TETON ENERGY CORP
Form 10-Q
August 14, 2006

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended June 30, 2006

o TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 001-31679

TETON ENERGY CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE	**84-1482290**
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)
410 17th Street Suite 1850 Denver, Colorado	**80202**
(Address of principal executive offices)	(Zip Code)

(303) 565-4600

(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 periods 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b 2 of the Act). (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer x

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

As of August 10, 2006, 14,698,414 shares of the issuer s common stock were outstanding.

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PART I. FINANCIAL INFORMATION

Consolidated Balance Sheets

	June 30, 2006 (Unaudited)	December 31, 2005
Assets		
Current assets		
Cash and cash equivalents	$ 5,140,044	$ 7,064,295
Trade accounts receivable	532,280	247,769
Advances to operator	227,750	224,429
Prepaid expenses and other assets	195,678	137,729
Total current assets	6,095,752	7,674,222
Non-current assets		
Oil and gas properties (using successful efforts method of accounting)		
Proved	5,980,005	1,717,213
Unproved	13,598,435	10,636,279
Wells in progress	4,000,848	2,105,884
Facilities in progress	641,506	120,554
Fixed assets	174,095	71,045
Total property and equipment	24,394,889	14,650,975
Less accumulated depreciation and depletion	(622,973)	(193,702)
Net property and equipment	23,771,916	14,457,273
Debt issuance costs	190,328	
Total non-current assets	23,962,244	14,457,273
Total assets	$ 30,057,996	$ 22,131,495
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	3,796,185	1,281,457
Accrued liabilities	159,695	297,351
Accrued payroll and severance	555,776	396,589
Accrued royalties		94,403
Accrued franchise taxes payable	23,569	62,025
Deposits on sale of assets		300,000
Accrued liability of discontinued operations		255,000
Accrued purchase consideration	3,699,311	
Total current liabilities	8,234,536	2,686,825
Long-term liability		
Asset retirement obligations	24,342	3,851
Commitments and contingencies		
Stockholders equity		
Common stock, $0.001 par value, 250,000,000 shares authorized, 12,262,392 and 11,329,652 shares issued and outstanding at June 30, 2006 and December 31, 2005, respectively	12,262	11,329
Additional paid-in capital	47,879,540	43,929,216
Accrued stock based compensation	1,196,013	
Accumulated deficit	(27,288,697)	(24,499,726)
Total stockholders equity	21,799,118	19,440,819
Total liabilities and stockholders equity	$ 30,057,996	$ 22,131,495

See notes to unaudited consolidated financial statements

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TETON ENERGY CORPORATION

Unaudited Consolidated Statements of Operations and Comprehensive Loss

	For the Three Months Ended June 30, 2006	2005
Oil and gas sales	$ 650,234	$
Cost of sales and expenses:		
Lease operating expenses	114,410	
Production taxes	11,832	
General and administrative	1,705,942	1,581,743
Depreciation and depletion	330,173	4,953
Exploration	74,745	113,654
Total cost of sales and expenses	2,237,102	1,700,350
Loss from operations	(1,586,868)	(1,700,350)
Other income		
Other income	60,523	55,657
Total other income	60,523	55,657
Net loss	(1,526,345)	(1,644,693)
Preferred stock dividend		(24,487)
Net loss applicable to common shares	$ (1,526,345)	$ (1,669,180)
Basic and diluted weighted average common shares outstanding	12,017,214	9,871,569
Basic and diluted loss per common share	$ (.13)	$ (.17)

See notes to unaudited consolidated financial statements.

TETON ENERGY CORPORATION

Unaudited Consolidated Statements of Operations and Comprehensive Loss

	For the Six Months Ended June 30, 2006	2005
Oil and gas sales	$ 940,483	$
Cost and expenses:		
Lease operating expenses	148,198	
Production taxes	19,850	
General and administrative	3,048,745	2,273,740
Depreciation and depletion	425,939	9,850
Exploration	215,262	150,880
Total cost of sales and expenses	3,857,994	2,434,470
Loss from operations	(2,917,511)	(2,434,470)
Other income		
Other income	128,540	134,270
Total other income	128,540	134,270
Net loss	(2,788,971)	(2,300,200)
Preferred stock dividend		(48,975)
Net loss applicable to common shares	$ (2,788,971)	$ (2,349,175)
Basic and diluted weighted average common shares outstanding	11,821,760	9,636,420
Basic and diluted loss per common share	$ (.24)	$ (.24)

See notes to unaudited consolidated financial statements.

