BIO KEY INTERNATIONAL INC
Form 10QSB
November 14, 2003

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-QSB

[X] Quarterly report under Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2003

[ ] Transition Report Under Section 13 or 15(d) of the Exchange Act

For the Transition Period from _________ to __________

Commission file number 1-13463

BIO-KEY INTERNATIONAL, INC.
(Exact Name of Small Business Issuer as Specified in Its Charter)

MINNESOTA	41-1741861
(State or Other Jurisdiction of Incorporation of Organization)	(IRS Employer Identification Number)

1285 CORPORATE CENTER DRIVE
SUITE # 175, EAGAN, MN 55121
(Address of Principal Executive Offices)

(651) 687-0414
(Issuer's Telephone Number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes [X] No [ ]

APPLICABLE ONLY TO ISSUERS INVOLVED IN
BANKRUPTCY PROCEEDINGS DURING THE
PRECEDING FIVE YEARS

Check whether the registrant filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court.

Yes [ ] No [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date : There were 19,074,936 issued and outstanding shares of the registrant's common stock, par value $.01

per share, as of November 12, 2003.

Transitional Small Business Disclosure Format (check one): Yes [ ] No[X]

BIO-KEY INTERNATIONAL, INC.

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PART I
FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	December 31, 2002	September 30, 2003
ASSETS		(Unaudited)
CURRENT ASSETS		
Cash and cash equivalents	$ 16,748	$ 58,774
Accounts Receivable	67,998	147,378

Prepaid expenses	50,897	118,183
Total current assets	135,643	324,335
EQUIPMENT AND FURNITURE AND FIXTURES - AT COST, Less accumulated depreciation	--	38,573
OTHER ASSETS	121,991	144,703
	$ 257,634	$ 507,611

LIABILITIES AND STOCKHOLDERS' DEFICIT

CURRENT LIABILITIES		
Current maturities of long-term obligations	$ 6,507,286	$ 9,075,170
Advances from shareholder	--	38,532
Accounts payable	354,694	219,918
Accrued liabilities	572,701	1,109,126
Deferred revenue	--	10,000
Total current liabilities	7,434,681	10,452,746
LONG-TERM OBLIGATIONS, net of discount less current maturities	--	--
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' DEFICIT		
Preferred stock - authorized, 5,000,000 shares of $ .01 par value (liquidation preference of $100 per share):Series B 9% Convertible; issued and outstanding, 18,430 and 11,930 shares, respectively	184	119
Common stock - authorized, 60,000,000 shares of $.01 par value; issued and outstanding, 14,377,406 and 17,020,776 shares, respectively	143,774	170,208
Additional contributed capital	16,284,399	16,590,140
Deficit accumulated during the development stage	(23,605,404)	(26,705,602)
	(7,177,047)	(9,945,135)
	$ 257,634	$ 507,611

See accompanying notes to financial statements.

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

	Three months ended September 30, 2002	Three months ended September 30, 2003	Nine months ended September 30, 2002	Nine months ended September 30, 2003
Revenues				
Product sales	$ 1,425	$ 987	$ 2,424	$ 7,817
Licensing fees	33,375	141,000	90,860	171,000
Reimbursed research and development	--	--	--	--
Technical support and other services	--	5,000	--	8,694
	34,800	146,987	93,284	187,511
Costs and other expenses				
Cost of product sales	1,200	2,641	2,320	6,644
Cost of technical support and other services	--	--	--	1,694
Selling, general and administrative	527,704	511,297	1,525,462	1,548,743
Research, development and engineering	253,473	246,523	819,554	721,399
	782,377	760,461	2,347,336	2,278,480
Operating loss	(747,577)	(613,474)	(2,254,052)	(2,090,969)
Other income (deductions)				
Interest expense	(270,669)	(317,609)	(882,046)	(911,864)
Sundry	351	1,766	1,314	2,745
	(270,318)	(315,843)	(880,732)	(909,119)
Loss before extraordinary gain	(1,017,895)	(929,317)	(3,134,784)	(3,000,088)
Extraordinary gain - troubled payable reduction	--	--	--	--
NET LOSS	$ (1,017,895)	$ (929,317)	$ (3,134,784)	$ (3,000,088)
Net loss	$ (1,017,895)	$ (929,317)	$ (3,134,784)	$ (3,000,088)
Convertible preferred stock dividends and accretion	--	(5,130)	(96,435)	(88,392)
Loss applicable to common Stockholders	$ (1,017,895)	$ (934,447)	$ (3,231,219)	$ (3,088,480)
Basic and diluted loss per share				

