

BIO KEY INTERNATIONAL INC
Form 10QSB
November 14, 2006

U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT
OF 1934

For the quarterly period ended September 30, 2006

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)

DELAWARE
(State or Other Jurisdiction of
Incorporation of Organization)

41-1741861
(IRS Employer
Identification Number)

3349 HIGHWAY 138, BUILDING D, SUITE B, WALL, NJ 07719

(Address of Principal Executive Offices)

(732) 359-1100

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(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 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

Indicate by check mark whether the registrant is a shell company (as defined by rule 12b-2 of the Exchange Act) Yes No

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: There were 53,956,837 issued and outstanding shares of the registrant's common stock, par value \$.0001 per share, as of November 10, 2006.

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

BIO-KEY INTERNATIONAL, INC.

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Restatement of Consolidated Financial Statements

As previously reported in our Annual Report on Form 10-KSB/A filed with the Securities and Exchange Commission on June 19, 2006, we have restated our previously reported financial information for the years ended December 31, 2003, 2004 and 2005 and our previously reported unaudited financial statements for the first, second and third quarters of 2003, 2004 and 2005 (the "restatement").

Our Annual Reports on Form 10-KSB for the years ended 2003 and 2004 and our Quarterly Reports on Form 10-QSB for fiscal 2003 through the third quarter of fiscal 2005 have not been revised to reflect the restatement and the financial statements contained in those reports should not be relied upon. The restated financial statements for years ended December 31, 2003, 2004 and 2005 included in our Annual Report on Form 10-KSB/A for the fiscal year ended December 31, 2005 should be relied upon.

The accompanying condensed consolidated financial statements for the three and nine months ended September 30, 2005 should be read in conjunction with the footnote entitled results by quarter (unaudited) contained in the Company's Annual Report on Form 10-KSB/A for the fiscal year ended December 31, 2005.

PART I

FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

| | September 30, 2006 (Unaudited) | December 31, 2005 |
|---|---|------------------------------|
| ASSETS: | | |
| Cash and cash equivalents | \$ 1,293,599 | \$ 1,422,827 |
| Receivables | | |
| Billed, less allowance for doubtful receivables of \$184,074 and \$160,000, respectively | 3,721,544 | 1,635,371 |
| Unbilled | 38,776 | 201,942 |
| Costs and earnings in excess of billings on uncompleted contracts | 1,448,905 | 4,321,392 |
| Inventory | 26,588 | 8,760 |
| Prepaid expenses | 163,332 | 137,000 |
| Total current assets | 6,692,744 | 7,727,292 |
| Equipment and leasehold improvements, net | 464,417 | 548,267 |
| Deposits | 800,974 | 1,828,560 |
| Intangible assets less accumulated amortization | 2,703,659 | 3,301,823 |
| Deferred financing costs, net | 231,879 | 1,562,338 |
| Goodwill | 11,389,654 | 11,389,654 |
| Total non-current assets | 15,590,583 | 18,630,642 |
| TOTAL ASSETS | \$ 22,283,327 | \$ 26,357,934 |
| LIABILITIES: | | |
| Current maturities of long-term obligations and related obligations, net of discount | \$ 1,481,611 | \$ 6,584,437 |
| Accounts payable | 1,151,100 | 833,608 |
| Billings in excess of costs and earnings on uncompleted contracts | 78,343 | 32,385 |
| Accrued liabilities | 4,393,872 | 5,520,515 |
| Deferred rent | 485,163 | 443,603 |
| Deferred revenue | 5,491,144 | 3,264,283 |
| Total current liabilities | 13,081,233 | 16,678,831 |
| Warrants and long-term obligations | 4,131,950 | 1,483,511 |
| Redeemable preferred stock derivatives | 1,387,238 | |
| Deferred rent | 498,601 | 867,850 |
| Deferred revenue | 137,879 | 1,163,738 |
| Total non-current liabilities | 6,155,668 | 3,515,099 |
| TOTAL LIABILITIES | 19,236,901 | 20,193,930 |
| Commitments and contingencies | | |
| Series B redeemable convertible preferred stock: authorized, 1,000,000 shares (liquidation preference of \$1 per share); issued and outstanding 1,000,000 and 0 shares of \$.0001 par value respectively, net | 753,229 | |
| Series C redeemable convertible preferred stock: authorized, 600,000 shares (liquidation preference of \$10 per share); issued and outstanding 592,032 and 0 shares of \$.0001 par value respectively, net | 4,878,005 | |
| | 5,631,234 | |
| STOCKHOLDERS (DEFICIT)/EQUITY: | | |
| Preferred stock authorized, 5,000,000 shares (liquidation preference of \$100 per share) Series A 7% Convertible; issued and outstanding 35,557 and 44,557 shares of \$.0001 par value, respectively | 4 | 4 |
| Common stock authorized, 170,000,000 shares; issued and outstanding; 53,956,837 and 46,306,589 shares of \$.0001 par value, respectively | 5,545 | 4,632 |
| Additional paid-in capital | 51,399,062 | 48,921,316 |
| Accumulated deficit | (53,989,419) | (42,761,948) |
| TOTAL STOCKHOLDERS (DEFICIT)/EQUITY | (2,584,808) | 6,164,004 |
| TOTAL LIABILITIES AND STOCKHOLDERS (DEFICIT)/EQUITY | \$ 22,283,327 | \$ 26,357,934 |

