BIO KEY INTERNATIONAL INC
Form PRE 14A
June 18, 2004

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

SCHEDULE 14A

Proxy Statement Pursuant to Section 14(a) of
the Securities Exchange Act of 1934 (Amendment No.)

Filed by the Registrant ý

Filed by a Party other than the Registrant o

Check the appropriate box:

ý Preliminary Proxy Statement

o **Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))**

o Definitive Proxy Statement

o Definitive Additional Materials

o Soliciting Material Pursuant to §240.14a-12

BIO-KEY INTERNATIONAL, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

ý No fee required.

o Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

(4) Proposed maximum aggregate value of transaction:

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o Fee paid previously with preliminary materials.

o Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

Dear Stockholder:

We cordially invite you to attend a Special Meeting of Stockholders in lieu of an Annual Meeting, to be held on Tuesday, July 20 , 2004 at [ ], located at [ ], commencing at 10:00 a.m. We look forward to greeting those of you who are able to attend.

A copy of our 2003 Annual Report is enclosed. Also enclosed is our notice of the special meeting, proxy statement and proxy card. We encourage you to read carefully all of the enclosed information.

At the special meeting, we will be asking you to vote for the re-election of four directors, to approve a reorganization to change our state of incorporation from Minnesota to Delaware (which would result in an increase in the number of authorized shares of common stock from 60,000,000 to 85,000,000), and to ratify the selection of our independent auditors, as described more fully in the enclosed proxy statement. **For the reasons set forth in the proxy statement, our Board of Directors recommends that you vote "FOR" each of the proposals described above.**

Whether or not you plan to attend the special meeting, it is important that your shares be represented and voted. Accordingly, please read the enclosed material and mark, date, sign and return the enclosed proxy card at your earliest convenience. If you attend the special meeting, you may revoke your proxy by requesting the right to vote in person.

Sincerely,
MICHAEL W. DEPASQUALE
Chief Executive Officer

July 9, 2004

BIO-key International, Inc.
1285 Corporate Center Drive, Suite 175
Eagan, Minnesota 55121

NOTICE OF SPECIAL MEETING OF STOCKHOLDERS
IN LIEU OF ANNUAL MEETING

A Special Meeting in lieu of Annual Meeting of Stockholders of BIO-key International, Inc. ("BIO-key") will be held at 10:00 a.m., on Tuesday, July 20, 2004 at [ ], located at [ ]. The special meeting is being held for the following purposes:

1. To re-elect four directors until their successors are duly elected and qualified;

2. To approve a reorganization of BIO-key to change its state of incorporation from Minnesota to Delaware; and

3. To ratify the selection of Divine, Scherzer & Brody, Ltd. as our independent auditors for the fiscal year ending December 31, 2004.

Stockholders of record at the close of business on June 24, 2004, the record date for the special meeting, are entitled to receive notice of and to vote at the special meeting.

The enclosed proxy card and proxy statement and our 2003 Annual Report are being sent to you along with this notice.

By order of the Board of Directors,
MICHAEL W. DEPASQUALE
Chief Executive Officer

Eagan, Minnesota
July 9, 2004

BIO-KEY INTERNATIONAL, INC.
PROXY STATEMENT
FOR THE
SPECIAL MEETING OF STOCKHOLDERS
IN LIEU OF ANNUAL MEETING
To Be Held On July 20, 2004

INFORMATION ABOUT SOLICITATION AND VOTING

General

This proxy statement is provided in connection with the solicitation of proxies by the Board of Directors of BIO-key International, Inc. ("BIO-key" or the "Company") for a Special Meeting in lieu of Annual Meeting of Stockholders to be held at 10:00 a.m., on Tuesday, July 20, 2004 at the [ ], located at [ ], and at any adjournment or postponement thereof (the "Meeting"). Our principal executive offices are located at 1285 Corporate Center Drive, Suite 175, Eagan, Minnesota 55121. This proxy statement and the accompanying proxy card are expected to be mailed on or about July 9, 2004 to all stockholders entitled to vote at the Meeting.

BIO-key's Board of Directors (the "Board of Directors" or the "Board") is soliciting proxies for the following purposes: (i) to re-elect four members to the Board of Directors to hold office until their successors are duly elected and qualified; (ii) to approve a reorganization of BIO-key to change its state of incorporation from Minnesota to Delaware; and (iii) to ratify the selection of Divine, Scherzer & Brody, Ltd. as independent auditors for BIO-key for the year ending December 31, 2004.

Shareholders Entitled to Vote

At the close of business on June 24, 2004, the record date for the Meeting, there were outstanding and entitled to vote 38,090,366 shares of the Company's Common Stock, $0.01 par value per share (the "Common Stock"). Only shareholders of record at the close of business on June 24, 2004 are entitled to vote at the Meeting. Each outstanding share of Common Stock is entitled to one vote on each matter to be voted upon at the Meeting.

Quorum and Voting

The representation, in person or by proxy, of at least a majority of the outstanding shares of Common Stock entitled to vote at the Meeting is necessary to establish a quorum. Assuming the presence of a quorum, directors are elected by a plurality vote, which means the four nominees receiving the most votes will be elected to fill the seats of the Board. The reorganization of BIO-key must be approved by the affirmative vote of the holders of at least a majority of the outstanding shares of Common Stock. All other actions considered at the Meeting, including an adjournment, may be taken upon the favorable vote of the majority of the votes present in person or by proxy at the Meeting. Shares of Common Stock represented in person or by proxy (including "broker non-votes (as defined below) and shares that abstain or do not vote with respect to one or more of the matters to be voted upon) will be counted for the purpose of determining whether a quorum exists. If a quorum is not present, the Meeting will be adjourned until a quorum is obtained.

Voting Shares Held in Street Name

If the shares you own are held in "street name" by a bank or brokerage firm, your bank or brokerage firm, as the record holder of your shares, is required to vote your shares according to your instructions. In order to vote your shares, you will need to follow the directions your bank or brokerage firm provides you. Many banks and brokerage firms also offer the option of voting over the Internet or

by telephone, instructions for which would be provided by your bank or brokerage firm on your vote instruction form.

If your shares are held in street name, you must bring an account statement or letter from your brokerage firm or bank showing that you are the beneficial owner of the shares as of the record date in order to be admitted to the meeting on the record date. To be able to vote your shares held in street name at the Meeting, you will need to obtain a proxy card from the holder of record.

Broker Non-Votes

If your shares are held in street name, your bank or brokerage firm will be prohibited under applicable regulations from using its discretion to vote your shares on the proposal to approve a reorganization of BIO-key to change its state of incorporation from Minnesota to Delaware. If your broker instructs us that you have not provided instructions on how to vote on those proposals, your shares will be treated as "broker non-votes" with respect to those proposals. However, even if you do not give your broker instructions as to how to vote on the other proposals described in this proxy statement, your broker may be entitled to use its discretion in voting your shares in accordance with industry practice.

Vote Required

Election of directors. The four nominees receiving the highest number of votes cast at the meeting will be elected, regardless of whether that number represents a majority of the votes cast. Abstentions and broker non-votes will have no effect on the outcome of this proposal.

Approval of the Proposed Reorganization of BIO-key to change its state of incorporation from Minnesota to Delaware. The affirmative vote of the holders of a majority of the shares represented or eligible to vote at the meeting is needed to approve the proposal to reorganize BIO-key to change its state of incorporation from Minnesota to Delaware. Abstentions will have the effect of a negative vote on this proposal. For shares held in street name, broker non-votes will have no effect on the outcome of this proposal because your bank or brokerage does not have the authority to vote your shares on this proposal absent instructions from you.

Ratification of Selection of Auditors. The affirmative vote of the holders of a majority of the shares represented or eligible to vote at the meeting is needed to approve the ratification of the selection of our independent auditors. Abstentions will have the effect of a negative vote on this proposal. For shares held in street name, broker non-votes will also have the effect of a negative vote on this proposal because your bank or brokerage does have the authority to vote your shares on this proposal absent instructions from you.

Revocability of Proxies

A shareholder who returns a proxy card may revoke it at any time before the shareholder's shares are voted at the Meeting by written notice to the Secretary of the Company received prior to the Meeting, by executing and returning a later-dated proxy, or by voting by ballot at the Meeting.