Net loss before extraordinary gain	$ (.08)	$ (.06)	$ (.24)	$ (.20)
Extraordinary gain	--	--	--	--
Net loss	(.08)	(.06)	(.24)	(.20)
Convertible preferred stock dividends and accretion	--	--	(.01)	--
Loss per common share	$ (.08)	$ (.06)	$ (.25)	$ (.20)
Weighted average number of common shares outstanding	13,305,343	16,389,475	12,801,284	15,222,172

See accompanying notes to financial statements

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

	Nine months ended September 30,		
	2002	2003	
Cash flows from operating activities			
Net loss	$(3,134,784)	$(3,000,088)	$
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	--	38,819	
Amortization			
Unearned compensation	--	--	
Deferred financing costs	--	--	
Discounts on convertible debt related to warrants and beneficial conversion features	523,502	415,634	
Write-down of inventory	--	--	
Write-down of deferred financing costs	--	--	
Gain on sale of Inter-Con/PC stock	--	--	
Revenues realized due to offset of billings against a stock repurchase	--	--	
Acquired research and development	--	--	
Options and warrants issued for			

services and other	383,194	156,000
Other	--	--
Change in assets and liabilities:		
Accounts receivable	(48,400)	(79,380)
Inventories	--	--
Prepaid expenses and other	106,713	8,714
Accounts payable	(17,930)	(134,776)
Accrued liabilities	372,824	536,425
Unearned Income	--	10,000
Net cash used in operations	(1,814,881)	(2,048,652)
Cash flows from investing activities		
Capital expenditures	--	(77,392)
Proceeds from sales of Inter-Con/PC stock	--	--
Other	(13,197)	(22,712)
Net cash used in investing activities	(13,197)	(100,104)
Cash flows from financing activities		
Net borrowings under short-term borrowing agreements	382,000	--
Issuance of convertible bridge note	--	--
Issuance of convertible debentures and long-term notes	1,080,000	2,152,250
Advances from shareholders	--	38,532
Issuance of warrants and discount on convertible debentures	--	--

See accompanying notes to financial statements.

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Financing costs	(50,000)	--
Exercise of stock options and warrants	--	--
Sales of common stock	--	--
Sale of preferred stock and assigned value of warrant	--	--
Redemption of common stock	--	--
Net cash provided by financing activities	1,412,000	2,190,782
Net increase (decrease) in cash and cash equivalents	(416,078)	42,026
Cash and cash equivalents, beginning of period	514,970	16,748

Cash and cash equivalents, end of period	$ 98,892	$ 58,774	$

See accompanying notes to financial statements.

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

NOTES TO FINANCIAL STATEMENTS

December 31, 2002, and September 30, 2003 (Unaudited)

1. Unaudited Statements

The accompanying unaudited interim financial statements have been prepared by BIO-key International, Inc. (the Company) in accordance with accounting principles generally accepted in the United States, pursuant to the rules and regulations of the Securities and Exchange Commission. Pursuant to such rules and regulations, certain financial information and footnote disclosures normally included in the financial statements have been condensed or omitted.

In the opinion of management, the accompanying unaudited interim financial statements contain all necessary adjustments, consisting only of those of a recurring nature, and disclosures to present fairly the financial position and the results of its operations and cash flows for the periods presented. It is suggested that these interim financial statements are read in conjunction with the financial statements and the related notes thereto included in the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002.

2. Liquidity and Capital Resource Matters

Broad commercial acceptance of the Company's technology is critical to the Company's success and ability to generate revenues. The Company has had no significant revenues to date, and has accumulated losses since inception of approximately $25,360,000 of which approximately $3,000,000 was incurred during 2003. As of September 30, 2003 there was a stockholders' deficit of approximately $9,945,000.

The Company is in need of substantial additional capital. The Company is currently considering various alternatives related to raising additional capital including continued funding from an investment group and new funding from other sources. No assurance can be given that any form of additional financing will be available on terms acceptable to the Company, that adequate financing will be obtained to meet its needs, or that such financing would not be dilutive to existing shareholders.

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States, which contemplate continuation of the Company as a going concern. The matters described in the preceding paragraphs raise substantial doubt about the Company's ability to continue as a going concern. Recoverability of a major portion of the recorded asset amounts shown in the accompanying

balance sheet is dependent upon the Company advancing beyond the development stage, which in turn is dependent upon the Company's ability to obtain additional financing, meet its financing requirements on a continuing basis, and succeed in its future operations. The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue in existence.

