board of Directors of the Company on December 31, 2002, the Company and Mr. Brown entered into a consulting agreement effective as of January 15, 2003. The consulting agreement terminated September 30, 2003, and provided for the payment of monthly consulting fees in the amount of $12,000, continued participation in the Company's health and benefit plans, and the reimbursement of out-of-pocket expenses in consideration of Mr. Brown providing strategic management and consulting services to the Company. During the previous two fiscal years, Mr. Brown was the chief architect of the Company's strategic plan and the principal person involved in establishing and developing relationships with the Company's alliance partners, potential customers and other industry contacts which were important to the continued execution of the Company's business plan. In recognition of his continued service to the Company, the termination date of options to purchase 400,000 shares of common stock at $.20 per share previously issued to Mr. Brown was extended from March 31, 2003 until December 31, 2003.

SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth, as of October 25, 2004, information with respect to the securities holdings of all persons which the Company, pursuant to filings with the Securities and Exchange Commission, has reason to believe may be deemed the beneficial owners of more than five percent (5%) of the Company's outstanding common stock. The following table also sets forth, as of such date, the beneficial ownership of the Company's common stock by all officers and directors, individually and as a group. Unless otherwise indicated, the address of each person listed below is c/o BIO-key International, Inc., 1285 Corporate Center Drive, Suite 175, Eagan, Minnesota 55121.

Name and Address of Beneficial Owner	Number of Shares Beneficially Owned(1)	Percentage of Common Stock Outstanding
Thomas J. Colatosti	855,000(2)	2.2%
Michael W. DePasquale	777,500(3)	1.9%
Gary E. Wendt	578,730(4)	1.5%
Jeffrey J. May	200,000(5)	*
Randy Fodero	206,932(6)	*
Richard E. Gaddy	0	*
All officers and directors as a group	2,645,374	6.2%

*
Less than one percent (1%) of the outstanding common stock.

(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 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 sixty (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 38,962,281 shares of common stock outstanding as of October 25, 2004.

(2)
Includes 325,000 shares issuable upon exercise of options and 500,000 shares issuable upon conversion of series C preferred stock. Does not include 200,000 shares issuable upon exercise of options subject to vesting.

(3)
Includes 777,500 shares issuable upon exercise of options. Does not include 322,500 shares issuable upon exercise of options subject to vesting.

(4)
Includes 173,380 shares issuable upon exercise of options.

(5)
Consists of shares issuable upon exercise of options. Does not include 50,000 shares issuable upon exercise of options subject to vesting.

(6)
Includes 190,904 shares issuable upon exercise of options. Also includes 20,500 shares owned by Mr. Fodero's minor children. Mr. Fodero disclaims beneficial ownership of those shares. Does not include 436,368 shares issuable upon exercise of options subject to vesting.

The following table sets forth, as of December 31, 2003, information with respect to our securities authorized for issuance under equity compensation plans.

	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights (A)	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights (B)	Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans (Excluding Securities Reflected in Column (A)(C)
Equity compensation plans approved by security holders	487,380	$ 0.5155	169,620
Equity compensation plans approved by security holders	5,640,601	$ 0.8022	629,588
Total	6,127,981	$ 0.7794	799,208

The Company's 1999 Stock Option Plan (the "1999 Plan") was adopted by the Board of Directors of the Company on or about August 31, 1999. The material terms of the 1999 Plan are summarized below.

The 1999 Plan is currently administered by the Board of Directors of the Company (the "Plan Administrator"). The Plan Administrator is authorized to construe the 1999 Plan and any option issued under the 1999 Plan, select the persons to whom options may be granted, and determine the number of shares to be covered by any option, the exercise price, vesting schedule and other material terms of such option.

The 1999 Plan provides for the issuance of options to purchase up to 2,000,000 shares of common stock to officers, employees, directors and consultants of the Company at exercise prices not less than 85% of the last sale price of the Company's common stock as reported on the OTC Bulletin Board on the date of grant. Options have terms of not more than ten (10) years from the date of grant, are subject to vesting as determined by the Plan Administrator and are not transferable without the permission of the Company except by will or the laws of descent and distribution or pursuant to a domestic relations order. Options terminate three (3) months after termination of employment or other association with the Company or one (1) year after termination due to disability, death or retirement. In the event that termination of employment or association is for a cause, as that term is defined in the 1999 Plan, options terminate immediately upon such termination. The Plan Administrator has the discretion to extend options for up to three years from the date of termination or disassociation with the Company.

The 1999 Plan provides for the immediate vesting of all options in the event of a "Change In Control" of the Company. In the event of a Change In Control, the Company is required 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 time all options issued under 1999 Plan may be exercised. Thereafter, all options issued under the 1999 Plan which are neither assumed or substituted in connection with such transaction, automatically expire, unless otherwise determined by the Board. Under the 1999 Plan, a "Change In Control" is defined 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.

As of December 31, 2003, there were outstanding options under the 1999 Plan to purchase 1,176,669 shares of common stock, and options to purchase an aggregate of 629,588 shares were available for future grants.

In addition to options issued under the 1999 Plan, the Company has issued options and warrants to employees, officers, directors and consultants to purchase an aggregate of 4,951,312 shares of common stock. The terms of these options are substantially similar to the provisions of the 1999 Plan and options issued thereunder.

DESCRIPTION OF SECURITIES

Common Stock

The Company is authorized to issue 85,000,000 shares of common stock, $.01 par value per share, of which 38,962,281 were outstanding as of October 25, 2004.

