BIO KEY INTERNATIONAL INC
Form 10-Q
May 14, 2010
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U.S. SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2010

o 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 registrant as specified in its charter)

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

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

(Address of Principal Executive Offices)

(732) 359-1100

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o	Smaller Reporting Company x

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

Number of shares of Common Stock, $.0001 par value per share, outstanding as of May 12, 2010 were 77,713,398

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PART I FINANCIAL INFORMATION

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

		March 31, 2010 (Unaudited)		December 31, 2009 (Audited)
ASSETS				
Cash and cash equivalents	$	487,971	$	792,426
Restricted cash		40,500		40,500
Accounts receivable, net of allowance for doubtful accounts of $11,526 at March 31, 2010 and December 31, 2009		1,397,005		847,215
Note receivable, current portion		1,334,000		1,334,000
Inventory		11,858		14,935
Prepaid expenses and other		148,875		123,911
Total current assets		3,420,209		3,152,987
Equipment and leasehold improvements, net		34,355		39,243
Deposits and other assets		8,712		8,712
Note receivable, net of current portion		2,666,000		2,666,000
Intangible assets less accumulated amortization		227,280		230,259
Total non-current assets		2,936,347		2,944,214
TOTAL ASSETS	$	6,356,556	$	6,097,201
LIABILITIES				
Accounts payable	$	269,660	$	340,241
Accrued liabilities		549,641		708,765
Deferred revenue		304,972		200,996
Convertible notes, derivatives and warrants		381,650		471,483
Redeemable preferred stock derivatives		93,211		563,599
Total current liabilities		1,599,134		2,285,084
Warrants				63,901
Deferred revenue		5,939		9,391
Total non-current liabilities		5,939		73,292
TOTAL LIABILITIES	$	1,605,073	$	2,258,376
Commitments and contingencies				
Series D redeemable convertible preferred stock: authorized, 100,000 shares (liquidation preference of $100 per share); issued and outstanding 30,557 shares of $.0001 par value at March 31, 2010 and December 31, 2009		2,789,328		2,630,593
		2,789,328		2,630,593
STOCKHOLDERS EQUITY:				
Common stock authorized, 170,000,000 shares; issued and outstanding; 77,713,398 of $.0001 par value at March 31, 2010 and December 31, 2009		7,771		7,771
Additional paid-in capital		51,041,119		51,187,754
Accumulated deficit		(49,086,735)		(50,087,293)
TOTAL STOCKHOLDERS EQUITY		1,962,155		1,108,232
TOTAL LIABILITIES AND STOCKHOLDERS EQUITY	$	6,356,556	$	6,097,201

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

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

	Three months ended March 31, 2010		Three months ended March 31, 2009	
Revenues				
Services	$	92,043	$	131,350
License fees and other		884,132		406,844
		976,175		538,194
Costs and other expenses				
Cost of services		30,429		17,417
Cost of license fees and other		79,671		119,662
		110,100		137,079
Gross Profit		866,075		401,115
Operating Expenses				
Selling, general and administrative		700,021		878,462
Research, development and engineering		284,788		250,267
		984,809		1,128,729
Operating loss		(118,734)		(727,614)
Other income (expenses)				
Derivative and warrant fair value adjustments		786,710		(35,330)
Interest income		60,000		
Interest expense		(162,736)		(23,494)
Other				(3,375)
		683,974		(62,199)
Income (loss) from continuing operations		565,240		(789,813)
Income from discontinued operations		435,318		1,011,862
Net Income	$	1,000,558	$	222,049
Basic Earnings(Loss) per Common Share:				
Income (loss) from continuing operations		0.005		(0.02)
Income from discontinued operations		0.006		0.02
Net earnings per Common Share	$	0.011	$	0.00
Diluted Earnings(Loss) per Common Share:				
Income (loss) from continuing operations		(0.002)		(0.02)
Income from discontinued operations		0.006		0.02
Net earnings per Common Share	$	0.004	$	0.00
Weighted Average Shares Outstanding:				
Basic		77,713,398		68,477,547
Diluted		91,207,492		68,477,547