3. Loss Per Common Share

Basic loss per share is calculated by dividing the net loss attributable to common stockholders by the number of weighted average common shares outstanding. Diluted earnings per share are calculated by dividing the net loss attributable to common stockholders by the weighted average common shares, and when dilutive, by including options, warrants and convertible securities outstanding using the treasury stock method. There was no difference between basic and diluted loss per share for all periods presented, because the impact of including options, warrants and convertible securities would be antidilutive.

4. Prepaid Expenses

	December 31, 2002	Sep
Consulting fees and other	$ 24,274	$
Insurance	26,673	
	$ 50,897	$

5. Equipment and Furniture and Fixtures

	December 31, 2002	Se
Equipment	$ 206,363	$
Furniture and fixtures	36,550	
	242,913	
Less accumulated depreciation	242,913	
	$ --	$

6. Other Assets

	December 31, 2002	Se
Deferred offering costs	$ 81,900	$
Patents pending	40,091	
	$ 121,991	$

Deferred Offering Costs

In March 2002, the Company engaged an investment banking firm to advise the Company regarding raising additional capital through the potential future issuance of the Company's equity, debt or convertible securities. The Company paid a nonrefundable retainer fee of $50,000, out of pocket expenses of $14,900 and granted a four year warrant to purchase 25,000 shares of the Company's common stock at an exercise price of $1.00 per share. The estimated value of the warrant is $17,000. These deferred costs shall be offset against any proceeds received from the sale of additional capital or charged to operations in the period this engagement terminates.

7. Accrued Liabilities

	December 31, 2002	September 30, 2003
Interest	$ 537,004	$1,032,800
Compensation	35,555	76,301
Other	142	25

	$ 572,701	$1,109,126

8. Long-term Obligations

As part of the Company's January 2003 funding transaction with an investor group (the "Investor"), the Investor agreed to provide additional financing (the Funding Agreement) in incremental monthly installments during the eleven-month period commencing January 27, 2003, subject to certain conditions. Currently, conditions are not being met, however, the Investor has continued to fund. During the nine months ended September 30, 2003 the Company has received $2,152,250 and issued notes payable to the Investor. The terms of the notes require the principal to be repaid on June 30, 2004, interest to be accrued at 7%, payable in a single payment on June 30, 2004, and provide for conversion of principal and accrued interest into shares of the Company's common stock at a conversion price of $0.75 per share, or shares of Series B Preferred stock at a conversion price of $100 per share.

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

NOTES TO FINANCIAL STATEMENTS
December 31, 2002 and September 30, 2003 (Unaudited)

9. Stockholders Equity

Series B Convertible Preferred Stock Dividends

The Company's series B preferred stock accrues dividends at 9% payable semi-annually on June 15 and December 15 and on such date that the preferred stockholder elects to convert preferred stock to common stock. As of September 30, 2003 cumulative dividends in arrears were approximately $184,000. All of the Company's series B preferred stock is convertible into shares of the Company's common stock.

Options and Warrants

The following summarizes option and warrant activity since December 31, 2002:

	Number		
	1996 Plan	1999 Plan	No Pl

Balance, December 31, 2002	390,380	1,836,669	1,963,
Granted	130,000	150,000	1,110,
Cancelled	33,000	510,000	655,
Balance, September 30, 2003	487,380	1,476,669	2,418,
Available for future grants, September 30, 2003	169,620	523,331	

Common Stock

On September 23, 2003, the Company issued 200,000 shares of common stock valued at $76,000 to an investor relations firm in consideration of services to be rendered pursuant to a six-month consulting agreement.

10. Events Occurring Subsequent to September 30, 2003

During October 2003, the Company and Investor amended the January 27, 2003 Note Purchase Agreement to provide up to $2,500,000 of additional financing. Of this amount $602,250 was advanced in October and November 2003, with the balance to be funded in incremental monthly installments during the eleven-month period commencing December 1, 2003, subject to certain conditions. In connection with the agreement the Company issued a convertible promissory note due October 31, 2004 in the principal amount of up to $2,500,000 with terms substantially similar to the January 2003 promissory note.

On October 31, 2003, the Investor amended the 10% secured convertible note issued in 2001, the zero interest convertible debenture, the 10% secured convertible notes issued in 2002, and the 7% convertible notes. The agreement provides that all principal and interest due under each of these notes shall be due and payable in a single payment on June 30, 2004.

During October and November 2003, the Investor elected to convert 7,750 shares of Series B Preferred Stock and $144,666 of dividends in arrears and accrued interest thereon into 1,795,836 shares of the Company's common stock.

During October 2003, the Company issued 258,324 shares of common stock upon exercise of options issued to a former director and executive officer of the Company.