Holders of common stock have equal rights to receive dividends when, as and if declared by the Board of Directors, out of funds legally available therefor. Holders of common stock have one vote for each share held of record and do not have cumulative voting rights.

Holders of common stock are entitled, upon liquidation of the Company, to share ratably in the net assets available for distribution, subject to the rights, if any, of holders of any preferred stock then outstanding. Shares of common stock are not redeemable and have no preemptive or similar rights. All outstanding shares of common stock are fully paid and nonassessable.

Preferred Stock

Within the limits and restrictions provided in the Company's Articles of Incorporation, the Board of Directors has the authority, without further action by the shareholders, to issue up to 5,000,000 shares of preferred stock, $.01 par value per share, in one or more series, and to fix, as to any such series, any dividend rate, redemption price, preference on liquidation or dissolution, sinking fund terms, conversion rights, voting rights, and any other preference or special rights and qualifications.

Series B Convertible Preferred Stock. The Board of Directors has authorized the designation of 50,000 shares of preferred stock as Series B Convertible Preferred Stock (the "Series B Shares"), of which no shares are issued and outstanding. The material provisions of the Series B Shares are more fully set forth in the Certificate of Designation on file with the Minnesota Secretary of State.

Series C Convertible Preferred Stock. In March 2004, we designated 100,000 shares of preferred stock as Series C Convertible Preferred Stock (the "Series C Shares"), of which 72,182 are issued and outstanding. The following describes the material provisions of the Series C Shares which are more fully set forth in the Certificate of Designation on file with the Minnesota Secretary of State.

The Series C Shares accrue a cumulative annual dividend of 7% on the $100 face amount of such shares payable June 15 and December 15 each year in shares of common stock. In the event of a liquidation, dissolution or winding up of the Company, the Series C shares have a liquidation preference of $100 per share (plus all accrued and unpaid dividends thereon) prior to any payment or distribution to holders of our common stock. The Series C Shares are convertible into common stock at a conversion price of $.75 per share. The conversion price is subject to proportional adjustment in the event of stock splits, stock dividends or reclassifications. Subject to certain exceptions, in the event we issue additional shares of common stock at a purchase price less than the conversion price of the Series C Shares, the conversion price shall be lowered to such lesser price. In the event that the average closing bid price of our common stock is less than $1.00 per share for thirty (30) consecutive trading days at any time after March 3, 2007, we will be required to redeem the Series C Shares by payment of $100 per share plus all accrued and unpaid dividends due thereon.

We are required to obtain the consent of the holders of a majority of the Series C Shares in order to, among other things, issue any shares of preferred stock that are equal to or have a preference over the Series C shares or issue any shares of preferred stock, rights, options, warrants, or any other securities convertible into common stock of the Company, other than those issued to employees of the Company in the ordinary course of their employment or to consultants or other persons providing services to the Company so long as such issuances do not exceed 500,000 shares of common stock. We are also required to obtain such consent in order to, among other things, complete a sale or other disposition of any material assets, complete an acquisition of a material amount of assets, engage in a merger, reorganization or consolidation, or incur or guaranty any indebtedness in excess of $50,000.

Dividend Policy

The Company has never paid cash dividends on its common stock. The Board of Directors does not anticipate paying cash dividends in the foreseeable future as it intends to retain future earnings, if any, to finance the growth of the business. The payment of future dividends will depend on such factors as earnings levels, anticipated capital requirements, the operating and financial condition of the Company and other factors deemed relevant by the Board of Directors.

Anti-Takeover Provisions of the Company's Articles of Incorporation

As described above, the Board of Directors is authorized without further stockholder action, to designate any number of series of preferred stock with such rights, preferences and designations as determined by the Board. Shares of preferred stock issued by the Board of Directors could be utilized, under certain circumstances, to make an attempt to gain control of the Company more difficult or time consuming. For example, shares of preferred stock could be issued with certain rights that might have the effect of diluting the percentage of common stock owned by a significant stockholder or issued to purchasers who might side with management in opposing a takeover bid that the Board of Directors determines is not in the best interest of the Company and its stockholders. The existence of the preferred stock may, therefore, be viewed as having possible anti-takeover effects.

Transfer Agent

The transfer agent for the Company's common stock is StockTrans, Inc., 44 West Lancaster Avenue, Ardmore, Pennsylvania 19003, (610) 649-7300.

ACQUISITION OF AETHER MOBILE GOVERNMENT

On September 30, 2004, we completed our acquisition from Aether of its Mobile Government Division. Pursuant to the Asset Purchase Agreement dated as of August 16, 2004 by and among the Company, Aether, Cerulean Technology, Inc. and SunPro, Inc., the Company paid Aether a purchase price of $10,000,000 in cash, subject to post-closing adjustments to reflect changes in Aether Mobile Government's working capital since June 30, 2004. In connection with this acquisition, the Company issued a Subordinated Secured Promissory Note to Aether in the face amount of $6,884,588 (the "Aether Note"). The Aether Note evidences a contingent reimbursement obligation of the Company to Aether and a surety fee payable by the Company to Aether, in each case with respect to a letter of credit maintained by Aether for the Company's benefit in connection with the acquisition. The Company's obligations under the Aether Note are secured by a security interest granted to Aether in all or substantially all of the Company's assets, subordinate to the security interest described in the "Convertible Debt Financing Transactions" section of this prospectus below.