Householding of Special Meeting Materials

Some banks, brokers and other nominee record holders may be participating in the practice of "householding" proxy statements and annual reports. This means that only one copy of our proxy statement and our annual report to stockholders may have been sent to multiple stockholders in your household. We will promptly deliver a separate copy of these documents to you if you contact us at 1285 Corporate Center Drive, Suite 175, Eagan, Minnesota 55121 or (651) 687-0414. If you want to receive separate copies of the proxy statement or annual report to stockholders in the future, or if you are receiving multiple copies and would like to receive only one copy per household, you should contact your bank, broker, or other nominee record holder, or you may contact us at the above address or telephone number.

ELECTION OF DIRECTORS
(Item 1 of Notice)

General

The current four directors of BIO-key have been nominated for re-election at the Special Meeting of Stockholders to serve until their successors have been elected and duly qualified. Unless instructed otherwise, the proxy holders will vote the proxies received by them for our nominees: Thomas J. Colatosti, Michael W. DePasquale, Gary E. Wendt and Jeffrey J. May.

In the event that those nominees are unable or decline to serve as directors at the time of the special meeting, the proxies may be voted for a substitute nominee designated by the present Board of Directors (unless another nominee is indicated in any particular proxy). Mr. Colatosti, Mr. DePasquale, Mr. Wendt and Mr. May have consented to serve as directors, and our Board of Directors has no reason to believe that they will be unavailable for service.

THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE "FOR" THE PROPOSED NOMINEES.

Composition of the Board of Directors

BIO-key's Amended and Restated Articles of Incorporation provide that the Board of Directors shall consist of not less than four directors, nor more than seven directors. Additionally, BIO-key's By-Laws provide that each director elected by the shareholders, or, alternatively, by the Board of Directors to fill a newly created directorship, shall serve an indefinite term not in excess of five years until such director's successor is duly elected and qualified. All elected directors hold office until the next annual meeting of shareholders and the election and qualification of their successors. The Board of Directors currently consists of Mr. Colatosti, Mr. DePasquale, Mr. Wendt and Mr. May.

Directors' Terms of Office

Mr. Wendt was initially elected to serve as a director in 1993, and was re-elected in 1998. Mr. May was initially elected to serve as a director in 2001. Mr. Colatosti was initially elected to serve as a director in 2002. Mr. DePasquale was initially elected as a director in 2003. Each such director was elected to serve until his successor is duly elected and qualified in accordance with the By-laws of the Company.

Information Regarding the Current Directors/Nominees

The following sets forth certain information regarding each of the directors 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, Secretary and Director
Jeffrey J. May	44	Director

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, Inc., 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 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 the Chief Financial Officer and a Director of the Company since its inception in 1993. Mr. Wendt has primary responsibility for the Company's financial reports and administers accounting operations. 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.

Board Independence

Presently, two of our four directors are "independent" within the meaning of The Nasdaq Stock Market's director independence standards. The OTC Bulletin Board, on which our common stock is currently traded, does not maintain director independence standards. In particular, our board of directors has determined that neither Mr. Colatosti nor Mr. May has a material relationship with us (either directly or as a partner, shareholder or officer of an organization that has a relationship with us) that would interfere with the exercise of independent judgment.

Board of Directors' Meetings and Committees

The Board of Directors has responsibility for establishing broad corporate policies and reviewing our overall performance rather than day-to-day operations. The primary responsibility of the Board of

Directors is to oversee the management of the Company and, in so doing, to serve the best interests of the Company and its stockholders. The Board of Directors selects, evaluates and provides for the succession of executive officers and, subject to stockholder election, directors. It reviews and approves corporate objectives and strategies, and evaluates significant policies and proposed major commitments of corporate resources. It participates in decisions that have a potential major economic impact on us. Management keeps the directors informed of company activity through regular written reports and presentations at board and committee meetings.

The Board of Directors met five times in 2003 (with each meeting held via teleconference). During 2003, each of our directors attended 75% or more of the total number of meetings of the Board of Directors and the committees of which such director was a member. None of the current Board members attended the last annual shareholder meeting. Our Board of Directors currently does not have a policy regarding director attendance at the annual meeting of stockholders.

Audit Committee

Until recently, our full Board of Directors acted as our Audit Committee. The Board met in its capacity as the Audit Committee two times in 2003. The Board, acting as the Audit Committee, was responsible for the oversight of BIO-key's accounting and financial reporting processes. The Board did not adopt a written charter for the Audit Committee.

In discharging its oversight responsibilities regarding the audit process, the Board:

1. Reviewed and discussed the audited financial statements with management;

2. Discussed with the independent auditors the material required to be discussed by Statement on Auditing Standards NO. 61, as modified and supplemented; and

3. Reviewed the written disclosures and the letter from the independent auditors required by the Independent Standards Board's Standard No. 1, and discussed with the independent auditors any relationships that may impact their objectivity and independence.

Based upon the review and discussions referred to above, the Board, serving as the Audit Committee, recommended that the audited financial statements be included in the Company's Annual Report on Form 10-KSB for the fiscal year ended December 31, 2003, as filed with the Securities and Exchange Commission.

On May 10, 2004, our Board of Directors appointed Thomas J. Colatosti and Jeffrey J. May to serve as the Audit Committee of the Board. The Audit Committee has not adopted a written charter.

Audit Committee's Pre-approval Policy and Procedures

Our Board of Directors approved the engagement of our independent auditor's rendering of audit and non-audit services before these services are engaged. All of the services performed by Divine, Scherzer & Brody, Ltd. for us have been pre-approved by our Board of Directors.

Compensation Committee

Our full Board of Directors acts as our Compensation Committee.

Nominating Committee

The Company does not have a standing Nominating Committee or other committee performing similar functions, as the Board believes that the process is currently best conducted by the entire Board of Directors. The principal basis for this view is that having such a committee would distract directors from other more immediately important tasks at a time when the Board considers its membership, all of whom are standing for re-election, to be sufficiently independent and capable. The nominating procedures simply consisted of all the directors unanimously approving all of the nominees named in this proxy statement. Therefore, the Board performs the functions of the nominating committee and the Company does not have a written charter for such a committee.

The Board utilizes a variety of methods for identifying and evaluating nominees for director. The Board's policy is to assess the appropriate size of the Board, and whether any vacancies are expected due to retirement or otherwise. In the event that vacancies are anticipated, or otherwise arise, the Board considers various potential candidates for director. Candidates may come to the attention of the Board through its current members, stockholders or other persons. These candidates are evaluated at regular or special meetings, and may be considered at any point during the year. The Board considers properly submitted stockholder nominations for candidacy for director.

In evaluating such nominations, like all nominations, the Board considers a variety of criteria, including business experience and skills, independence, judgment, integrity, the ability to commit sufficient time and attention to Board activities and the absence of potential conflicts with the Company's interests.

Any stockholder nominations proposed for consideration by the Board should include the nominee's name and qualifications for Board membership and should be addressed to Board of Directors of BIO-key International, Inc., 1285 Corporate Center Drive, Suite 175, Eagan, Minnesota 55121. Following verification of the stockholder status of persons recommending candidates to the Board, recommendations are aggregated and considered by the Board at a regularly scheduled meeting. If any materials are provided by a stockholder in connection with the nomination of a director candidate, such materials are forwarded to the Board.

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, and in 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. 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.

Stockholder Communication with the Board of Directors

Stockholders may communicate with the Board by writing to Board of Directors of BIO-key International, Inc., 1285 Corporate Center Drive, Suite 175, Eagan, Minnesota 55121. All such communications will be forwarded to the Chairman of the Board of Directors as promptly as practicable after receipt.

REINCORPORATION OF BIO-KEY BY MERGER
FROM MINNESOTA TO DELAWARE
(Item 2 of Notice)

The Board of Directors has unanimously approved and recommended for shareholder approval a proposal to reincorporate the Company in Delaware. The reincorporation would be effected by merging the Company (the "Merger") into BIO-key International, Inc., a Delaware corporation which is a newly created and currently a wholly owned subsidiary of the Company ("BIO-key Delaware"). The Board of Directors has unanimously approved and recommends the Merger for shareholder approval, pursuant to the terms of the Agreement and Plan of Merger (the "Merger Agreement"), which is attached to this proxy statement as Appendix A. If approved by the shareholders, the Merger will allow the Company to change its state of incorporation from Minnesota to Delaware (the "Reincorporation") and, accordingly, take advantage of certain provisions of the corporate laws of Delaware.