TETON ENERGY CORPORATION

Unaudited Consolidated Statements of Cash Flows

	For the Six Months Ended June 30, 2006	2005
Cash flows from operating activities		
Net loss	$ (2,788,971)	$ (2,300,200)
Adjustments to reconcile net loss to net cash used in operating Activities		
Depreciation and depletion	425,939	9,850
Accrued stock based compensation, net of stock returned	1,038,513	834,775
Changes in assets and liabilities		
From discontinued operations	(255,000)	
Trade accounts receivable	(284,511)	
Advances to operator	(3,321)	
Prepaid expenses and other current assets	(57,949)	(313,044)
Accounts payable and accrued liabilities	497,324	201,907
Accrued royalties, franchise taxes and payroll and severance	26,328	
	1,387,323	733,488
Net cash used in operating activities	(1,401,648)	(1,566,712)
Cash flows from investing activities		
Proceeds from sale of oil and gas properties	2,700,000	
Increase in fixed assets	(103,050)	(5,345)
Increase in oil and gas properties	(7,037,981)	(8,755,835)
Net cash used in investing activities	(4,441,031)	(8,761,180)
Cash flows from financing activities		
Proceeds from exercise of warrants and issuance of stock, net of issue costs of $0 and $48,862, respectively	4,108,756	248,527
Debt issuance costs from bank debt	(190,328)	
Payment of dividends		(48,975)
Net cash provided by financing activities	3,918,428	199,552
Net decrease in cash and cash equivalents	(1,924,251)	(10,128,340)
Cash and cash equivalents- beginning of year	7,064,295	17,433,424
Cash and cash equivalents - end of period	$ 5,140,044	$ 7,305,084
Supplemental Cash Flow Information:		
Non-cash accruals for awards in respect of stock based compensation	$ 1,196,013	$
Reduction in service fees	$ 157,500	$
Deposit applied to oil and gas properties Note 1	$ 300,000	$
Capital expenditures included in accounts payable	$ 1,879,748	$ 282,500
Accrued purchase consideration. Note 1	$ 3,699,311	$
Common stock and warrants issued for the acquisition of PGR LLC	$	$ 1,088,949
Common stock issued for accounting and legal services	$	$ 905,625
Common stock issued for settlement of accrued liabilities	$	$ 10,500
Common stock issued for services by outside director	$	$ 39,400
Common stock and warrants issued for the acquisition of oil and gas properties	$	$ 792,928

See notes to unaudited consolidated financial statements.

TETON ENERGY CORPORATION

Notes to Unaudited Consolidated Financial Statements

Note 1 Organization and Summary of Significant Accounting Policies

Organization

Teton Energy Corporation (the Company, Teton, we, or us) was formed in November 1996 and is incorporated in the State of Delaware. We ar an independent energy company engaged primarily in the development, production, and marketing of natural gas and oil in North America. Our strategy is to increase shareholder value by profitably growing reserves and production, primarily through acquiring under-valued properties with reasonable risk-reward potential and by participating in or actively conducting drilling operations in order to exploit our properties. We seek high-quality exploration and development projects with potential for providing long-term drilling inventories that generate high returns.

Interim Reporting

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC), they do not necessarily include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements include all adjustments (consisting of normal and recurring accruals) considered necessary to present fairly our financial position as of June 30, 2006, the results of operations for the three and six months ended June 30, 2006, and 2005, and cash flows for the six months ended June 30, 2006, and 2005. For a more complete understanding of our operations, financial position and accounting policies, these consolidated unaudited financial statements and the notes thereto should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2005, previously filed with the SEC on March 10, 2006.

In the course of preparing the consolidated financial statements, management makes various assumptions, judgments, and estimates to determine the reported amount of assets, liabilities, revenue and expenses, and in the disclosures of commitments and contingencies. Changes in these assumptions, judgments, and estimates will occur as a result of the passage of time and the occurrence of future events and, accordingly, actual results could differ from amounts initially established.

The more significant areas requiring the use of assumptions, judgments, and estimates relate to volumes of natural gas and oil reserves used in calculating depletion, the amount of expected future cash flows used in determining possible impairments of oil and gas proved and unproved properties, and the amount of future capital costs used in such calculations. Assumptions, judgments, and estimates also are required in determining future abandonment obligations.

Principles of Consolidation

The consolidated financial statements include the accounts of all wholly owned and majority-owned subsidiaries. All inter-company profits, transactions, and balances have been eliminated. As is common in the oil and gas industry, we use pro rata consolidation for investments in partnerships and limited liability companies (LLC). In making such determination the Company will review the LLC operating agreement to determine if the characteristics of the LLC are more like a corporation or more like a partnership.