During November 2003, the Company entered into a twelve-month consulting agreement with a financial advisory services company requiring a total of $108,000 to be paid in fees over the term of the agreement.

BIO-key International, Inc.
(a corporation in the Development Stage)

NOTES TO FINANCIAL STATEMENTS
December 31, 2002 and September 30, 2003 (Unaudited)

11. Supplementary Disclosures of Cash Flow Information

	Nine Months Ended September 30, 2002	Nine Months Ended September 30, 2003	January 7, 1993 (date of inception through September 30, 2003
Cash paid for:			
Interest	$ --	$ --	$ 28,544
Noncash Financing Activities:			
Conversion of short-term notes, accrued interest and penalties into long-term notes and debentures	--	--	4,567,546
Conversion of convertible debentures, bridge notes, and accrued interest into common stock	100,000	--	2,907,360
Accretion of preferred stock beneficial conversion feature	--	--	877,000
Issuance of Series B preferred stock in exchange for Series A preferred stock and cumulative dividends in arrears, thereon	--	--	281,049
Issuance of common stock in exchange for Series A and Series B preferred stock and cumulative dividends in arrears thereon	--	100,175	156,738
Issuance of preferred stock effected through reduction of debt	--	--	350,000
Unearned compensation reversal related to			

employee termination	--	--	227,111
Common stock repurchases effected through a reduction in receivable	--	--	170,174
Offset deferred offering costs against proceeds of initial public offering, and other	--	--	159,021
Issuance of warrants for reduction in payables	32,000	--	32,000
Issuance of common stock in exchange For services rendered	--	76,000	76,000

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

CAUTIONARY STATEMENT FOR FORWARD-LOOKING STATEMENTS

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

OVERVIEW

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

BIO-key International, Inc. (the "Company") develops and markets proprietary fingerprint identification biometric technology and software solutions. These solutions are built around the advanced capabilities of the Company's proprietary patent pending VST(TM) (Vector Segment Technology(TM)) algorithm. The Company has pioneered the development of automated, finger identification technology that can be used without the aide of non-automated methods of identification such as a personal identification (PIN), password, token, smart card, ID card, credit card, passport, drivers license or other form of possession based or knowledge based identification. This advanced BIO-key(TM) identification technology improves both the accuracy and speed of finger-based biometrics and is the only finger identification algorithm that has been certified by the International Computer Security Association (ICSA).

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

manufacturers, systems integrators and direct users of its technology to generate recurring monthly revenue.

The Company has completed the development of its core technology, commenced the marketing of its technology in late 2002, and expects to continue to generate revenue from licensing arrangements during 2003. During 2003, the Company has entered into a number of license agreements and strategic partnerships with systems integrators, original equipment manufacturers and network security solutions providers. The foregoing arrangements are expected to generate significant recurring monthly revenue. The Company is also in discussions with a number of additional potential licensee and strategic partnerships.

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

The Company believes its existing financial resources will last through June 2004. See "Liquidity and Capital Resources" below. Due to this and other uncertainties, the Company's independent auditors have included an explanatory paragraph in their opinion for the year ended December 31, 2002 as to the substantial doubt about the Company's ability to continue as a going concern. The Company's long-term viability and growth will depend upon the successful commercialization of its technologies and its ability to obtain adequate financing, among other matters, as to which there can be no assurance.

RESULTS OF OPERATIONS

THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2003 AS COMPARED TO THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2002

Revenue

The Company generated revenue of approximately $147,000 and $188,000 during the three and nine month periods ended September 30, 2003 as compared to approximately $35,000 and $93,000 during the corresponding periods in 2002. The revenue consists of $141,000 in licensing fees, $5,000 in services and approximately $1,000 in product sales. The Company expects to generate significant additional licensing fees during the fourth quarter of 2003 and into 2004 from new and existing customers.

Costs of Product Sales and Technical Support

Cost of products and services sold was approximately $2,600 and $8,300 during the three and nine month periods ended September 30, 2003, respectively, as compared to approximately $1,200 and $2,300 for the corresponding periods in 2002. Of the increase, approximately $4,300 related to cost of products sold for evaluation and approximately $1,700 related to technical support and other services. As the Company continues to generate revenue primarily from license fees and technical service, it expects costs of technical support to increase.

Selling, General and Administrative Expenses

Selling, general and administrative expenses decreased approximately $17,000 to approximately $511,000 during the three months ended September 30, 2003 as compared to approximately $528,000 for the corresponding period in 2002. Of the decrease, approximately $170,000 was due to a decrease in marketing consulting costs. This amount was offset by approximately $45,000 of additional marketing costs as the Company focused on marketing its biometric authentication software solution, approximately $50,000 of additional executive personnel costs and approximately $58,000 of additional general administrative costs. The Company expects selling, general and administrative expenses to remain at current levels or decrease slightly during the remainder of the year.