Under the terms of the Merger, the Company's shareholders will exchange their shares of capital stock of the Company for a like number and class of shares of BIO-key Delaware capital stock, and the corporate existence of the Company will cease. Upon consummation of the Merger, the Company will become subject to the Certificate of Incorporation attached hereto as Appendix B, which will comply with the Delaware General Corporation Law (as described below). Such Certificate of Incorporation authorizes BIO-key Delaware to issue up to 85,000,000 shares of its common stock, which reflects an increase of 25,000,000 shares over the 60,000,000 shares of common stock that the Company is currently authorized to issue pursuant to its Articles of Incorporation. The effects of the Merger are described briefly in the paragraphs below and are more fully summarized under the caption "Summary Effects of the Merger."

General Effects and Purposes of the Merger

BIO-key Delaware, which was incorporated in June 2004 for the sole purpose of effecting the Merger, has not engaged in any business to date and has no assets. The Merger will not result in any change to the business, management, assets or liabilities of the Company. However, by operation of law, the Company's business, management, assets and liabilities will be transferred to BIO-key Delaware. If the Merger is consummated, by operation of law, the Company will cease to exist and the shareholders of the Company who do not exercise their dissenters' rights (as further described below) will become the shareholders of BIO-key Delaware. In management's judgment, no activities contemplated by the Company at present will be either favorably or unfavorably affected in any material respect by adoption of the Merger proposal.

The corporation law of Delaware and the corporation law of Minnesota differ in several significant respects, however, including differences pertaining to the rights of shareholders. Some of these differences are summarized below under the caption, "Summary Effects of the Merger." Upon shareholder approval of the Merger and upon approval of appropriate articles or certificates of merger by the Secretaries of State of the States of Minnesota and Delaware, the Company will be merged with and into BIO-key Delaware pursuant to the Merger Agreement, resulting in a change in the Company's state of incorporation. The Company will then be subject to the Delaware General Corporation Law and the Certificate of Incorporation and Bylaws set forth in Appendices B and C, respectively. The Company anticipates that the Merger will become effective as soon as practicable following shareholder approval. However, the Merger Agreement provides that the Merger may be abandoned by the Board of Directors of the Company before the effective date of the Merger as specified in the Merger Agreement (the "Effective Time") either before or after shareholder approval. In addition, the Merger Agreement may be amended before the Effective Time, either before or after shareholder approval; however, the Merger Agreement may not be amended after shareholder approval if such amendment

would, in the judgment of the Board of Directors, violate applicable law or have a material adverse effect on the rights of the shareholders.

The Company's Board of Directors believes that the Reincorporation will provide flexibility for both the management and business of the Company. Delaware has followed a policy of encouraging incorporation in Delaware for many years and, in furtherance of that policy, has adopted comprehensive, modern and flexible corporate laws which are periodically updated and revised to satisfy changing business needs. As a result, many major corporations initially have chosen Delaware for their domicile or have subsequently reincorporated in Delaware in a manner similar to that proposed by the Company. Because of Delaware's significance as the state of incorporation for many major corporations, the Delaware judiciary has become particularly familiar with matters of corporate law, and a substantial body of court decisions has developed construing Delaware's corporation laws. Consequently, Delaware corporate law has been, and is likely to continue to be, interpreted and explained in a number of significant court decisions, a circumstance which will provide greater predictability with respect to the Company's legal affairs. In contrast, the Minnesota Business Corporation Act ("MBCA"), to which the Company is presently subject, has not been the subject of a significant number of judicial decisions interpreting its provisions. Moreover, many investors are more comfortable investing in Delaware corporations since they already are familiar with Delaware corporate law and know that it will not create unexpected obstacles or problems. For the foregoing reasons, the Board of Directors believes the interests of the Company's shareholders would be better served by reincorporating in Delaware.

Conversion of Shares and Exchange of Certificates

At the Effective Time, each outstanding share of the Common Stock of the Company, $0.01 par value per share, will be automatically converted into one share of common stock, $0.0001 par value per share, of BIO-key Delaware (other than shares as to which the holder thereof has properly exercised dissenters' rights under Minnesota law). Additionally, each outstanding share of the Series C 7% Convertible Preferred Stock of the Company, $0.01 par value per share, will be automatically converted into one share of Series A 7% Convertible Preferred Stock, $0.0001 par value per share, of BIO-key Delaware at the Effective Time (other than shares as to which the holder thereof has properly exercised dissenters' rights under Minnesota law), with such Series A 7% Convertible Preferred Stock containing substantially identical terms as the Series C 7% Convertible Preferred Stock of the Company. From and after the Effective Time, certificates representing shares of capital stock of BIO-key Delaware will be deemed to have been issued without regard to the date or dates on which certificates representing shares of capital stock are physically surrendered for exchange or certificates representing shares of capital stock of BIO-key Delaware are actually issued. Each certificate representing shares of capital stock outstanding immediately before the Effective Time will, from and after the Effective Time, be deemed for all corporate purposes (except as hereinafter described) to represent the same number of shares of capital stock of BIO-key Delaware. Each option to purchase shares of the Company's Common Stock granted by the Company under any warrant, stock option plan or similar plan of the Company outstanding immediately before the Effective Time shall, by virtue of the Merger and without any action on the part of the holder thereof, be converted into and become an option to purchase, upon the same terms and conditions, the same number of shares of BIO-key Delaware common stock. The exercise price per share under each of such options shall be equal to the exercise price per share thereunder immediately before the Effective Time. Under the terms of the Merger Agreement, any warrant, option or stock option plan of the Company will be assumed by and continue to be a warrant, option or plan of BIO-key Delaware. All stock options granted thereunder, outstanding immediately before the Effective Time, shall be deemed to provide for the purchase of BIO-key Delaware's capital stock. It will not be necessary for shareholders of the Company to exchange their existing stock certificates for stock certificates of BIO-key Delaware; outstanding certificates of the Company should not be destroyed or sent to the Company. Following the Merger, delivery of

previously outstanding stock certificates of the Company will constitute "good delivery" in connection with sales through a broker, or otherwise, of shares of BIO-key Delaware. Accordingly, as a result of the Merger, the shareholders of the Company will become shareholders of BIO-key Delaware, and the Company will cease to exist.

Authorized Shares

Currently, the Articles of Incorporation of the Company provide for 60,000,000 authorized shares of common stock. The Certificate of Incorporation of BIO-key Delaware, attached hereto as Appendix B, authorizes BIO-key Delaware to issue up to 85,000,000 shares of its common stock. An effect of the Reincorporation, therefore, would be to increase the number of shares of common stock available for issuance.

The Company's Board of Directors believes that, following the Reincorporation, it is in the best interests of BIO-key Delaware and its shareholders to have additional shares of common stock authorized and available for issuance or reservation on an as-needed basis without the delay or expense of seeking shareholder approval (unless required by applicable law). The Company has announced that it is actively pursuing strategic acquisitions. An increase in the number of authorized shares from 60,000,000 to 85,000,000 will enable the Company to respond rapidly to acquisition opportunities, and to meet other future needs that could arise.

Additional shares of authorized common stock may also be (i) sold and issued in a public or private offering that would be used to provide BIO-key Delaware with capital necessary to further develop its core businesses or to pursue strategic opportunities, (ii) used for issuance in connection with stock option plans and (iii) used to pursue other corporate purposes that may be identified in the future by the Board of Directors.

Although the increase in the authorized number of shares of common stock will not, in and of itself, have any immediate effect on the rights of BIO-key Delaware shareholders following the Reincorporation, any future issuance of additional shares of common stock could affect such BIO-key Delaware shareholders in a number of respects, including by diluting the voting power of the holders of BIO-key Delaware common stock, and by diluting the earnings per share and book value per share of outstanding shares of BIO-key Delaware common stock at such time. In addition, the issuance of additional shares could adversely affect the market price of our common stock following the Reincorporation. Moreover, if BIO-key Delaware issues securities convertible into common stock or other securities that have rights, preferences and privileges senior to those of BIO-key Delaware common stock, the holders of BIO-key Delaware common stock may suffer significant dilution.