Sale of Oil and Gas Properties

Effective December 31, 2005, we entered into an Acreage Earning Agreement (the Agreement) with Noble Energy, Inc. (Noble), which closed on January 27, 2006. Under the terms of the Agreement, Noble will retain a 75% working interest in our DJ Basin acreage after drilling 20 wells by March 1, 2007 at no cost to us. During that time, we will receive 25% of any revenues derived from the first 20 wells. After completion of the first 20 wells, we will split with Noble all costs associated with future drilling according to each party s working interest percentage.

We have recorded the entire $3,000,000 (including $300,000, which was reflected as a deposit at December 31, 2005) as a reduction of the investment in our DJ Basin property.

Purchase of Oil and Gas Properties

On May 5, 2006, we closed a definitive agreement with American Oil and Gas, Inc. (American) acquiring a 25% working interest in approximately 59,000 net acres in the Williston Basin located in North Dakota for a total purchase price of $6.17 million.

Per the terms of the agreement, the Company paid American approximately $2.47 million in cash at closing and will pay an additional $3.7 million to American for their 50% share of drilling and completion on the two planned wells through June 1, 2007. Any portion of the $3.7 million not expended for drilling and completion by June 1, 2007, will be paid to American on that date. In addition, to our obligation to fund America s share, we are also obligated to pay costs in respect of our own 25% share of drilling and completion costs of such wells during the same time period.

In addition to our 25% interest, we have two partners in the acreage: American, which has a 50% working interest in the acreage, and Evertson Energy Company (Everston), which has a 25% interest. Current plans call for an affiliate of Everston to drill one multi-lateral horizontal well in 2006 at an estimated cost of $4.5 million to $5.5 million to test the acreage.

Revenue Recognition

Oil and natural gas revenue is recognized monthly based on production and delivery. We follow the sales method of accounting for our natural gas and crude oil revenue, so that we recognize sales revenue on all natural gas or crude oil sold to our purchasers at a fixed or determinable price, when delivery has occurred and title has transferred, and if collectibility of the revenue is probable. Processing costs for natural gas that are paid in-kind are deducted from our revenues.

The volume of natural gas sold may differ from the volume to which we are entitled based on our working interest. An imbalance is recognized as a liability only when the estimated remaining reserves will not be sufficient to enable the under-produced owner(s) to recoup its entitled share through future production. Natural gas imbalances can arise on properties for which two or more owners have the right to take production in-kind. In a typical gas balancing arrangement, each owner is entitled to an agreed-upon percentage of a property s total production; however, at any given time, the amount of natural gas sold by each owner may differ from its allowable percentage. Two principal accounting practices have evolved to account for natural gas imbalances. These methods differ as to whether revenue is recognized based on the actual sale of natural gas (sales method) or an owner s entitled share of the current period s production (entitlement method). We have elected to use the sales method. If we used the entitlement method, our future reported revenues may be materially different than those reported under the sales method.

At June 30, 2006, there are no liabilities in respect of gas balancing arrangements.

Successful Efforts Method of Accounting

We account for our crude oil exploration and natural gas development activities utilizing the successful efforts method of accounting. Under this method, costs of productive exploratory wells, development dry holes and productive wells and undeveloped leases are capitalized. Oil and gas lease acquisition costs are also capitalized. Exploration costs, including personnel costs, certain geological and geophysical expenses and delay rentals for oil and gas leases, are charged to expense as incurred. Exploratory drilling costs are initially capitalized, but charged to expense if and when the well is determined not to have found reserves in commercial quantities. The sale of a partial interest in a proved property is accounted for as a cost recovery and no gain or loss is recognized as long as this treatment does not significantly affect the unit-of-production amortization rate. A gain or loss is recognized for all other sales of producing properties.

The application of the successful efforts method of accounting requires managerial judgment to determine the proper classification of wells designated as developmental or exploratory that will ultimately determine the proper accounting treatment of the costs incurred. The results from a drilling operation can take considerable time to analyze and the determination that commercial reserves have been discovered requires both judgment and industry experience. Wells may be completed that are assumed to be productive and actually deliver oil and gas in quantities insufficient to be economic, which may result in the abandonment of the wells at a later date. Wells are drilled that have targeted geologic structures that are both developmental and exploratory in nature and an allocation of costs is required properly to account for the results. Delineation seismic incurred to select development locations within an oil and gas field is typically considered a development cost and capitalized, but often these seismic programs extend beyond the reserve area considered proved and management must estimate the portion of the seismic costs to expense. The evaluation of oil and gas leasehold acquisition costs requires managerial judgment to estimate the fair value of these costs with reference to drilling activity in a given area. Drilling activities in an area by other companies may also effectively condemn leasehold positions.