Selling, general and administrative expenses remained relatively constant during the nine months ended September 30, 2003 increasing approximately $23,000 to approximately $1,549,000 as compared to approximately $1,525,000 for the corresponding period in 2002. During this period, the Company incurred an increase of approximately $152,000 of additional marketing costs as the Company focused on marketing its Web-based biometric authentication software solution, approximately $167,000 of additional executive personnel costs, approximately $108,000 of additional general administrative costs and an approximate $18,000 increase in professional services. These amounts were offset by an approximate $421,000 decrease in outside consulting costs.

Research, Development, and Engineering Expenses

Research, development, and engineering expenses also remained relatively constant at approximately $247,000 during the three months ended September 30, 2003 as compared to approximately $253,000 for the corresponding period in 2002. General development costs decreased approximately $13,000 and software subcontract costs decreased approximately $16,000 which was offset by approximately $23,000 in additional wages for development personnel. The Company has completed the transition from subcontracting software development to utilizing its own employees and expects these costs to remain at current levels through the remainder of the year.

Research, development, and engineering expenses decreased approximately $99,000 to approximately $721,000 during the nine months ended September 30, 2003 as compared to approximately $820,000 for the corresponding period in 2002. Of the decrease, approximately $81,000 was due to a decrease in general development expenses and approximately $32,000 was due to a decrease in software subcontracting costs. These amounts were offset by approximately $14,000 due to an increase in wages for development personnel.

Other Income and Expense

Other expense increased approximately $46,000 to approximately $316,000 during the three months ended September 30, 2003 as compared to approximately $270,000 for the corresponding period in 2002. The increase was primarily due to a increase in interest expense due to increased borrowings.

Other expense increased approximately $28,000 to approximately $909,000 during the nine months ended September 30, 2003 as compared to approximately $881,000 for the corresponding period in 2002. The increase was primarily due to a increase in interest expense due to increased borrowings.

LIQUIDITY AND CAPITAL RESOURCES

Net cash used in operating activities during the nine months ended September 30, 2003 was approximately $2,049,000 compared to approximately $1,815,000 during the nine months ended September 30, 2002. The primary use of cash for both years was to fund the net loss. Net cash used in investing activities for the nine months ended September 30, 2003 was approximately $100,000 compared to net cash used in investing activities of approximately $13,000 for the same period in 2002 and consisted of $77,000 of fixed asset purchases and $23,000 of capitalization of costs associated with the Company's patent applications. Net cash provided by financing activities during the nine months ended September 30, 2003 was approximately $2,191,000 compared to approximately $1,412,000 in the same period in 2002 and consisted primarily of long-term borrowings during 2003.

Working capital decreased approximately $2,829,000 during the nine months ended September 30, 2003 to a deficit of approximately $10,128,000 as compared to a deficit of approximately $7,299,000 as of December 31, 2002. This decrease is primarily due to an increase of current maturities of long term obligations.

Pursuant to a recapitalization transaction in November, 2001, the Company obtained $1,065,000 of additional financing and all then existing promissory notes payable ($3,027,920) to Shaar Fund Ltd. (the "Investor") were cancelled and converted into a secured convertible promissory note in the principal amount of $4,092,920 (the "Secured Note"). The Secured Note was originally due September 30, 2003 (subsequently extended until June 30, 2004), is secured by substantially all of the Company's assets, including its intellectual property, accrues interest at the rate of 10% per annum payable at maturity on June 30, 2004, may be prepaid without penalty, and is convertible into shares of common stock at a conversion price of $.75 per share. The security interest terminates upon the Company obtaining $5,000,000 of additional equity financing. Pursuant to the recapitalization transaction, between March and September 2002, the Investor provided $1,080,000 of additional financing in incremental monthly installments. All such funding was provided pursuant to secured promissory notes (collectively, the "Advance Notes") on the terms described above. The full principal amount of the Secured Note and Advance Notes along with accrued interest of approximately $918,000 is due on the maturity date which was recently extended to June 30, 2004.