We have no present intention to use the increased authorized common stock for anti-takeover purposes, nor is the proposed Reincorporation in response to any effort by any person or group to accumulate our stock or to obtain control of the Company by any means. The proposed Reincorporation is not intended to have any anti-takeover effect and is not part of any series of anti-takeover measures contained in BIO-key Delaware's Certificate of Incorporation or the By-Laws as in effect on the date hereof. However, the issuance of additional shares of common stock would increase the number of shares necessary to acquire control of BIO-key Delaware's Board of Directors or to meet the voting requirements imposed by Delaware law with respect to a merger or other business combination involving BIO-key Delaware. Issuance of additional shares unrelated to any takeover attempt could also have these effects. Management has no current intent to propose anti-takeover measures in future proxy solicitations.

Dissenters' Rights

Section 302A.471 of the MBCA grants any shareholder of the Company of record on June 24, 2004 who objects to the Merger the right to have the Company purchase the shares owed by the

dissenting shareholder at their fair value at the Effective Time of the Merger. Any shareholder contemplating the exercise of these dissenter's rights should review carefully the discussion of dissenting shareholder rights under the caption "Dissenters' Rights" and the provisions of Section 302A.471 and 203A.473 of the MBCA, particularly the procedural steps required to perfect such rights. SUCH RIGHTS WILL BE LOST IF THE PROCEDURAL REQUIREMENTS OF SECTIONS 302A.471 AND 302A.473 ARE NOT FULLY AND PRECISELY SATISFIED. A COPY OF SECTIONS 302A.471 AND 302A.473 IS ATTACHED AS APPENDIX D. It is the present intention of the Company to abandon the Merger in the event shareholders exercise dissenter's rights and the Company becomes obligated to make a substantial payment to such dissenting shareholders.

SUMMARY EFFECTS OF THE MERGER

The following summary of the Merger does not purport to be a complete description of the Merger and is qualified in its entirety by reference to the Merger Agreement, the Certificate of Incorporation of BIO-key Delaware, the Bylaws of BIO-key Delaware, copies of which are attached hereto as Appendix A, Appendix B and Appendix C, respectively, and reference to the applicable corporate laws of Minnesota and Delaware.

Change in the Company's State of Incorporation

After the Effective Time, the Company's state of incorporation will change from Minnesota to Delaware. The rights and preferences of the holders of the Company's capital stock are governed by the MBCA. Upon the consummation of the Reincorporation, these rights and preferences will be governed by the Delaware General Corporation Law. Although Delaware and Minnesota corporation laws currently in effect are similar in many respects, certain differences will affect the rights of BIO-key Delaware's stockholders if the Merger is consummated. The following discussion summarizes certain differences considered by management to be significant and is qualified in its entirety by reference to the full text of the MBCA and Delaware General Corporation Law.

Shareholders' Action Without a Meeting

Under Minnesota law, any action required or permitted to be taken at a shareholders' meeting may be taken without a meeting by written consent signed by all of the shareholders entitled to vote on such action. This power cannot be restricted by a corporation's articles of incorporation. In contrast, Delaware law permits such an action to be taken if the written consent is signed by the holders of shares that would have been required to effect the action at a meeting of the stockholders. Stockholders who do not sign the written consent must be notified promptly following the effectiveness of a written consent. Generally, holders of a majority of the Company's outstanding shares may take action by written consent in lieu of a shareholder meeting. However, Delaware law also provides that a corporation's certificate of incorporation may restrict or prohibit stockholders' action without a meeting. BIO-key Delaware's Certificate does not contain any such restriction, so actions may be adopted by a written consent signed by the holders of shares that would have been required to vote in favor of the proposed action at a meeting of stockholders.

Treasury Shares

The MBCA does not allow treasury shares. Under the Delaware General Corporation Law, the Company may hold treasury shares and such shares may be held, sold, loaned, pledged or exchanged by the Company. Such treasury shares, however, are not outstanding shares and therefore do not receive any dividends and do not have voting rights.

Anti-Takeover Legislation

Both the MBCA and the Delaware General Corporation Law contain provisions intended to protect shareholders from individuals or companies attempting a takeover of a corporation in certain circumstances. The anti-takeover provisions of the MBCA and the Delaware General Corporation Law differ in a number of respects, and it is not practical to summarize all of the differences. However, the following is a summary of certain significant differences.

Section 302A.671 of the MBCA, the Minnesota control share acquisition statute, establishes various disclosure and shareholder approval requirements that must be satisfied by individuals or companies attempting a takeover. Delaware has no comparable provision. The Minnesota control share acquisition statute applies to an "issuing public corporation." An "issuing public corporation" is a publicly-held corporation which is incorporated under or governed by the MBCA and has at least fifty shareholders. The Company is currently subject to this statute, however, BIO-key Delaware, because it is a Delaware corporation, will not be subject to this statute. The Minnesota control share acquisition statute requires disinterested shareholder approval for acquisitions of shares of an "issuing public corporation" which result in the "acquiring person" owning more than a designated percentage of the outstanding shares of such corporation. Accordingly, shareholders who acquire shares without shareholder approval and in excess of a designated percentage of outstanding shares lose their voting rights and are subject to certain redemption privileges of the corporation. Such shares regain their voting rights only if the acquiring person discloses certain information to the corporation and such voting rights are granted by the shareholders at an annual or special meeting of the shareholders. The Minnesota control share acquisition statute applies unless the "issuing public corporation" opts out of the statute in its articles of incorporation or bylaws. The Company has not opted out of such provisions.

While there is no Delaware statute comparable to the Minnesota control share acquisition statute, both Minnesota and Delaware have business combination statutes that are intended primarily to deter takeover bids which propose to use the target's assets as collateral for the offeror's debt financing and to liquidate the target, in whole or in part, to satisfy financing obligations. Proponents of the business combination statute argue that such takeovers have a number of abusive effects when the target is broken up, such as adverse effects on the community and employees. Further, proponents argue that if the offeror can wholly finance its bid with the target's assets, that fact suggests that the price offered was not fair in relation to the value of the company, regardless of the current market price.

Section 302A.673 of the MBCA, the Minnesota business combination statute, provides that an issuing public corporation (as described above with respect to the Minnesota control share acquisition statute) may not engage in certain business combinations with any person that acquires beneficial ownership of 10% or more of the voting stock of that corporation (i.e., an interested shareholder) for a period of four years following the date on which the person became a 10% shareholder (the share acquisition date) unless, before that share acquisition date, a committee of the corporation's disinterested directors approve either the business combination or the acquisition of shares. Only specifically defined types of "business combinations" are prohibited by this statute. In general, the definition includes: any merger or exchange of securities of the corporation with the interested shareholder; certain sales, transfers, or other disposition of assets of the corporation to an interested shareholder; transfers by the corporation to interested shareholders of shares that have a market value of 5% or more of the value of all outstanding shares, except for a pro rata transfer made to all shareholders; any liquidation or dissolution of, or reincorporation in another jurisdiction of, the corporation which is proposed by the interested shareholder; certain transactions proposed by the interested shareholder or any affiliate or associate of the interested shareholder that would result in an increase in the proportion of shares entitled to vote owned by the interested shareholder; and transactions whereby the interested shareholder receives the benefit of loans, advantages, guarantees, pledges, or other financial assistance or tax advances or credits from the corporation. For purposes of

selecting a disinterested committee, a director or person is "disinterested" if the director or person is neither an officer nor an employee of the issuing public corporation or a related corporation, nor has been an officer or employee within five years preceding the formation of the committee of the issuing public corporation or a related corporation. The disinterested committee must consider and act on any written, good faith proposal to acquire shares or engage in a business combination. The disinterested committee must consider and take action on the proposal and within 30 days render a decision in writing regarding the proposal.