Aether Mobile Government provides wireless data solutions for use by public safety organizations, primarily state and local police, fire and rescue and emergency medical services organizations, that enable such organizations to access law enforcement databases to validate identities and obtain suspect information. Its public safety solutions are integrated into fifty (50) different state databases, as well as local and federal databases, and its products deliver real-time information in seconds, without the need for human dispatchers or other resources. Upon completing the purchase of Aether Mobile Government, we acquired its principal products, which are:

The PacketCluster® family of products, which are open, standards-based wireless information software products that provide police officers in the field with direct access to motor vehicle and warrant information and other critical information;

The handheld version of PacketCluster® Patrol (called PocketBlue), which is a handheld application for mobile law enforcement that is part of a fully integrated mobile data system, providing criminal database queries, secure messaging and alarm capabilities for all connected mobile users;

PacketWriter , which is a mobile field reporting solution that allows for mobile data collection, data sharing with PacketCluster® and work-flow management;

The FireRMS family of products for fire and rescue companies, which are compliant incident reporting products specifically developed to cut report completion time for front-line emergency response personnel; and

Handheld applications for fire and rescue companies (PocketFD and PocketCluster Rescue), which allow fire services personnel to wirelessly access and update records in the field and extends computer aided dispatch, fire records management systems and other in-house data sources to a mobile environment.

CONVERTIBLE DEBT FINANCING TRANSACTIONS

Secured Debt Financing

On September 29, 2004, we entered into a Securities Purchase Agreement (the "Senior Purchase Agreement") with Laurus Master Fund, Ltd. ("Laurus") and certain other institutional and accredited investors (together with Laurus, the "Senior Investors"). Under the Senior Purchase Agreement, the Company issued secured convertible term notes (the "Senior Convertible Notes") in the aggregate principal amount of $5,050,000, convertible into common stock of the Company in certain circumstances at $1.35 per share, and issued warrants (the "Senior Warrants") to purchase an aggregate of 1,122,222 shares of our common stock at an exercise price of $1.55 per share. The proceeds from this transaction were used in part to finance the Company's acquisition of Aether Mobile Government (the "Aether Acquisition"). The Company's obligations under the Senior Purchase Agreement, the Senior Convertible Notes and the Senior Warrants are secured by a security interest in all or substantially all of the Company's assets.

Under the terms of the Senior Convertible Notes, we are required to make monthly payments of accrued interest only beginning on November 1, 2004. In addition, the Senior Convertible Notes provide for monthly payments of principal in equal $^{1}/_{32}$ increments thereof, plus accrued interest, commencing February 1, 2005. The Senior Convertible Notes bear interest at an initial rate equal to the prime rate plus two percent (2%), subject to a six percent (6%) floor. The interest rate on the Senior Convertible Notes is subject to reduction on a month-by-month basis if specified conditions are met. In particular, if (a) we register the common stock underlying the Senior Convertible Notes and Senior Warrants on a registration statement declared effective by the Securities and Exchange Commission and (b) our common stock is trading at a 25% or greater premium to the note conversion price, then the interest rate will be adjusted downward by 2.0% for each incremental 25% increase over the note conversion price. Alternatively, if (x) we have not registered such common stock under an effective registration statement, but (y) our common stock is trading at a 25% or greater premium to the note conversion price, then the interest rate will be adjusted downward by 1.0% for each incremental 25% increase over the note conversion price.

For any cash payments we make on the Senior Convertible Notes (e.g., any amounts due that are not converted into common stock), we are required to pay an amount equal to 102% of the principal amount due. In addition, we can prepay the note at any time upon payment of an amount equal to 110% of the then outstanding principal balance, plus accrued and unpaid interest.

The Senior Investors have the option at any time to convert any or all of the outstanding principal and accrued and unpaid interest on the Senior Convertible Notes into shares of our common stock at a conversion price of $1.35 per share. In addition, for each monthly payment under the note, the Senior Investors will be obligated to convert a portion of the monthly payment into common stock at the applicable conversion price, so long as:

the average closing price of our common stock (for the five trading days immediately preceding the payment date) is greater than $1.48 l per share (which represents 110% of the note conversion price, based on the initial conversion price of $1.35),

such amount being converted does not exceed 25% of the aggregate dollar trading volume for such immediately preceding twenty-two trading days, and

the shares of common stock underlying the note are registered under an effective registration statement with the Securities and Exchange Commission.

The terms of the Senior Convertible Notes and Senior Warrants prohibit conversion of the notes or exercise of the warrants to the extent that conversion of the notes and exercise of the warrants would result in any holder thereof, together with its affiliates, beneficially owning in excess of 4.99% of our outstanding shares of common stock. A holder may waive the 4.99% limitation upon 75 days' prior written notice to us. Also, this limitation does not preclude the holder from converting or exercising the note or warrant and selling shares underlying the note or warrant in stages over time where each stage does not cause the holder and its affiliates to beneficially own shares in excess of the limitation amount.