The successful efforts method of accounting can have a significant impact on the operational results reported when the Company is entering a new exploratory area in an effort to find an oil and gas field that will be the focus of future development drilling activity. The initial exploratory wells may be unsuccessful and will be expensed. Seismic costs can be substantial, which will result in additional exploration expenses when incurred.

Note 2 Earnings per Share

Basic earnings per common share (EPS) are computed by dividing income available to common stockholders by the weighted-average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that would occur if securities or other contracts to issue common stock were exercised or converted into common stock. All potential dilutive securities have an anti-dilutive effect on earnings (loss) per share and accordingly, basic and dilutive weighted average shares are the same.

Note 3 Revolving Credit Facility

On June 15, 2006, the Company entered into a $50 million revolving credit facility (the Credit Facility) with BNP Paribas as administrative agent, sole lead arranger, and sole book runner. The Credit Facility matures on June 15, 2010.

The Credit Facility provides for as much as $50 million in borrowing capacity, depending upon a number of factors, such as the projected value of our proven oil and gas assets. The borrowing base for the Credit Facility at any time will be the loan value assigned to the proved reserves attributable to our and/or our subsidiaries direct or indirect oil and gas interests. The Credit Facility has an initial borrowing base of $3.0 million. The borrowing base will be redetermined on a semi-annual basis, based upon an engineering report delivered by us from an approved petroleum engineer. The Credit Facility is available for working capital requirements, capital expenditures, acquisitions, general corporate purposes and to support letters of credit.

Under the Credit Facility, each loan bears interest at a Eurodollar rate or a base rate, as requested by us, plus an additional margin based on the amount of our total outstanding borrowings relative to the total borrowing base. The Eurodollar rate is based on the London Interbank Offered Rate. The base rate is the higher of the Prime Rate or the Federal Funds Rate plus one-half of one percent. In addition, under the terms of the Credit Facility, we are required to pay a commitment fee based on the average daily amount of the unused amount of the commitment of each lender. This fee accrues at a rate of 0.05% per annum and is paid quarterly in arrears on the last day of March, June, September, and December of each year and on the date on which the Credit Facility is terminated. Loans made under the Credit Facility are secured by a first mortgage against the Company s properties, a pledge of the equity of our subsidiaries and a guaranty by those same subsidiaries.

The Credit Facility contains customary affirmative and negative covenants such as minimum/maximum ratios for liquidity and leverage. Under the terms of the Credit Facility, certain covenants are not immediately effective and are phased in beginning at the end of the first quarter of 2007 and are then gradually phased-in over the first three quarters of 2007. As of June 30, 2006, there were no outstanding balances associated with the credit facility.

Note 4 Stockholders Equity

Our authorized capital stock consists of 250,000,000 shares of common stock, $.001 par value per share.

During the six months ended June 30, 2006, 980,835 warrants and options were exercised, purchasing an equivalent of number of common shares of the Company for net proceeds to the Company of $4,108,756.

In connection with the resignation of our former contract Chief Financial Officer effective March 31, 2006, 50,000 restricted shares of common stock were returned to us as an agreed-upon reduction in service fees charged. The return of such shares had been recorded as a reduction in accounting fees totaling $157,500 at March 31, 2006.

On June 2, 2005, our Board of Directors declared a dividend distribution of one Preferred Stock Purchase Right (each a Right and collectively the Rights) for each outstanding share of Common Stock, $0.001 par value (Common Stock), of the Company. The distribution was paid as of June 14, 2005 (the Record Date), to stockholders of record on that date. Each Right entitles the registered holder to purchase from the Company one one-hundredth of a share of the Company s Series C Preferred Stock, $0.001 par value at a price of $22.00, subject to adjustment on the occurrence of certain events which generally involve a person acquiring 15% of the Company s Common Stock without the permission of our Board of Directors. The description and terms of the Rights are set forth in the Rights Agreement dated as of June 3, 2005, between the Company and Computershare Investor Services, LLC, as Rights Agent.

Note 5 Stock-based Compensation

At June 30, 2006, we had several stock-based compensation plans, which are more fully described in Note 8 in our Annual Report on Form 10-K for the year ended 2005.

Prior to 2006, we accounted for those plans under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, as permitted by SFAS No. 123. Effective January 1, 2006, we adopted Statement of Financial Accounting Standard 123R Share-Based

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Payment (SFAS 123R) which applies to all employee awards granted, modified, or settled after January 1, 2006. SFAS No. 123R establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods and services, focusing primarily on accounting for transactions in which an entity obtains employee services in share-based payment transactions. It also addresses transactions in which an entity incurs liabilities in exchange for goods and services that are based on the fair value of the entity s equity instruments or that may be settled by the issuance of those equity instruments.