In contrast to the Minnesota business combination statute, the Delaware statute provides that if a person acquires 15% or more of the voting stock of a Delaware corporation, the person is designated an interested stockholder and the corporation may not engage in certain business combinations with such person for a period of three years. However, an otherwise prohibited business combination may be permitted if one of three conditions is satisfied. First, if before the date the person became an interested stockholder, the board of directors approved either the business combination or the transaction which resulted in the stockholder becoming an interested stockholder, then the business combination is permitted. Second, a business combination is permitted if the tender offer or other transaction pursuant to which the person acquires 15% stock ownership is attractive enough such that the interested stockholder is able to acquire ownership in the same transaction of at least 85% of the outstanding voting stock (excluding for purposes of determining the number of shares outstanding those shares owned by directors who are also officers and those shares owned by certain employee stock ownership plans). Finally, the business combination is permissible under Delaware law if approved by the board of directors and authorized at an annual or special meeting of stockholders (action by written consent is not permitted) by the affirmative vote of at least two-thirds of the outstanding voting shares held by disinterested stockholders. As in Minnesota, only certain Delaware corporations are subject to the business combination provisions of Delaware corporation law. A corporation is subject to the statute if it is incorporated under the laws of Delaware and has a class of voting stock that is listed on a national securities exchange, quoted on an inter-dealer quotation system of a registered national securities association, or held of record by more than 2,000 shareholders. Because BIO-key Delaware will have a class of voting stock quoted on an inter-dealer quotation system if the Merger is consummated, it will be subject to these provisions.

The "business combinations" prohibited under Delaware law include any of the following: any merger or consolidation with the interested stockholder; any sale, transfer or other disposition of assets to the interested stockholder if the assets have a market value equal to or greater than 10% of the aggregate market value of all of the corporation's assets; any transfer of stock of the corporation to the interested stockholder, except for transfers in a conversion or exchange or a pro rata distribution; and any receipt by the interested stockholder of any loans, advances, guarantees, pledges, and other financial benefits, except in connection with a pro rata transfer. The Delaware statute does not apply to any business combination in which the corporation, with the support of a majority of those directors who were serving as directors before any person became an interested stockholder, proposes a merger, sale, lease, exchange or other disposition of at least 50% of its assets, or supports (or does not oppose) a tender offer for at least 50% of its voting stock. In such a case, all interested stockholders are not required to comply with the three year prohibition and may compete with the corporation-sponsored transaction.

Minnesota law is somewhat more restrictive than Delaware law with respect to a prospective takeover attempt. In Minnesota, an interested shareholder is one who owns 10% of the outstanding shares while in Delaware 15% is the share ownership threshold. An interested shareholder must wait four years in Minnesota to engage in prohibited business combinations, compared to a three-year waiting period in Delaware. Minnesota also has a potentially broader definition of a business combination which arguably encompasses a larger variety of transactions. Another difference between the two business combination statutes is the method by which prohibited transactions become

permissible. In Delaware, an otherwise prohibited business combination may be permitted by board approval, by stockholder approval, or by an acquisition of 85% of the outstanding shares of voting stock. In Minnesota, a prohibited transaction is permitted only by advance board committee approval. In addition, the Delaware statute provides that if the corporation proposes a merger or sale of assets, or does not oppose a tender offer, all interested stockholders are not required to comply the three year prohibition and in certain circumstances may compete with such proposed transaction. The Minnesota statute does not have a comparable provision. Both the Minnesota and Delaware provisions permit a corporation to "opt out" of the business combination statute by electing to do so in its articles or certificate of incorporation within a specified time period. Neither the Bylaws nor the Articles of Incorporation of the Company contain such an "opt out" provision. Similarly, neither the Certificate nor the Bylaws of BIO-key Delaware contain such an "opt out" provision.

The MBCA includes other provisions relating to takeovers that are not included in the Delaware General Corporation Law. Some of these provisions address a corporation's use of golden parachutes, greenmail and the standard of conduct of the Board of Directors in connection with the consideration of takeover proposals. The MBCA contains a provision which prohibits a publicly-held corporation from entering into or amending agreements (commonly referred to as golden parachutes) that increase current or future compensation of any officer or director during any tender offer or request or invitation for tenders. The MBCA provides that a publicly-held corporation is prohibited from purchasing or agreeing to purchase any shares from a person who beneficially owns more than 5% of the voting power of the corporation if the shares had been beneficially owned by that person for less than two years, and if the purchase price would exceed the market value of those shares. However, such a purchase will not violate the statute if the purchase is approved at a meeting of the shareholders by a majority of the voting power of all shares entitled to vote or if the corporation's offer is of at least equal value per share and made to all holders of shares of the class or series and to all holders of any class or series into which the securities may be converted. In considering the best interests of the corporation with respect to a proposed acquisition of an interest in the corporation, the MBCA authorizes the board of directors to consider the interest of the corporation's employees, customers, suppliers and creditors, the economy of the state and nation, community and social considerations and the long-term as well as short-term interests of the corporation and its shareholders, including the possibility that these interests may be best served by the continued independence of the corporation.

Directors' Standard of Care and Personal Liability

Minnesota law provides that a director must discharge the director's duties in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. A director who complies with such standards may not be held liable by reason of being a director or having been a director of the corporation. Delaware law provides that the business and affairs of a Delaware corporation are to be managed by or under the direction of its board of directors. The directors of a company owe fiduciary duties to the company and its stockholders. These fiduciary duties require directors in making a business decision to act on an informed basis, in good faith, and in the honest belief that the action to be taken is in the best interests of the company and its stockholders. In general, directors of a Delaware corporation owe two distinct fiduciary duties: the duty of care and the duty of loyalty.

Limitation or Elimination of Director's Personal Liability

Minnesota law provides that the personal liability of a director for breach of fiduciary duty may be eliminated or limited if the articles of incorporation so provide, but the articles may not limit or eliminate such liability for (a) any breach of the directors' duty of loyalty to the corporation or its shareholders, (b) acts or omissions not in good faith or that involve intentional misconduct or a

knowing violation of law, (c) the payment of unlawful dividends, stock repurchases or redemptions, (d) any transaction in which the director received an improper personal benefit, (e) certain violations of the Minnesota securities laws, or (f) any act or omission that occurs before the effective date of the provision in the articles eliminating or limiting liability. The Company's Articles of Incorporation provide that, to the fullest extent permitted by the MBCA, a director shall not be personally liable to the Company or its shareholders for monetary damages for breach of a directors' fiduciary duty. Delaware law provides that if the certificate of incorporation so provides, the personal liability of a director for breach of fiduciary duty as a director may be eliminated or limited, but that the liability of a directors is not limited or eliminated for (a) any breach of the directors' duty of loyalty to the corporation or its shareholders, (b) acts or omissions not in good faith or involving intentional misconduct or a knowing violation of law, (c) the payment of unlawful dividends, stock repurchases or redemptions, or (d) any transaction in which the director received an improper personal benefit. BIO-key Delaware's Certificate of Incorporation contains a provision eliminating the personal liability of its directors for breach of fiduciary duty, subject to the foregoing limitations. The Company is not aware of any pending or threatened litigation to which the limitation of directors' liability would apply.

Indemnification

Minnesota law generally provides for mandatory indemnification of persons acting in an official capacity on behalf of the corporation if such a person acted in good faith, did not receive any improper personal benefit, acted in a manner the person reasonably believed to be in, or not opposed to, the best interests of the corporation and, in the case of a criminal proceeding, had no reasonable cause to believe that the conduct was unlawful. Delaware law permits a corporation to indemnify its officers, directors, employees and agents and expressly provides that such indemnification shall not be deemed exclusive of any indemnification right provided under any bylaw, vote of shareholders or disinterested directors or otherwise. Delaware law permits indemnification against expenses and certain other liabilities arising out of legal actions brought or threatened against parties entitled to indemnity for their conduct on behalf of the corporation, provided that each such person acted in good faith and in a manner such person reasonably believed was in or not opposed to the best interests of the corporation. In Delaware, indemnification is available in a criminal action only if the person seeking indemnity had no reasonable cause to believe that the person's conduct was unlawful. Delaware law does not allow indemnification for directors in the case of an action by or in the right of the corporation (including stockholder derivative suits) as to which such director shall have been adjudged to be liable to the corporation unless indemnification (limited to expenses) is ordered by a court. The Certificate of Incorporation of BIO-key Delaware provides for indemnification to the fullest extent permitted by Delaware law.