As security for our obligations to the Senior Investors, we, along with our wholly-owned subsidiary Public Safety Group, Inc. ("PSG"), granted to the Senior Investors a blanket security interest in all of our assets, and we entered into a stock pledge with the Senior Investors for the capital stock in PSG. If an event of default occurs under the Senior Convertible Notes or the other related investment agreements, 120% of the unpaid principal balance on the Senior Convertible Notes, plus accrued interest and fees, shall become immediately due and the Senior Investors shall be entitled to payment of a default interest rate of 1.5% per month on all amounts due under the Senior Convertible Notes. Such events of default include the following:

a failure to pay interest and principal payments under the Senior Convertible Notes within three days of when due;

a breach by us of any material covenant or term or condition of the Senior Convertible Notes or in any of the investment agreements, if not cured within 30 days of such breach;

a breach by us of any material representation or warranty made in the Senior Convertible Notes or in any of the investment agreements;

if we make an assignment for the benefit of our creditors, or a receiver or trustee is appointed for us, or any form of bankruptcy or insolvency proceeding is instituted by us, or any involuntary proceeding is instituted against us if not vacated within 60 days;

the filing of any money judgment or similar final process against us for more than $50,000, which remains unvacated, unbonded or unstayed for a period of 30 days;

if our common stock is suspended for five consecutive days or for five days during any ten consecutive days from a principal market or pursuant to a Securities and Exchange Commission stop order; and

a failure by us to timely deliver shares of common stock when due upon conversions of the Senior Convertible Notes.

Upon an event of default, the Senior Lenders will be entitled to specified remedies, including remedies under the Uniform Commercial Code.

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We have agreed to register with the Securities and Exchange Commission for resale the shares of common stock that are issuable upon conversion of the Senior Convertible Notes and upon exercise of the Senior Warrants. Under the registration rights agreement, we are obligated to file a registration statement with the Securities and Exchange Commission on or before October 29, 2004, and to use reasonable commercial efforts to have the registration statement declared effective not later than December 28, 2004. The resale registration statement of which this prospectus is a part was filed with the Securities and Exchange Commission on October 29, 2004 for the shares underlying the Senior Convertible Notes and Senior Warrants. If we fail to comply with our registration obligations, the Senior Investors will be entitled to certain specified remedies, including monetary liquidated damages. In particular, for each 30 days (or such pro rated number of days) that we are out of compliance with our registration obligations, we will be subject to a liquidated damage assessment of 2% of the then outstanding principal amount of the Senior Convertible Notes.

Each Senior Investor has agreed, pursuant to the Senior Purchase Agreement, that neither it nor any of its affiliates and investment partners will (and will not cause any other person or entity, directly or indirectly, to) engage in "short sales" of our common stock for as long as any Senior Convertible Notes held by it remain outstanding. "Short sales" are contracts for the sale of shares of stock that the seller does not own, or certificates which are not within the seller's control, so as to be available for delivery at the time when, under applicable rules, delivery must be made.

Subordinated Debt Financing

On September 29, 2004, we entered into a Securities Purchase Agreement (the "Subordinated Purchase Agreement") with The Shaar Fund, Ltd. ("Shaar") and other existing shareholders of the Company and accredited investors (collectively, the "Subordinated Investors"). Under the Subordinated Purchase Agreement, the Company issued unsecured convertible term notes (the "Subordinated Convertible Notes") in the aggregate principal amount of $4,768,000, convertible into common stock of the Company in certain circumstances at $1.35 per share, and issued warrants (the "Subordinated Warrants") to purchase an aggregate of 1,059,553 shares of our common stock at an exercise price of $1.55 per share. The proceeds from this transaction were used in part to finance a portion of the Aether Acquisition and will be used in part for working capital purposes.

Under the terms of the Subordinated Convertible Notes, we are required to make monthly payments of accrued interest only beginning on November 1, 2004. In addition, the Subordinated Convertible Notes provide for monthly payments of principal in equal $^{1}/_{32}$ increments thereof, plus accrued interest, commencing February 1, 2005, which payments may be made in shares of common stock at the option of each noteholder. The Subordinated Convertible Notes bear interest at an initial rate equal to the prime rate plus seven and one-half percent (7.5%), subject to an eleven percent (11%) floor.

We may prepay the Subordinated Convertible Notes at any time upon payment of an amount equal to 110% of the then outstanding principal balance, plus accrued and unpaid interest. Upon any such prepayment, the Senior Convertible Notes must also be prepaid. The Subordinated Investors have the option at any time to convert any or all of the outstanding principal and accrued and unpaid interest on the Subordinated Convertible Notes into shares of our common stock at a conversion price of $1.35 per share.

The terms of the Subordinated Convertible Notes and Subordinated Warrants prohibit conversion of the notes or exercise of the warrants to the extent that conversion of the notes and exercise of the warrants would result in any holder thereof, together with its affiliates, beneficially owning in excess of 4.99% of our outstanding shares of common stock. A holder may waive the 4.99% limitation upon 75 days' prior written notice to us. Also, this limitation does not preclude the holder from converting or exercising the note or warrant and selling shares underlying the note or warrant in stages over time where each stage does not cause the holder and its affiliates to beneficially own shares in excess of the limitation amount.

If an event of default occurs under the Subordinated Convertible Notes or the other related investment agreements, the unpaid principal balance on the Subordinated Convertible Notes, plus accrued interest, shall, at the noteholder's option, become immediately due and the Subordinated Investors shall be entitled to payment of additional default interest at the rate of 2.0% per month on all amounts due under the Subordinated Convertible Notes. Such events of default include the following:

- failure to pay interest and principal payments under the Subordinated Convertible Notes within three days of when due;
- a breach by us of any covenant, term or condition in any material respect of the Subordinated Convertible Notes or in any of the investment agreements, if not cured within 30 days of such breach;
- any representation or warranty made in the Subordinated Convertible Notes or in any of the investment agreements being false or misleading in any material respect;
- if we make an assignment for the benefit of our creditors, or a receiver or trustee is appointed for us, or any form of bankruptcy or insolvency proceeding is instituted by us, or any involuntary proceeding is instituted against us;
- the filing of any money judgment or similar final process against us for more than $50,000, which remains unvacated, unbonded or unstayed for a period of 30 days;
- if our common stock is suspended for five consecutive days or for five days during any ten consecutive days from a principal market or pursuant to a Securities and Exchange Commission stop order;
- a failure by us to timely deliver shares of common stock when due upon conversions of the Subordinated Convertible Notes; and
- a change in our controlling ownership.