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

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

	Three Months Ended March 31, 2010		Three Months Ended March 31, 2009	
CASH FLOW FROM OPERATING ACTIVITIES:				
Net income	$	1,000,558	$	222,049
Less:				
Income from discontinued operations		(435,318)		(1,011,862)
Income (loss) from continuing operations	$	565,240	$	(789,813)
Adjustments to reconcile net income (loss) to cash used for operating activities:				
Derivative and warrant fair value adjustments		(786,710)		35,330
Depreciation		7,962		5,809
Amortization				
Intangible assets		2,979		2,812
Discounts on convertible debt related to derivatives		162,588		
Share-based compensation		11,490		49,590
Change in assets and liabilities:				
Accounts receivable trade		(549,790)		(238,692)
Inventory		3,077		955
Prepaid expenses and other		(24,964)		(19,639)
Accounts payable		(70,581)		17,049
Accrued liabilities		(159,124)		135,206
Deferred revenue		100,524		(310,116)
Net cash used for continuing operations		(737,309)		(1,111,509)
Net cash provided by discontinued operations		435,928		765,542
Net cash used for operating activities		(301,381)		(345,967)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Capital expenditures		(3,074)		(2,872)
Deposits				(300)
Net cash used for continuing operations		(3,074)		(3,172)
Net cash used for discontinued operations				(1,899)
Net cash used for investing activities		(3,074)		(5,071)
CASH FLOW FROM FINANCING ACTIVITIES:				
Dividends				(37,207)
Net cash used for continuing operations				(37,207)
Net cash used for financing activities				(37,207)
NET DECREASE IN CASH AND CASH EQUIVALENTS		(304,455)		(388,245)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		792,426		1,712,912
CASH AND CASH EQUIVALENTS, END OF PERIOD	$	487,971	$	1,324,667

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

SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION

	Three Months Ended March 31, 2010	2009
Cash paid for:		
Interest	$	$ 22,793
Noncash Investing and Financing Activities:		
Issuance of common stock in exchange for Series A, B and C preferred stock and cumulative dividends in arrears, thereon		149,566

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

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BIO-KEY INTERNATIONAL, INC. AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2010(Unaudited)

1. BASIS OF PRESENTATION

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

In the opinion of management, the accompanying unaudited interim consolidated financial statements contain all necessary adjustments, consisting only of those of a recurring nature, and disclosures to present fairly the Company s financial position and the results of its operations and cash flows for the periods presented. The balance sheet at December 31, 2009 was derived from the audited financial statements, but does not include all of the disclosures required by accounting principles generally accepted in the United States of America. These unaudited interim condensed consolidated financial statements should be read in conjunction with the financial statements and the related notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2009 (the Form 10-K), filed on March 26, 2010.

Recently Issued Accounting Pronouncements

In January 2010, the FASB issued ASU 2010-06, Fair *Value Measurements and Disclosures (Topic 820), Improving Disclosures about Fair Value Measurements*, amending ASC 820. ASU 2010-06 requires entities to provide new disclosures and clarify existing disclosures relating to fair value measurements. The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances, and settlements in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Company is currently evaluating the impact of ASU 2010-06, but does not expect its adoption to have a material impact on the Company s financial position or results of operations.

In September 2009, the FASB issued ASU 2009-13, *Multiple Element Arrangements*. ASU 2009-13 addresses the determination of when the individual deliverables included in a multiple arrangement may be treated as separate units of accounting. ASU 2009-13 also modifies the manner in which the transaction consideration is allocated across separately identified deliverables and establishes definitions for determining fair value of elements in an arrangement. This standard must be adopted by the Company no later than January 1, 2011 with earlier adoption permitted. The Company is currently evaluating the impact, if any, that this standard update will have on its consolidated financial statements.