Stockholder Voting

Under both Minnesota law and Delaware law, action on certain matters, including the sale, lease or exchange of all or substantially all of the corporation's property or assets, mergers, and consolidations and voluntary dissolution, must be approved by the holders of a majority of the outstanding shares. In addition, both states' laws provide that the articles or certificate of incorporation may provide for a supermajority of the voting power of the outstanding shares to approve such extraordinary corporate transactions. Neither the Company's Articles of Incorporation nor BIO-key Delaware's Certificate of Incorporation contain such a provision.

Action by Directors Without a Meeting

Minnesota and Delaware law permit directors to take written action without a meeting for an action otherwise required or permitted to be taken at a board meeting. Minnesota law provides that a corporation's articles of incorporation may provide for such written action, other than an action

requiring shareholder approval, by the number of directors that would be required to take the same action at a meeting of the board at which all directors were present. The Company's Articles of Incorporation contain such a provision allowing an action to be taken by written consent of less than all of the directors. Delaware law contains no such provision and, thus, written actions by the directors of BIO-key Delaware must be unanimous. Minnesota law also states that if the articles of incorporation or bylaws so provide, a director may give advance written consent or opposition to a proposal to be acted on at a board meeting; however, such consent or opposition of a director not present at a meeting does not constitute presence for determining the existence of a quorum. The Company's Articles of Incorporation, however, do not contain such a provision. Delaware law does not contain any advance written consent or opposition provision.

Conflicts of Interest

Under both Minnesota law and Delaware law, a contract or transaction between a corporation and one or more of its directors, or an entity in or of which one or more of the corporation's directors are directors, officers, or legal representatives or have a material financial interest, is not void or voidable solely because of such reason, provided that the contract or transaction is fair and reasonable at the time it is authorized and is ratified by the corporation's disinterested stockholders after disclosure of the relationship or interest, or such contract or transaction is authorized in good faith by a majority of the disinterested members of the board of directors after disclosure of the relationship or interest. However, if such contract or transaction is authorized by the board, under Minnesota law the interested director may not be counted in determining the presence of a quorum and may not vote on such contract or transaction. Delaware law permits the interested director to be counted in determining whether a quorum of the directors is present at the meeting approving the contract or transaction, and further provides that the contract or transaction shall not be void or voidable solely because the interested director's vote is counted at the meeting which authorizes the contract or transaction.

Number of Directors

Minnesota law provides that the number of directors shall be fixed by or in the manner provided in the articles of incorporation or bylaws, and that the number of directors may be changed at any time by amendment to or in the manner provided in the articles of incorporation or bylaws. The Company's Bylaws provide that the Board of Directors shall consist of a minimum of four directors and a maximum of seven directors. Currently, the Company has four directors. Delaware law provides that the number of directors shall be fixed by, or in the manner provided in, the bylaws, unless the certificate of incorporation fixes the number of directors, in which case a change in the number of directors shall be made only by amendment of the certificate. Under the Bylaws and the Certificate of Incorporation of BIO-key Delaware, the number of directors may be fixed by resolution of the Board of Directors.

Classified Board of Directors

Both Minnesota and Delaware permit a corporation's bylaws to provide for a classified board of directors. Delaware permits a maximum of three classes; Minnesota law does not limit the number of classes. The Company does not currently have a classified board of directors and the Certificate of Incorporation and the Bylaws of BIO-key Delaware do not provide for a classified board of directors.

Removal of Director

Under Minnesota law, unless a corporation's articles of incorporation provide otherwise, a director may be removed with or without cause by the affirmative vote of a majority of the shareholders or, if the director was named by the board to fill a vacancy, by the affirmative vote of a majority of the other directors. Under Delaware law a director of a corporation may be removed with or without cause by the affirmative vote of a majority of shares entitled to vote for the election of directors. However, a director of a Delaware corporation that has a classified board may be removed but only for cause, unless the certificate of incorporation provides otherwise. The Certificate of Incorporation and Bylaws of BIO-key Delaware provide that a director may be removed at any time but only for cause by the stockholders.

Vacancies on Board of Directors

Under Minnesota law, unless the articles of incorporation or bylaws provide otherwise, (a) a vacancy on a corporation's board of directors may be filled by the vote of a majority of directors then in office, although less than a quorum, (b) a newly created directorship resulting from an increase in the number of directors may be filled by the board, and (c) any director so elected shall hold office only until a qualified successor is elected at the next regular or special meeting of shareholders. The Company's bylaws follow these provisions. Under Delaware law, a vacancy on a corporation's board of directors may be filled by a majority of the remaining directors, even if less than a quorum, or by the affirmative vote of a majority of the outstanding voting shares, unless otherwise provided in the certificate of incorporation or bylaws. The Certificate of Incorporation and Bylaws of BIO-key Delaware provides that a vacancy on the board of directors shall be filled by the affirmative vote of a majority of the remaining directors, and not by the stockholders.

Annual Meetings of Stockholders

Minnesota law provides that if a regular meeting of shareholders has not been held during the immediately preceding 15 months, a shareholder or shareholders holding 3% or more of the voting power of all shares entitled to vote may demand a regular meeting of shareholders. Delaware law provides that if no date has been set for an Annual Meeting of stockholders for a period of 13 months after the last Annual Meeting, any stockholder or director may request the Delaware court to order a meeting to be held.

Special Meetings of Stockholders

Minnesota law provides that the chief executive officer, the chief financial officer, two or more directors, a person authorized in the articles or Bylaws to call a special meeting, or a shareholder holding 10% or more of the voting power of all shares entitled to vote, may call a special meeting of the shareholders, except that a special meeting concerning a business combination must be called by 25% of the voting power. Under Delaware law, only the board of directors or those persons authorized by the corporation's certificate of incorporation or Bylaws may call a special meeting of the corporation's stockholders. The Bylaws of BIO-key Delaware provide that special meetings of shareholders may be called by the corporation's Board of Directors.

Voluntary Dissolution

Minnesota law provides that a corporation may be dissolved by the voluntary action of holders of a majority of a corporation's shares entitled to vote at a meeting called for the purpose of considering such dissolution. Delaware law provides that voluntary dissolution of a corporation first must be deemed advisable by a majority of the board of directors and then approved by a majority of the outstanding stock entitled to vote. Delaware law further provides for voluntary dissolution of a

corporation without action of the directors if all of the stockholders entitled to vote on such dissolution consent in writing to such dissolution.

Involuntary Dissolution

Minnesota law provides that a court may dissolve a corporation in an action by a shareholder where: (a) the situation involves a deadlock in the management of corporate affairs and the shareholders cannot break the deadlock; (b) the directors have acted fraudulently, illegally, or in a manner unfairly prejudicial to the corporation; (c) the shareholders are divided in voting power for two consecutive regular meetings to the point where successor directors are not elected; (d) there is a case of misapplication or waste of corporate assets; or (e) the duration of the corporation has expired. Delaware law provides that courts may revoke or forfeit the charter of any corporation for non-use, misuse or nonuse of its corporate powers, privileges or franchises.

Inspection of Shareholder Lists

Under Minnesota law, any shareholder has an absolute right, upon written demand, to examine and copy, in person or by a legal representative, at any reasonable time, the corporation's share register. Under Delaware law, any stockholder, upon written demand under oath stating the purpose thereof, has the right during the usual hours for business to inspect for any proper purpose a list of the corporation's stockholders and to make copies or extracts therefrom.

Amendment of the Charter

Under Minnesota law, before shareholders may vote on an amendment to the articles of incorporation, either a resolution to amend the articles must have been approved by the affirmative vote of the majority of the directors present at the meeting where such resolution was considered, or the amendment must have been proposed by shareholders holding 3% or more of the voting power of the shares entitled to vote. Amending the articles of incorporation requires the affirmative vote of the holders of the majority of the voting power present and entitled to vote at the meeting (and of each class, if entitled to vote as a class), unless the articles of incorporation require a larger proportion. The Company's Articles of Incorporation do not require a larger proportion. Minnesota law provides that a proposed amendment may be voted upon by the holders of a class or series even if the articles of incorporation would deny that right, if among other things, the proposed amendment would increase or decrease the aggregate number of authorized shares of the class or series, change the rights or preferences of the class or series, create a new class or series of shares having rights and preferences prior and superior to the shares of that class or series or limit or deny any existing preemptive right of the shares of the class or series. Under Delaware law, the board of directors must adopt a resolution setting forth an amendment to the certificate of incorporation before the stockholders may vote on such amendment. Unless the certificate of incorporation provides otherwise, amendments to the certificate of incorporation generally require the approval of the holders of a majority of the outstanding stock entitled to vote thereon, and if the amendment would increase or decrease the number of authorized shares of any class or series or the par value of such shares, or would adversely affect the rights, powers or preferences of such class or series, a majority of the outstanding stock of such class or series also must approve the amendment.