Upon an event of default, the rights and remedies of the Subordinated Investors will be subordinate to those of the Senior Investors pursuant to a Subordination and Intercreditor Agreement dated as of September 30, 2004 by and among Laurus, as Collateral Agent, Shaar, as Purchaser Agent, Aether Systems, Inc., PSG and the Company

We have agreed to register with the Securities and Exchange Commission for resale the shares of common stock that are issuable upon conversion of the Subordinated Convertible Notes and upon exercise of the Subordinated Warrants. Under the registration rights agreement, we are obligated to file a registration statement with the Securities and Exchange Commission on or before October 29, 2004, and to use reasonable commercial efforts to have the registration statement declared effective not later than December 28, 2004. The resale registration statement of which this prospectus is a part was filed with the Securities and Exchange Commission on October 29, 2004 for the shares underlying the Subordinated Convertible Notes and Subordinated Warrants. If we fail to comply with our registration obligations, the Subordinated Investors will be entitled to certain specified remedies, including monetary liquidated damages. In particular, for each 30 days (or such pro rated number of days) that we are out of compliance with our registration obligations, we will be subject to a liquidated damage assessment of 2% of the then outstanding principal amount of the Subordinated Convertible Notes.

Each Subordinated Investor has agreed, pursuant to the Subordinated Purchase Agreement, that neither it nor any of its affiliates and investment partners will (and will not cause any other person or entity, directly or indirectly, to) engage in "short sales" of our common stock for as long as any Subordinated Convertible Notes held by it remain outstanding.

SELLING SECURITY HOLDERS

We are registering for resale shares of our common stock issued to the selling security holders identified below. The selling security holders identified in the following table are offering for sale up to 10,996,925 shares of common stock, of which 8,815,150 shares are issuable upon conversion of convertible term notes and 2,181,775 shares are issuable upon exercise of warrants, each issued to the selling security holders in private placement transactions. The following table sets forth:

- the name of each selling security holder;
- the nature of any material relationship within the past three years between any selling security holder and the Company or any of our affiliates based on information currently available to us;
- the number of shares of our common stock beneficially owned by each selling security holder prior to this offering;
- the number of shares of our common stock offered hereunder by each selling security holder; and
- the number and percent of shares of our common stock beneficially owned by each selling security holder after this offering is complete. This calculation assumes that all shares are sold pursuant to this offering and that no other shares of common stock are acquired or disposed of by the selling security holder prior to the termination of this offering.

We are unable to determine the exact number of shares that will actually be sold or when, or if, these sales will occur. Additionally, we are unable to determine the exact number of shares, if any, that will be issued to the selling security holders who hold our convertible term notes upon conversion of such notes.

Each of the selling security holders is offering for sale with this prospectus the number of shares listed below subject to the limitations described in the section of this prospectus entitled "Plan of Distribution". Beneficial ownership is determined in accordance with the rules and regulations of the Securities and Exchange Commission. Except as indicated in the footnotes to this table and subject to applicable community property laws, each of the selling security holders named in this table has sole voting power with respect to all shares of common stock listed as beneficially owned by such selling security holders.

The applicable percentages of beneficial ownership set forth below are based on an aggregate of 38,962,281 shares of our common stock issued and outstanding on October 25, 2004.

Name of Selling Security Holder	Number of Shares Beneficially Owned Prior to Offering	Shares Offered Pursuant to this Prospectus	Shares Beneficially Owned After Offering is Complete	
			Number	Percent
Laurus Master Fund, Ltd.(1)	5,405,834	5,405,834	0	0
Albert Fried & Company, LLC(2)	112,157	112,157	0	0
The Shaar Fund Ltd.(3)	1,260,170	1,260,170	214,098	*
Longview Equity Fund, LP(4)	1,081,217	1,081,217	0	0
Longview Fund, LP(5)	864,973	864,973	0	0
Longview International Equity Fund, LP(6)	360,405	360,405	0	0
Longview Special Finance (7)	576,649	576,649	0	0
Etienne Des Roys(8)	115,330	115,330	0	0
Eric Haber(9)	57,665	57,665	0	0
Cordillera Fund, L.P.(10)	115,330	115,330	0	0

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Investors Management Corporation(11)	239,886	239,886	0	0
The Tocqueville Fund(12)	576,649	576,649	0	0
Tocqueville Amerique Value Fund(13)	230,659	230,659	0	0
Total	10,996,925	10,996,925	214,098	*

* Less than one percent (1%) of the outstanding common stock.

(1) Includes 4,294,723 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 1,111,111 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of $1.55. This selling security holder has identified Laurus Master Fund, Ltd. as having voting and dispositive power with respect to these securities. Laurus Capital Management, LLC, a Delaware limited liability company, is a control person of the securities held by Laurus Master Fund, Ltd, and David Grin and Eugene Grin are the sole members of Laurus Capital Management, LLC.