2. LIQUIDITY AND CAPITAL RESOURCE MATTERS

We have incurred significant losses to date, and at March 31, 2010, we had an accumulated deficit of approximately $49 million. In addition, broad commercial acceptance of our technology is critical to the Company s success and ability to generate future revenues. If the Company is unable to generate sufficient revenue to meet our goals, we will need to obtain additional third-party financing to (i) conduct the sales, marketing and technical support necessary to execute our plan to substantially grow operations, increase revenue and serve a significant customer base; and (ii) provide working capital. No assurance can be given that any form of additional financing will be available on terms acceptable to the Company, that adequate financing will be obtained by the Company in order to meet its needs, or that such financing would not be dilutive to existing shareholders.

The accompanying condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern, and assumes continuity of operations, realization of assets and the satisfaction of liabilities and commitments in the normal course

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of business. The matters described in the preceding paragraph 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 sheets is dependent upon the Company s ability to meet its financing requirements on a continuing basis, and maintain profitability in its future operations. The accompanying condensed consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

3. DISCONTINUED OPERATIONS

On December 8, 2009, the Company consummated the sale (the Asset Sale) of its Law Enforcement division (the Business) to InterAct911 Mobile Systems, Inc. (Buyer), a wholly-owned subsidiary of InterAct911 Corporation (the Parent), pursuant to the Asset Purchase Agreement dated as of August 13, 2009 by and between the Company and Buyer (the Purchase Agreement).

Pursuant to the Purchase Agreement, Buyer acquired substantially all of the assets relating to the Business, including the Company s customer contracts, intellectual property, accounts receivable, equipment, inventories, software, technologies, communication systems and goodwill relating to the Business. Buyer also assumed certain specified liabilities as set forth in the Purchase Agreement. The Company and InterAct Public Safety Systems, an affiliate of Buyer, had collaborated on many projects in the past, including partnership arrangements in which products used in the Business (including elements of the MobileCop®, PocketCop®, MobileRescue , MobileOffice , and InfoServer product lines) had been integrated with those of InterAct Public Safety Systems and sold to law enforcement agencies and other emergency response customers. Outside of those commercial dealings, at the time of the Asset Sale there were no material relationships among the Company and Buyer or any of their respective affiliates other than in respect of the Purchase Agreement and the related ancillary agreements.

As consideration for the Asset Sale, Buyer paid the Company an aggregate purchase price of approximately $11.3 million. Of that amount, approximately $7.0 million was paid in cash at the closing of the Asset Sale, and approximately $300,000 was paid pursuant to the working capital adjustment provided for in the Purchase Agreement. Buyer issued a promissory note (the Note) in the original principal amount of $4.0 million in favor of the Company. The Note is to be paid in three equal annual installments beginning on the first anniversary of the closing and will bear interest, payable on a quarterly basis, at a rate per annum equal to six percent (6%) compounded annually on the principal sum from time to time outstanding. The Note is guaranteed by SilkRoad Equity, LLC (SilkRoad), a private investment firm and a principal owner of Buyer, and is secured by all of the intellectual property assets of the Business transferred to Buyer as part of the Asset Sale. In addition, at the closing of the Asset Sale, the Company issued to SilkRoad a warrant to purchase up to 8 million shares of the Company s common stock at an exercise price of $0.30 per share. This warrant will expire if not exercised prior to the fifth anniversary of the closing.

Prior to the sale, the Business had been reported as a separate segment. The Business has been reported as a discontinued operation and all periods presented have been recast accordingly to reflect these operations as discontinued.

During the period ended March 31, 2010, the Company recorded income of approximately $483,000 from a contract delivered under our arrangement with Buyer which was reduced by expenses for professional fees, resulting in net income from discontinued operations of approximately $435,000. The Company does not expect any additional income from discontinued operations in the future. The Company and Buyer have agreed to extend the period that Buyer can assert potential post closing purchase price adjustments to May 31, 2010.

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