Amendment of the Bylaws

Minnesota law provides that unless the articles of incorporation reserve the power to the shareholders, the power to adopt, amend, or repeal a corporation's bylaws is vested in the board of directors, subject to the power of the shareholders to adopt, repeal, or amend the bylaws. After adoption of initial bylaws, the board of directors of a Minnesota corporation cannot adopt, amend, or repeal a bylaw fixing a quorum for meetings of shareholders, prescribing procedures for removing

directors or filling vacancies on the board, or fixing the number of directors or their classifications, qualifications, or terms of office, but may adopt or amend a bylaw to increase the number of directors. Delaware law provides that the power to adopt, amend, or repeal bylaws remains with the corporation's stockholders, but permits the corporation, in its certificate of incorporation, to place such power in the board of directors. Under Delaware law, the fact that such power has been placed in the board of directors neither divests nor limits the stockholders' power to adopt, amend, or repeal bylaws.

Proxies

Both Minnesota and Delaware law permit proxies of definite duration. If the proxy is indefinite as to its duration, under Minnesota law it is valid for 11 months, under Delaware law, the proxy is valid for three years.

Preemptive Rights

Under Minnesota law, shareholders have preemptive rights to acquire a certain fraction of the unissued securities or rights to purchase securities of a corporation before the corporation offers them to other persons, unless the corporation's articles of incorporation provide otherwise. The Company's Articles provide that the Company's shareholders do not have preemptive rights. Under Delaware law, preemptive rights do not exist unless the corporation's certificate of incorporation specifies otherwise. BIO-key Delaware's Certificate of Incorporation does not provide for any such preemptive rights.

Dividends

Generally, a Minnesota corporation may pay a dividend if its board of directors determines that the corporation will be able to pay its debts in the ordinary course of business after paying the dividend and if, among other things, the dividend payment does not reduce the remaining net assets of the corporation below the aggregate preferential amount payable in the event of liquidation to the holders of the shares having preferential rights, unless the payment is made to those shareholders in the order and to the extent of their respective priorities. A Delaware corporation may pay dividends out of surplus or, if there is no surplus, out of net profits for the fiscal year in which the dividend is declared and/or for the preceding fiscal year, except that dividends may not be paid out of net profits if, after the payment of the dividend, capital is less than the capital represented by the outstanding stock of all classes having a preference upon the distribution of assets.

Stock Repurchases

A Minnesota corporation may acquire its own shares if, after the acquisition, it is able to pay its debts as they become due in the ordinary course of business and if enough value remains in the corporation to satisfy all preferences of senior securities. Under Delaware law, a corporation may purchase or redeem shares of any class except when its capital is impaired or such purchase would cause impairment of capital, except that a corporation may purchase or redeem any of its preferred shares if such shares will be retired upon the acquisition and the capital of the corporation will be reduced by such retirement of shares.

Dissenting Shareholder Rights in Connection with Corporate Reorganizations and Other Actions

In some circumstances under Minnesota law and Delaware law, shareholders have the right to dissent from certain corporate transactions by demanding payment in cash for their shares equal to the fair value of the shares as determined by agreement with the corporation or by a court in an action timely brought by the dissenting shareholders. Minnesota law, in general, affords dissenters' rights upon certain amendments to the articles of incorporation that materially and adversely affect the rights or preferences of the shares of the dissenting shareholder, upon the sale of substantially all corporate

assets and upon merger or exchange by a corporation, regardless of whether the shares of the corporation are listed on a national securities exchange or widely held. Delaware law allows for dissenters' rights only in connection with certain mergers or consolidations. No such appraisal rights exist, however, for corporations whose shares are listed on a national securities exchange or held of record by more than 2,000 stockholders unless the certificate of incorporation provides otherwise (the BIO-key Delaware Certificate does not provide otherwise) or the shareholders are to receive in the merger or consolidation anything other than (a) shares of stock of the corporation surviving or resulting from such merger or consolidation, (b) shares of stock of any other corporation which at the effective date of the merger or consolidation will be either listed on a national securities exchange or held of record by more than 2,000 shareholders, (c) cash in lieu of fractional shares of the corporation described in the foregoing clauses (a) and (b), or (d) any combination of clauses (a), (b), or (c). The procedures for asserting dissenters' rights in Delaware impose most of the initial costs of such assertion on the dissenting shareholder, whereas the Minnesota procedures pose little financial risk to the dissenting shareholder in demanding payment in excess of the amount the corporation determined to be the fair value of its shares.

Dissenters' Rights

Section 302A.471 of the MBCA grants any shareholder of the Company of record on June 24, 2004 who objects to the Reincorporation the right to have the Company purchase the shares owned by the dissenting shareholder at their fair value at the Effective Time. It is the present intention of the Company to abandon the Merger in the event shareholders exercise dissenter's rights and the Company becomes obligated to make a substantial payment to such dissenting shareholders.

Requirements for Exercising Dissenters' Rights

TO BE ENTITLED TO PAYMENT, THE DISSENTING SHAREHOLDER MUST FILE WITH THE COMPANY BEFORE THE VOTE FOR THE PROPOSED MERGER A WRITTEN NOTICE OF INTENT TO DEMAND PAYMENT OF THE FAIR VALUE OF THE SHARES AND MUST NOT VOTE IN FAVOR OF THE PROPOSED MERGER; PROVIDED, THAT SUCH DEMAND SHALL BE OF NO FORCE AND EFFECT IF THE PROPOSED MERGER IS NOT EFFECTED. The notice must be submitted to the Company at 1285 Corporate Center Drive, Suite 175, Eagan, Minnesota, 55121, Attention: Michael W. DePasquale, Chief Executive Officer, and must be received before the vote for the proposed Merger. The submission of a blank proxy will constitute a vote in favor of the Merger and a waiver of dissenter's rights. A vote against the Merger is not necessary for the shareholder to exercise dissenters' rights and require the Company to purchase their shares. A vote against the Merger will not be deemed to satisfy the notice requirements of state law. The liability to the dissenting shareholder for the fair value of the shares also shall be the liability of BIO-key Delaware when and if the Merger is consummated. Any shareholder contemplating the exercise of these dissenter's rights should review carefully the provisions of Sections 302A.471 and 302A.473 of the MBCA, particularly the procedural steps required to perfect such rights. SUCH DISSENTERS' RIGHTS WILL BE LOST IF THE PROCEDURAL REQUIREMENTS OF SECTIONS 302A.471 AND 302A.473 ARE NOT FULLY AND PRECISELY SATISFIED. A COPY OF SECTIONS 302A.471 AND 302A.473 IS ATTACHED AS APPENDIX D.

Notice of Procedure

If and when the proposed Reincorporation is approved by shareholders of the Company and the Reincorporation is not abandoned by the Board of Directors, the Company will deliver to all shareholders who have duly dissented to the Reincorporation a notice that: (1) lists the address to which demand for payment and certificates for shares must be sent to obtain payment for such shares and the date by which such certificates must be received; (2) describes any restriction on transfer of

uncertificated shares that will apply after the demand for payment is received; (3) encloses a form to demand payment and to be used to certify the date on which the shareholder, or the beneficial owner on whose behalf the shareholder dissents, acquired the shares or an interest in them; and (4) encloses a copy of Sections 302A.471 and 302A.473 of the MBCA and a brief description of the procedures to be followed to dissent and obtain payment of fair values for shares.