(2) Includes 89,935 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term notes held by this selling security holder and 22,222 shares issuable upon exercise of warrants held by this selling security holder at an exercise price of $1.55. This selling security holder has identified Albert Fried, Jr. as having voting and dispositive power with respect to these securities. This selling security holder has identified itself as an affiliate of a registered broker-dealer. See "Plan of Distribution" section of this prospectus for required disclosure regarding such selling security holder's status as an affiliate of a registered broker-dealer.

(3) Includes 1,024,614 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 235,556 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of $1.55. This selling security holder has identified Hugo Van Neutegem as having voting and dispositive power with respect to these securities. This selling security holder has been the principal creditor and source of financing for the Company since June 1998.

(4) Includes 872,884 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 208,333 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of $1.55. This selling security holder has identified Peter T. Benz as having voting and dispositive power with respect to these securities.

(5) Includes 698,307 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 166,666 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of $1.55. This selling security holder has identified Peter T. Benz as having voting and dispositive power with respect to these securities.

(6) Includes 290,961 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 69,444 shares issuable upon exercise of the

warrant held by this selling security holder at an exercise price of $1.55. This selling security holder has identified Peter T. Benz as having voting and dispositive power with respect to these securities.

(7) Includes 465,538 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 111,111 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of $1.55. This selling security holder has identified Peter T. Benz as having voting and dispositive power with respect to these securities.

(8) Includes 93,108 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 22,222 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of $1.55.

(9) Includes 46,554 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 11,111 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of $1.55.

(10) Includes 93,108 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 22,222 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of $1.55. This selling security holder has identified James P. Andrew as having voting and dispositive power with respect to these securities.

(11) Includes 193,664 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 46,222 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of $1.55. This selling security holder has identified Richard A. Urquhart, III as having voting and dispositive power with respect to these securities.

(12) Includes 465,538 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 111,111 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of $1.55. This selling security holder has identified Robert W. Kleinschmidt as having voting and dispositive power with respect to these securities. In addition, this selling security holder has identified itself as an affiliate of a registered broker-dealer. See "Plan of Distribution" section of this prospectus for required disclosure regarding such selling security holder's status as an affiliate of a registered broker-dealer.

(13) Includes 186,215 shares as our estimate of the number of shares of common stock that may be issuable upon conversion, from time to time, of principal, interest and fees under the convertible term note held by this selling security holder and 44,444 shares issuable upon exercise of the warrant held by this selling security holder at an exercise price of $1.55. This selling security holder has identified Robert W. Kleinschmidt as having voting and dispositive power with respect to these securities. In addition, this selling security holder has identified itself as an affiliate of a registered broker-dealer. See "Plan of Distribution" section of this prospectus for required disclosure regarding such selling security holder's status as an affiliate of a registered broker-dealer.

PLAN OF DISTRIBUTION

The selling security holders may, from time to time after the registration statement which includes this prospectus becomes effective, sell any or all of their shares of common stock on any 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. The selling security holders 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;
- broker-dealers may agree with the selling security holders to sell a specified number of such shares at a stipulated price per share;
- a combination of any such methods of sale; and
- any other method permitted pursuant to applicable law.

The selling security holders may also sell shares under Rule 144 under the Securities Act, if available, rather than under this prospectus.

Laurus Master Fund, Ltd., The Shaar Fund Ltd. and the other selling security holders offering shares of our common stock under this prospectus upon conversion of our convertible term notes and accompanying warrants have each agreed, pursuant to the applicable securities purchase agreement with us, that neither it nor any of its affiliates and investment partners will (and will not cause any other person or entity, directly or indirectly, to) engage in "short sales" of our common stock for as long as such notes held by it remain outstanding. "Short sales" are contracts for the sale of shares of stock that the seller does not own, or certificates which are not within the seller's control, so as to be available for delivery at the time when, under applicable rules, delivery must be made.

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. The selling security holders do not expect these commissions and discounts to exceed what is customary in the types of transactions involved. Any profits on the resale of shares of common stock by a broker-dealer acting as principal might be deemed to be underwriting discounts or commissions under the Securities Act. Discounts, concessions, commissions and similar selling expenses, if any, attributable to the sale of shares will be borne by a selling security holder. The selling security holders may agree to indemnify any agent, dealer or broker-dealer that participates in transactions involving sales of the shares if liabilities are imposed on that person under the Securities Act.

In order to comply with the securities laws of certain states, if applicable, the shares being offered hereby must be sold in such jurisdictions only through registered or licensed brokers or dealers. In addition, in certain states such 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 there has been compliance thereof.

The selling security holders may from time to time pledge or grant a security interest in some or all of the shares of common stock owned by them and, if they default in the performance of their secured obligations, the pledgees or secured parties may offer and sell the shares of common stock

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from time to time under this prospectus after we have filed an amendment to this prospectus under Rule 424(b)(3) or other applicable provision of the Securities Act amending the list of selling security holders to include the pledgee, transferee or other successors in interest as selling security holders under this prospectus.

The selling security holders also may transfer the shares of common stock in other circumstances, in which case the transferees, pledgees or other successors in interest will be the selling beneficial owners for purposes of this prospectus and may sell the shares of common stock from time to time under this prospectus after we have filed an amendment to this prospectus under Rule 424(b)(3) or other applicable provision of the Securities Act amending the list of selling security holders to include the pledgee, transferee or other successors in interest as selling security holders under this prospectus.

The selling security holders and any broker-dealers or agents that are involved in selling the shares of common stock 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 of common stock purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act.