On August 28, 2002, the Company entered into a bridge note agreement with the Investor pursuant to which it provided $750,000 of additional financing in incremental monthly installments during the four-month period commencing August 28, 2002 pursuant to the terms of a convertible promissory note (the "August Note"). The August Note is secured by substantially all of the Company's assets, including its intellectual property, accrues interest at the rate of 7% per annum payable on maturity and may be prepaid without penalty. The principal amount and accrued interest is convertible at the option of the Investor into either shares of Common Stock at a conversion price of $.75 per share or shares of Series B Preferred Stock at a conversion price of $100 per share. The full principal amount of the August Note along with accrued interest of approximately $51,000 is due on the maturity date which was recently extended to June 30, 2004.

On January 27, 2003, the Company entered into a Note Purchase Agreement with the Investor to provide up to $2,350,000 of additional financing pursuant to the terms of a secured promissory note (the "January Note"). Of this amount $600,000 was advanced at closing, with the balance to be funded in incremental monthly installments during the nine (9) month period commencing February 1, 2003, provided that certain conditions are satisfied. Currently conditions are not being met. The January Note is due June 30, 2004, is secured by substantially all of the Company's assets, including its intellectual property, accrues interest at the rate of 7% per annum payable on maturity, and may be prepaid without penalty. The principal amount and accrued interest is convertible at the option of the Investor into either shares of Common Stock at a conversion price of $.75 per share or shares of Series B Preferred Stock at a conversion price of $100 share. In the event the Company completes a private placement of its equity securities resulting in gross proceeds in excess of $5,000,000 on or before June 30, 2004, the principal and accrued interest shall at the option of the Investor, be either converted into such equity securities or repaid in cash.

Under the Note Purchase Agreement, the Investor agreed to provide up to $1,750,000 of additional financing in incremental monthly installments during the nine month period commencing February 1, 2003. Any such funding will be provided pursuant to a secured promissory note on the terms described above. The Investor's obligation to provide this financing is conditioned upon:

- The Company being in compliance with all material obligations under the January 27, 2003 funding agreement between the parties and the January Note.
- The continued truth and accuracy of the representations and warranties of the Company set forth in the funding agreement.
- The average closing bid price of the Company's common stock during the calendar month preceding the advance exceeding $1.00 per share.

Provided the forgoing conditions are satisfied, funds are advanced on the first day of each month upon receipt of written notice from the Company. Between February 1, 2003 and the date of this Report, the Company requested and received advances in the aggregate amount of $1,750,000. The Company has agreed to file a registration statement covering the public resale of the shares of common stock issuable upon conversion of the Secured Note, Advance Notes, August Note and January Note.

On or about October 31, 2003, the Company and Investor amended the January 27, 2003 Note Purchase Agreement to provide up to $2,500,000 of additional financing pursuant to the terms described above. Of this amount, $602,250 was advanced in October and November 2003, with the balance to be funded in incremental monthly installments during the eleven (11) month period commencing December 1, 2003 upon satisfaction of the conditions set forth above. In connection with the amendment:

- The Company issued a convertible promissory note due October 31, 2004 in the principal amount of up to $2,500,000 with terms substantially similar to the January Note described above.
- The Investor extended the maturity dates and the scheduled interest payments of the Secured Note, Advance Notes, August Note and a $1,000,000 principal amount convertible debenture until June 30, 2004.

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

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

As of the date of this Report, the Company has cash resources of approximately $600,000. Pursuant to its agreements with the Investor, $1,897,750 of additional financing is available to the Company upon fulfillment of the conditions described above. Currently, all of the conditions are not being satisfied. Although the Investor has, in the past, provided financing to the Company notwithstanding that all of the conditions have not been satisfied, there can be no assurance that it will continue to do so. The Company currently requires approximately $210,000 per month to conduct operations. Based on available cash resources and the existing funding obligations, the Company believes it can maintain operations at current levels through June 2004. The Company needs approximately $2,500,000 to continue to operate at current levels for the next twelve (12) months. Ideally, the Company needs approximately $3,000,000 to $5,000,000 to execute its business plan and support the growth of operations through 2004 and to continue product enhancements. The additional financing is also required to conduct the sales and marketing effort necessary to engage in significant direct selling and marketing activities.

During 2002 and 2003, the Company has entered into license agreements, generated a small amount of revenue and believes it will continue to generate revenue from existing and new relationships during the remainder of 2003 and into 2004. Anticipated revenues are expected to defray operating expenses and reduce the amount of required additional financing, but are not expected to be sufficient for the Company to expand operations.