Submission of Share Certificates

To receive the fair value of his or her shares, a dissenting shareholder must demand payment and deposit his or her share certificates within 30 days after the notice is delivered by the Company, but the dissenting shareholder retains all other rights of a shareholder until the proposed action takes effect. Under Minnesota law, notice by mail is made by the Company when deposited in the United States mail. A shareholder who fails to make demand for payment and fails to deposit certificates will lose the right to receive the fair value of the shares notwithstanding the timely filing of such shareholder's notice of intent to demand payment.

Purchase of Dissenting Shares

After the Effective Time, the Company shall remit to the dissenting shareholders who have complied with the above-described procedures the amount the Company estimates to be the fair value of the shares held by such shareholders, plus interest accompanied by certain financial information about the Company, an estimate of the fair value of the shares and the method used and a copy of Sections 302A.471 and 302A.473 of the MBCA.

Acceptance or Settlement of Demand

If a dissenting shareholder believes that the amount remitted by the Company is less than the fair value of the shares, with interest, the dissenting shareholder may give written notice to the Company of his or her estimate of fair value, with interest, within 30 days after the Company mails such remittance and must demand payment of the difference. UNLESS A SHAREHOLDER MAKES SUCH A DEMAND WITHIN SUCH THIRTY-DAY PERIOD, THE SHAREHOLDER WILL BE ENTITLED ONLY TO THE AMOUNT REMITTED BY THE COMPANY. Within 60 days after the Company receives such a demand from a shareholder, it will be required either to pay the shareholder the amount demanded (or agreed to after discussion between the shareholder and the Company) or to file in court a petition requesting that the court determine the fair value of the shares, with interest.

Court Determination

All shareholders who have demanded payment for their shares, but have not reached agreement with the Company, will be made parties to such court proceeding. The court will then determine whether the dissenting shareholders have fully complied with the provisions of Section 302A.473 of the MBCA and will determine the fair value of the shares, taking into account any and all factors the court finds relevant (including the recommendation of any appraisers appointed by the court), computed by any method that the court, in its discretion, sees fit to use, whether or not such method was used by the Company or a shareholder. The expenses of the court proceeding will be assessed against the Company, except that the court may assess part or all of those costs and expenses against a shareholder whose action in demanding payment is found to be arbitrary, vexatious, or not in good faith. The fair value of the Company's shares means the fair value of the shares immediately before the Effective Time. Under Section 302A.471 of the MBCA, a shareholder of the Company has no right at law or equity to set aside the consummation of the Merger, except if such consummation is fraudulent with respect to such shareholder or the Company. Any shareholder making a demand for payment of fair value for his or her shares may withdraw the demand at any time before the determination of the fair value of the shares by filing with the Company written notice of such withdrawal.

Abandonment of Merger

Notwithstanding shareholder approval, the Board of Directors of the Company may terminate the Merger Agreement and abandon the Merger at any time before consummation of the Merger if: (i) shareholders exercise dissenter's rights and the Company becomes obligated to make a substantial payment to such dissenting shareholders; or (ii) the Board of Directors of the Company determines that in its judgment the Merger does not appear to be in the best interests of the Company or its shareholders. In the event the Merger Agreement is terminated, the Board of Directors abandons the Merger, or the Company's shareholders fail to approve the Merger, the Company would remain a Minnesota corporation.

Certain Federal Income Tax Consequences of the Merger

The Merger provided for in the Agreement and Plan of Merger is intended to be tax free under the Internal Revenue Code. Accordingly, the Company believes that no gain or loss will be recognized by shareholders for federal income tax purposes as a result of the consummation of the Merger. Each shareholder will have a tax basis in the shares of capital stock of BIO-key Delaware deemed received upon the Effective Time equal to the tax basis of the shareholder in the shares of capital stock deemed exchanged therefor, and, provided that the shareholder held the shares of capital stock as a capital asset, such shareholder's holding period for the shares of capital stock of BIO-key Delaware deemed to have been received will include the holding period of the shares of capital stock deemed exchanged therefor. No gain or loss will be recognized for federal income tax purposes by the Company or BIO-key Delaware and BIO-key Delaware will succeed, without adjustment, to the tax attributes of the Company.

NOTWITHSTANDING THE FOREGOING, SHAREHOLDERS SHOULD CONSULT THEIR OWN TAX ADVISERS REGARDING THE PARTICULAR TAX CONSEQUENCES OF THE MERGER UNDER APPLICABLE STATE, LOCAL OR FOREIGN TAX LAWS.

Required Vote for the Reincorporation

The MBCA requires an affirmative vote of a majority of all shares of Common Stock entitled to vote at the Meeting, to authorize the Reincorporation and its resulting effects. The enclosed form of Proxy provides a means for shareholders (i) to vote for the Reincorporation and its resulting effects, (ii) to vote against the Reincorporation and its resulting effects, or (iii) to abstain from voting with respect to the Reincorporation and its resulting effects. Each properly executed proxy received in time for the Meeting will be voted at such meeting as specified therein. IF A SHAREHOLDER EXECUTES AND RETURNS A PROXY BUT DOES NOT SPECIFY OTHERWISE, THE SHARES REPRESENTED BY SUCH SHAREHOLDER'S PROXY WILL BE VOTED FOR THE REINCORPORATION AND ALL ITS RESULTING EFFECTS. A vote for the proposal will constitute specific approval of the Reincorporation and its resulting effects, BIO-key Delaware's Certificate of Incorporation and Bylaws, and all transactions and proceedings related to the Reincorporation described in this Proxy Statement.

THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE "FOR" THE APPROVAL OF THE REINCORPORATION OF BIO-KEY BY MERGER FROM MINNESOTA TO DELAWARE.

RATIFICATION OF SELECTION OF INDEPENDENT AUDITORS
(Item 3 of Notice)

The Board of Directors has selected the accounting firm of Divine, Scherzer & Brody, Ltd as the Company's independent public auditors for the fiscal year ending December 31, 2004.

Stockholder ratification of the selection of Divine, Scherzer & Brody, Ltd is not required by the Company's By-Laws or otherwise. The Board of Directors, however, is submitting the selection of Divine, Scherzer & Brody, Ltd to the shareholders as a matter of good corporate practice. If the shareholders fail to ratify the selection, the Board of Directors will reconsider whether or not to retain such firm. Even if the selection is ratified, the Board, in its discretion, may direct the appointment of a different independent public accounting firm at any time during the year if they determine that such a change would be in the best interest of the Company and its shareholders. Representatives of Divine, Scherzer & Brody, Ltd are expected to be present at the Special Meeting and available to respond to appropriate questions. They will have an opportunity to make a statement if they desire to do so.

The following table presents fees for professional audit services by Divine, Scherzer & Brody, Ltd for the audit of the Company's annual financial statements for 2003 and 2002, and fees billed for other services rendered by Divine, Scherzer & Brody, Ltd.

	2003	2002
Audit Fees:	95,622	92,877
Audit-Related Fees:		
Tax Fees:	1,846	2,812
All Other Fees:		
Total Fees	97,468	95,689

"Audit Fees" consist of fees billed for professional services rendered for the audit of our financial statements and review of the interim financial statements included in quarterly reports and services that are normally provided by Divine, Scherzer & Brody, Ltd in connection with statutory and regulatory filings or engagements. "Audit-Related Fees" consist of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of the Company's consolidated financial statements and are not reported under "Audit Fees." "Tax Fees" consists of fees billed for professional services for tax compliance, tax advice and tax planning. These services include assistance regarding federal and state tax compliance, tax audit defense, customs and duties, and mergers and acquisitions.

The Board of Directors has determined that Divine, Scherzer & Brody, Ltd's provision of services other than for its audit and reviews of BIO-key's financial statements is compatible with maintaining the independence of Divine, Scherzer & Brody, Ltd. All audit and non-audit services provided by in 2002 and 2003 were approved in advance by the Board of Directors.

THE BOARD OF DIRECTORS RECOMMENDS THAT YOU VOTE "FOR" THE RATIFICATION OF THE SELECTION OF DIVINE, SCHERZER & BRODY, LTD AS OUR INDEPENDENT AUDITORS, AND PROXIES SOLICITED BY THE BOARD WILL BE VOTED IN FAVOR THEREOF UNLESS A STOCKHOLDER HAS INDICATED OTHERWISE ON THE PROXY.

EXECUTIVE COMPENSATION

Summary Compensation Table

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

		Annual Compensation			Long-Term 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						