We are required to pay all fees and expenses incident to the registration of the shares of common stock. We have agreed to indemnify the selling security holders against certain losses, claims, damages and liabilities, including liabilities under the Securities Act. The selling security holders will be responsible, however, for all selling commissions applicable to the sale of shares pursuant to this prospectus.

Each selling security holder that is an affiliate of a registered broker-dealer has represented to us that it purchased our securities for its own account for investment only and that at the time of such purchase, such selling security holder had no agreements, plans or understandings, directly or indirectly, with any person to distribute such securities.

The selling security holders have advised us that they have not entered into any agreements, understandings or arrangements with any underwriters or broker-dealers regarding the sale of their shares of common stock, nor is there an underwriter or coordinating broker acting in connection with a proposed sale of shares of common stock by any selling security holder. If we are notified by any selling security holder that any material arrangement has been entered into with a broker-dealer for the sale of shares of common stock, if required, we will file a supplement to this prospectus. If the selling security holders use this prospectus for any sale of the shares of common stock, they will be subject to the prospectus delivery requirements of the Securities Act.

The anti-manipulation rules of Regulation M under the Exchange Act may apply to sales of our common stock and activities of the selling security holders. We have informed the selling security holders that, during such time as they may be engaged in a distribution of any of the shares we are registering by this registration statement, they are required to comply with Regulation M, and the selling security holders have agreed, and will cause each of their affiliates and investment partners, to comply with Regulation M in all respects during such time. In general, Regulation M precludes any selling security holder, any affiliated purchasers and any broker-dealer or other person who participates in a distribution from bidding for or purchasing, or attempting to induce any person to bid for or purchase, any security which is the subject of the distribution until the entire distribution is complete. Regulation M defines a "distribution" as an offering of securities that is distinguished from ordinary trading activities by the magnitude of the offering and the presence of special selling efforts and selling methods. Regulation M also defines a "distribution participant" as an underwriter, prospective underwriter, broker, dealer or other person who has agreed to participate or who is participating in a distribution.

Regulation M also prohibits any bids or purchases made in order to stabilize the price of a security in connection with the distribution of that security, except as specifically permitted by Rule 104 of Regulation M. These stabilizing transactions may cause the price of our common stock to be more than it would otherwise be in the absence of these transactions. We have informed the selling security holders that stabilizing transactions permitted by Regulation M allow bids to purchase our common stock if the stabilizing bids do not exceed a specified maximum, and the selling security holders have agreed, and will cause each of their affiliates and investment partners, to comply with Regulation M in all respects during such time as they may be engaged in a distribution of any of the shares we are registering by this registration statement. Regulation M specifically prohibits stabilizing that is the result of fraudulent, manipulative or deceptive practices. Selling security holders and distribution participants are required to consult with their own legal counsel to ensure compliance with Regulation M.

DISCLOSURE OF COMMISSION POSITION OF INDEMNIFICATION FOR SECURITIES ACT LIABILITIES

The Company's Articles of Incorporation limit the personal liability of the Company's officers and directors for monetary damages for breach of their fiduciary duty as directors, except for liability that cannot be eliminated under the Minnesota Business Corporation Act (the "MBCA"). The Company's Bylaws also provide for the Company to indemnify directors and officers to the fullest extent permitted by the MBCA.

The indemnification provisions described above would provide coverage for claims arising under the Securities Act and the Exchange Act. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the Company pursuant to the Company's Articles of Incorporation, Bylaws, the MBCA, or otherwise, the Company has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable.

EXPERTS

Our financial statements as of December 31, 2003 and for each of the two years in the period ended December 31, 2003 and the financial statements of Public Safety Group, Inc. as of December 31, 2003 and 2002 and for each of the two years in the period ended December 31, 2003 included in this prospectus have been audited by Divine, Scherzer & Brody Ltd., independent certified public accountants, as stated in their reports appearing herein, and have been so included in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission under the Exchange Act. Such reports and other information may be inspected and copied at the Securities and Exchange Commission's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the Public Reference Room. The Securities and Exchange Commission also maintains an Internet site that contains reports, proxy statements and other information about issuers, like us, who file electronically with the Securities and Exchange Commission. The address of the Securities and Exchange Commission's web site is *http://www.sec.gov*.

This prospectus is part of a registration statement that we have filed with the Securities and Exchange Commission. The prospectus, which forms a part of such registration statement, and any accompanying prospectus supplement do not contain all of the information included in the registration statement. We have omitted a few parts of the registration statement according to the rules and regulations of the Securities and Exchange Commission. For further information, we refer you to the registration statement, including its exhibits and schedules. 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 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. You should not assume that the information in this prospectus or any supplement is accurate as of any date other than the date on the front of those documents. We do not intend to distribute annual reports or audited financial statements to our shareholders. This information may be found in our filings with the Securities and Exchange Commission.

ITEM 7 FINANCIAL STATEMENTS

The following consolidated financial statements of BIO-key International, Inc. and Subsidiary are included herein at the indicated page numbers:

Report of Independent Certified Public Accountants

Board of Directors and Stockholders
BIO-key International, Inc.

We have audited the accompanying balance sheet of BIO-key International, Inc. as of December 31, 2003 and the related statements of operations, stockholders' equity (deficit) and cash flows for each of the two years in the two year period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of BIO-key International, Inc. as of December 31, 2003, and the results of its operations and its cash flows for each of the two years in the two year period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States.