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

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

| | Three months ended September 30, 2006 | 2005 (As restated) | Nine months ended September 30, 2006 | 2005 (As restated) |
|---|---|-----------------------|--|------------------------|
| Revenues | | | | |
| Services | \$ 3,226,184 | \$ 2,496,883 | \$ 8,397,122 | \$ 8,318,624 |
| License fees and other | 973,914 | 735,588 | 2,784,937 | 2,538,990 |
| | 4,200,098 | 3,232,471 | 11,182,059 | 10,857,614 |
| Costs and other expenses | | | | |
| Cost of services | 612,441 | 503,843 | 2,024,655 | 2,373,535 |
| Cost of license fees and other | 148,275 | 125,633 | 361,334 | 658,875 |
| | 760,716 | 629,476 | 2,385,989 | 3,032,410 |
| Gross Profit | 3,439,382 | 2,602,995 | 8,796,070 | 7,825,204 |
| Operating Expenses | | | | |
| Selling, general and administrative | 2,467,347 | 2,836,875 | 7,834,137 | 8,808,969 |
| Research, development and engineering | 1,653,238 | 1,799,845 | 4,830,186 | 5,545,386 |
| | 4,120,585 | 4,636,720 | 12,664,323 | 14,354,355 |
| Operating loss | (681,203) | (2,033,725) | (3,868,253) | (6,529,151) |
| Other income (deductions) | | | | |
| Derivative and warrant fair value adjustments | 547,752 | 3,210,057 | 5,548,604 | 8,160,305 |
| Interest income | | 6,908 | | 35,958 |
| Interest expense | (586,689) | (1,605,771) | (4,915,445) | (2,992,780) |
| Loss on extinguishment of debt | (5,493,701) | | (7,815,717) | |
| Other | (18,891) | (24,816) | (51,185) | (45,348) |
| | (5,551,529) | 1,586,378 | (7,233,743) | 5,158,135 |
| NET LOSS | \$ (6,232,732) | \$ (447,347) | \$ (11,101,996) | \$ (1,371,016) |
| Basic and Diluted Loss to Common Shareholders: | | | | |
| Net loss | \$ (6,232,732) | \$ (447,347) | \$ (11,101,996) | \$ (1,371,016) |
| Convertible preferred stock dividends and accretion | (369,200) | (72,632) | (581,877) | (261,152) |
| Net loss attributable to common shareholders | \$ (6,601,932) | \$ (519,979) | \$ (11,683,873) | \$ (1,632,168) |
| Net Loss Per Share: | | | | |
| Basic | \$ (0.13) | \$ (0.01) | \$ (0.24) | \$ (0.04) |
| Diluted | \$ (0.13) | \$ (0.02) | \$ (0.24) | \$ (0.09) |
| Weighted Average Shares Outstanding: | | | | |
| Basic | 50,733,960 | 45,476,802 | 48,752,262 | 45,129,000 |
| Diluted | 50,733,960 | 53,861,595 | 48,752,262 | 52,017,328 |

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

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

| | Nine Months Ended September 30, | |
|--|---------------------------------|-----------------|
| | 2006 | 2005 |
| CASH FLOW FROM OPERATING ACTIVITIES: | | |
| Net Loss | \$ (11,101,996) | \$ (1,371,016) |
| Adjustments to reconcile net loss to cash used in operating activities: | | |
| Derivative and warrant fair value adjustments | (5,548,604) | (8,160,305) |
| Loss on extinguishment of debt | 7,815,719 | |
| Depreciation | 203,288 | 179,642 |
| Amortization | | |
| Intangible assets | 647,640 | 1,474,979 |
| Deferred financing costs | 167,275 | 29,621 |
| Discounts on convertible debt related to warrants and beneficial conversion features | 2,515,875 | 1,067,927 |
| Allowance for doubtful receivables | 24,073 | 22,440 |
| Deferred rent | (327,692) | (290,807) |
| Options and warrants issued for services and other | 529,055 | 542,758 |
| Loss on sale of investment | | 20,000 |
| Change in assets and liabilities: | | |
| Accounts receivable trade | (1,947,080) | (862,889) |
| Costs and earnings in excess of billings on uncompleted contracts | 2,872,487 | 1,546,812 |
| Inventory | (17,829) | 26,134 |
| Prepaid expenses and other | (26,332) | (221,842) |
| Accounts payable | 317,492 | (418,332) |
| Billings in excess of costs and earnings on uncompleted contracts | 45,958 | 24,173 |
| Accrued liabilities | (315,427) | 683,989 |
| Deferred revenue | 1,201,003 | 1,174,224 |
| Net cash used in operating activities | (2,945,095) | (4,532,492) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Capital expenditures | (119,437) | (144,916) |
| Deposits | 1,027,585 | 1,004,097 |
| Patent costs | | |