In addition to generating revenue, the Company is seeking to obtain additional financing through the issuance of additional debt or equity

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securities of the Company on a negotiated private placement basis to institutional and accredited investors. As of the date of the Report, the Company has not reached a definitive agreement with any potential investor regarding the specific terms of an investment in the Company. No assurance can be given that any form of additional financing will be available on terms acceptable to the Company, that adequate financing will be obtained to meet its needs, or that such financing would not be dilutive to existing stockholders. If available financing is insufficient or unavailable or the Company fails to generate any meaningful revenue, it may be required to further reduce operating expenses, suspend operations, seek a merger or acquisition candidate or ultimately liquidate its assets.

ITEM 3. CONTROLS AND PROCEDURES

An evaluation of the effectiveness of the Company's "disclosure controls and procedures" (as such term is defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) was carried out by the Company under the supervision and with the participation of the Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"). Based upon that evaluation, the Company's CEO and CFO concluded that, as of the end of the period covered by this quarterly report, the Company's disclosure controls and procedures were effective to provide reasonable assurance that information the Company is required to disclose in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms. There has been no change in the Company's internal control over financial reporting identified in connection with that evaluation that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 2. CHANGES IN SECURITIES

1. Between September 3, 2003 and November 10, 2003, the Company issued an aggregate of 2,436,945 shares of common stock upon conversion of 9,500 shares of the Company's Series B 9% Convertible Preferred Stock and $174,725 of dividends and accrued interest thereon to the Shaar Fund, Ltd. The shares were issued to one accredited investor in a private placement transaction exempt from the registration requirements of the Securities Act of 1933, as amended, pursuant to Section 4(2) thereunder without payment of underwriting discounts or commissions to any person.

2. On or about September 23, 2003, the Company issued 200,000 shares of common stock to an investor relations firm in consideration of services rendered. The shares were issued to one accredited investor in a private

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

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

As of September 30, 2003, cumulative dividends in arrears on the Company's Series B 9% Preferred Stock were approximately $184,000.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) The following exhibits are included herein:

Exhibit No.	Exhibit	Method of Filing
3.1	Amended and Restated Articles of Incorporation	Incorporated by reference to Exhibit 3.1 to the Registrant's Registration Statement on SB-2, File No. 333-16451 filed February 14, 1997 (the "Registration Statement")
3.2	Amended and Restated Bylaws	Incorporated by reference to Exhibit 3.2 to the Registration Statement
3.3	Certificate of Amendment to Amended and Restated Articles of Incorporation	Incorporated by reference to Exhibit 3.3 to the Registrant's Report on Form 10-QSB for the quarter ended March 31, 1999
3.4	Certificate of Designation of Series A 9% Convertible Preferred Stock	Incorporated by reference to Exhibit 3.4 to the Registrant's Current Report on Form 8-K dated July 8, 1999
3.5	Amended and Restated Certificate of Designation of Series A 9% Convertible Preferred Stock	Incorporated by reference to Exhibit 3.5 to the Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 1999 (the "1999 10-KSB")
3.6	Certificate of Designation of Series B 9% Convertible Preferred Stock	Incorporated by reference to Exhibit 3.6 to the Registrants Current Report on Form 8-K dated November 26, 2001 (the "November 20, 2001 8-K")

3.7	Amendment to the Amended and	Incorporated by reference to

	Restated Articles of Incorporation filed February 28, 2002	Exhibit 3.7 to the Registrant's Registration Statement on Form SB-2 filed March 27, 2002
4.1	Specimen of Common Stock Certificate	Incorporated by reference to Exhibit 4.1 to the Registration Statement
10.1	SAC Technologies, Inc. 1996 Stock Option Plan	Incorporated by reference to Exhibit 10.1 to the Registration Statement
10.2	Employment Agreement by and between Gary E. Wendt and the Company dated as of May 10, 1996 (with Non-Competition Letter effective May 10, 1996 Attached as Exhibit A)	Incorporated by reference to Exhibit 10.5 to the Registration Statement
10.3	Amendment No. 1 to the SAC Technologies, Inc. 1996 Stock Option Plan	Incorporated by reference to Exhibit 10.23 to the 1999 10-KSB
10.4	SAC Technologies, Inc. 1999 Stock Option Plan	Incorporated by reference to Exhibit 10.24 to the 1999 10-KSB
10.5	Employment Agreement dated November 3, 2000 by and between the Registrant and Jeffry R. Brown	Incorporated by reference to Exhibit 10.25 to the Registrant's Quarterly Report on Form 10-QSB for quarter ended September 30, 2000 (the "September 30, 2000 10-QSB")
10.6	Option to Purchase 280,000 shares of Common Stock issued to Jeffry R. Brown	Incorporated by reference to Exhibit 10.26 to the September 30, 2000 10-QSB
10.7	Non-Qualified Stock Option Agreement Under the Registrant's 1999 Stock Option Plan to purchase 300,000 shares of Common Stock issued to Jeffry Brown	Incorporated by reference to Exhibit 10.27 to the September 30, 2000 10-QSB
10.8	Consulting Agreement dated July 1, 2001 by and between the Registrant and Barry M. Wendt	Incorporated by reference to Exhibit 10.28 to the June 30, 2001 10-QSB