In our previous audit report on these financial statements dated March 25, 2004, we referred to several issues that raised substantial doubt about the Company's ability to continue as a going concern. However, as disclosed in Note A, the Company has entered into a significant financing arrangement which removed the substantial doubt about the Company's ability to continue as a going concern.

/s/ Divine, Scherzer & Brody, Ltd.

Minneapolis, Minnesota
March 25, 2004 (except for Note A, as to which
the date is March 31, 2004)

BIO-key International, Inc.

BALANCE SHEET

December 31, 2003

ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$	1,012,790
Accounts receivable, less allowance for doubtful receivables of $2,000		409,803
Inventory		65,857
Prepaid expenses		165,929
Total current assets		1,654,379
EQUIPMENT, FURNITURE AND FIXTURES at cost, less accumulated depreciation		60,157
OTHER ASSETS		150,206
	$	1,864,742
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
CURRENT LIABILITIES		
Note payable	$	
Advances from stockholder		34,030
Accounts payable		351,742
Accrued liabilities		173,736
Deferred revenue		10,000
Total current liabilities		569,508
DEFERRED REVENUE		
LONG-TERM OBLIGATIONS		10,431,223
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY (DEFICIT)		
Preferred stock authorized, 5,000,000 shares of $.01 par value (liquidation preference of $100 per share) Series B 9% Convertible; issued and outstanding 4,180 shares		42
Common stock authorized, 60,000,000 shares of $.01 par value; issued and outstanding 21,222,889 shares		212,229
Additional contributed capital		18,327,992
Accumulated deficit		(27,676,252)
		(9,135,989)
	$	1,864,742

The accompanying notes are an integral part of this statement.

BIO-key International, Inc.

STATEMENTS OF OPERATIONS

Years ended December 31,

	2002	2003
Revenues		
Product sales	$ 3,154	$ 102,007
License fees	131,460	411,400
Technical support and other services	20,785	10,694
	155,399	524,101
Costs and other expenses		
Cost of product sales	2,720	87,387
Cost of technical support and other services		1,694
Selling, general and administrative	1,926,328	2,118,122
Research, development and engineering	1,084,513	1,037,330
	3,013,561	3,244,533
Operating loss	(2,858,162)	(2,720,432)
Other income (deductions)		
Interest expense	(1,162,935)	(1,109,786)
Sundry	1,123	4,145
	(1,161,812)	(1,105,641)
NET LOSS	$ (4,019,974)	$ (3,826,073)
Basic and diluted loss to common stockholders		
Net loss	$ (4,019,974)	$ (3,826,073)
Convertible preferred stock dividends and accretion	(164,965)	(136,755)
Loss applicable to common stockholders	$ (4,184,939)	$ (3,962,828)
Basic and diluted loss per common share		
Net loss	$ (.31)	$ (.22)
Convertible preferred stock dividend and accretion	(.01)	(.01)
Loss applicable per common share	$ (.32)	$ (.23)
Weighted average number of shares	13,227,735	17,543,586

The accompanying notes are an integral part of these statements.

BIO-key International, Inc.

STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)

Years ended December 31, 2002 and 2003

	Series B 9% Convertible Preferred Stock		Common Stock		Additional contributed capital	Accumulated deficit	Total
	Shares	Amount	Shares	Amount			
Balance as of December 31, 2001	21,430	$ 214	12,528,469	$ 125,285	$ 15,538,025	$ (19,560,523)	$ (3,896,999)
Conversion of series B preferred stock and cumulative dividends in arrears into common stock	(3,000)	(30)	1,045,739	10,457	14,480	(24,907)	
Conversion of note and accrued interest into common stock			803,198	8,032	314,360		322,392
Options and warrants issued for services and other					417,534		417,534
Net loss						(4,019,974)	(4,019,974)
Balance as of December 31, 2002	18,430	184	14,377,406	143,774	16,284,399	(23,605,404)	(7,177,047)
Conversion of series B preferred stock and cumulative dividends in arrears into common stock	(14,250)	(142)	4,239,206	42,392	202,525	(244,775)	
Conversion of note, debenture and accrued interest into common stock			2,097,953	20,980	1,552,486		1,573,466
Exercise of options into common stock			308,324	3,083	58,582		61,665
Options and warrants issued for services and other					156,000		156,000
Common stock issued in exchange for services and other			200,000	2,000	74,000		76,000
Net loss						(3,826,073)	(3,826,073)
Balance as of December 31, 2003	4,180	$ 42	21,222,889	$ 212,229	$ 18,327,992	$ (27,676,252)	$ (9,135,989)

The accompanying notes are an integral part of this statement.

BIO-key International, Inc.

STATEMENTS OF CASH FLOWS

Years ended December 31,

	2002	2003
Cash flows from operating activities		
Net loss	$ (4,019,974)	$ (3,826,073)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation		6,386
Amortization of discounts on convertible debt related to warrants and beneficial conversion features	662,048	415,634
Non-cash interest		1,131,053
Options and warrants issued for services and other	385,534	156,000
Common stock issued for services and other		76,000
Change in assets and liabilities:		
Accounts receivable	(67,998)	(341,805)
Inventories		(65,857)
Prepaid expenses and other	155,737	(115,032)
Accounts payable	116,198	(2,951)
Accrued liabilities	503,518	(300,500)
Deferred revenue		10,000
Net cash used in operating activities	(2,264,937)	(2,857,145)
Cash flows from investing activities		
Capital expenditures		