10.9	Option to purchase 400,000 shares of common stock issued to Jeffrey R. Brown	Incorporated by reference to Exhibit 10.29 to the June 30, 2001 10-QSB
10.10	Funding Agreement by and between the Registrant and The Shaar Fund dated November 26, 2001	Incorporated by reference to Exhibit 10.31 to the November 20, 2001 8-K
10.11	Registration Rights Agreement by and between The Shaar Fund dated November 26, 2001	Incorporated by reference to Exhibit 10.32 to the November 20, 2001 8-K
10.12	Exchange Agreement by and between the Registrant and The Shaar Fund dated November 26, 2001	Incorporated by reference to Exhibit 10.33 to the November 20, 2001 8-K
10.13	Secured Note Due September 30, 2003	Incorporated by reference to Exhibit 10.34 to the November 20, 2001 8-K
10.14	Restated 5% Convertible Debenture Due September 30, 2003	Incorporated by reference to Exhibit 10.35 to the November 20, 2001 8-K
10.15	No Interest Debenture Due September 30, 2003	Incorporated by reference to Exhibit 10.36 to the November 20, 2001 8-K
10.16	Warrant	Incorporated by reference to Exhibit 10.37 to the November 20, 2001 8-K
10.17	Security Interest Provisions	Incorporated by reference to Exhibit 10.38 to the November 20, 2001 8-K
10.18	Employment Agreement by and between the Registrant and Mira LaCous dated November 20, 2001	Incorporated by reference to Exhibit 10.39 to the November 20, 2001 8-K
10.19	Option to Purchase 140,000 Shares of Common Stock issued to Mira LaCous	Incorporated by reference to Exhibit 10.40 to the November 20, 2001 8-K
10.20	Option to Purchase 150,000 Shares of Common Stock issued to Thomas J. Colatosti.	Incorporated by reference to Exhibit 10.21 to the Registrant's Annual Report on Form 10-KSB for the fiscal year

		ended December 31, 2002

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10.21	Non-Qualified Stock Option Agreement under the Registrant's 1999 Stock Incentive Plan to Purchase 200,000 Shares of Common Stock issued to Thomas J. Colatosti	Incorporated by reference to Exhibit 10.22 to the Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002
10.22	Employment Agreement by and between the Registrant and Michael W. DePasquale dated January 3, 2003	Incorporated by reference to Exhibit 10.23 to the Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002
10.23	Option to Purchase 580,000 Shares of Common Stock issued to Michael W. DePasquale	Incorporated by reference to Exhibit 10.24 to the Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002
10.24	Note Purchase Agreement dated January 27, 2003	Incorporated by reference to Exhibit 10.25 to the Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002
10.25	Secured Convertible Promissory Due June 30,2004	Incorporated by reference to Exhibit 10.26 to the Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002
10.26	Option to Purchase 200,000 Shares of Common Stock issued to Charles P. Romeo	Incorporated by reference to Exhibit 10.27 to the Registrant's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2002
10.27	Amendment No. 1 to Note Purchase Agreement dated October 31, 2003	Filed herewith
10.28	Secured Convertible Promissory Note due October 31, 2004	Filed herewith
10.29	Letter of Amendment and Waiver dated October 31, 2003	Filed herewith
31.1	Certificate of CEO of Registrant required by Rule 13a-14(a) under the Securities Exchange Act of	Filed herewith

	1934, as amended	
31.2	Certificate of CFO of Registrant required by Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended	Filed herewith
32.1	Certificate of CEO of Registrant Pursuant to 18 USC Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Filed herewith

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

(b) Current Reports on Form 8-K filed during the three month period ended September 30, 2003:

On October 29, 2003, the Company furnished under Item 7 - "Financial Statements, Pro Forma Financial Information and Exhibits" and Item 12 - "Results of Operations and Financial Condition" of Form 8-K, a copy of its earnings press release that was issued on October 28, 2003.

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SIGNATURES

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

BIO-KEY INTERNATIONAL, INC.

Dated: November 14, 2003 /s/ Michael W. DePasquale

Michael W. DePasquale
Chief Executive Officer

Dated: November 14, 2003 /s/ Gary Wendt

Gary Wendt
Chief Financial Officer

EXHIBIT INDEX

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