SFAS No. 123R requires measurement of the cost of share-based payment transactions to employees at the fair value of the award on the grant date and recognition of expense over the requisite service or vesting period. SFAS No. 123R requires implementation using a modified version of prospective application, under which compensation expense for the unvested portion of previously granted awards and all new awards will be recognized on or after the date of adoption. SFAS No. 123R also allows companies to adopt SFAS No. 123R by restating previously issued financial statements, basing the amounts on the expense previously calculated and reported in their pro forma footnote disclosures required under SFAS No. 123. The provisions of SFAS No. 123R were adopted by the Company effective January 1, 2006, using the modified prospective application method.

APB 25 did not require any compensation expense to be recorded in the financial statements if the exercise price of the award was not less than the market price on the date of grant. Prior to July 2005, the Company issued only stock options and since all options granted by the Company had exercise prices equal to or greater than the market price on the date of the grant, no compensation expense was recognized for stock option grants prior to January 1, 2006.

Awards under our 2003 Employee Stock Compensation Plan vest in periodic installments after their grant and expire 10 years from grant date. Therefore, the cost related to stock-based employee compensation included in the determination of net income in 2005 is less than that which would have been recognized if the fair value based method had been applied to all awards since the original effective date of SFAS 123. Awards under our 2005 Long-term Incentive Plan (LTIP) vest upon the attainment of one, two, and three year performance milestones. During the second quarter of 2005, we issued 45,000 options to certain employees that vest in equal tranches for three years, and are described in further detail below.

Stock options granted during 2005 under the 2003 Plan will vest over a three year period and a pro rata portion of the anticipated total expense of that grant or $9,863 was accrued during the three-month period ending March 31, 2006, to account for the pro rata portion attributable for the first quarter of 2006. An additional accrual of $9,863 has been made to reflect the balance in respect of that portion of the grant that vested during the quarter ended June 30, 2006. These options are exercisable at $3.11 per share and vest over a three-year period, assuming the employees remain in our employ. These stock options were valued at $118,529 on the grant date using the Black-Scholes option-pricing model with the following assumptions: volatility of 109.46%, a risk-free rate of 4%, zero dividend payments and a life of 10 years. Vested and unvested options outstanding under the Plan at June 30, 2006, are 2,524,434 shares with exercise prices ranging from $3.11 to $3.71 per share.

A summary of stock option activity under our stock-based compensation plans for the six months ended June 30, 2006 is summarized below:

	Number Outstanding (in thousands)	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term (in years)**	**Aggregate Intrinsic Value (in thousands)**
Outstanding at December 31, 2005	2,875	$ 3.54		
Granted				
Exercised	351	3.53		
Forfeited or Expired				
Outstanding at June 30, 2006	2,524	$ 3.54	5.69	$ 5,478
Exercisable at June 30, 2006	2,494	$ 3.55	5.66	$ 5,400

There were no options granted during the six months ended June 30, 2006. As of June 30, 2006, the total unrecognized compensation cost adjusted for estimated forfeitures related to non-vested options was $78,900, which is expected to be recognized over a weighed average period of approximately 24 months or 8 remaining quarters.

On June 28, 2005, the Company s shareholders approved a long-term incentive plan (the LTIP) that permits the grant of unvested share awards, grants, options, performance share units, and share equivalents to employees, directors, consultants and vendors as directed by the Compensation Committee of the Board of Directors, with management recommendations

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regarding consultants, vendors, and non-executive employees.

Grants were made in the third quarter of 2005 (the 2005 Grants) and the first and second quarters of 2006 (the 2006 Grants), each of which vest over a one, two, and three year performance period assuming specified goals are achieved. The number of shares that are finally awarded to LTIP participants is both fixed and variable. It is fixed as it is based in part upon being in the Company s service at the time of vesting and is variable because achievement of a combination of performance-related objectives as determined by the Compensation Committee of the Board of Directors is mandatory for vesting. Performance objectives established by the Compensation Committee include: reserve and production growth, expense management, stock performance, management efficiency and effectiveness, and completion of acquisitions.

The 2005 Grants totaled 400,000 performance share units (each unit equivalent to one share of common stock, assuming vesting) in respect of the target or base objectives and 800,000 performance share units in respect of stretch objectives. The 2005 Grants called for vesting of 20% in 2005, 30% in 2006 and 50% in 2007, provided the milestones are achieved. The number of shares finally awarded will range from zero shares if the minimum criteria are not met, to 200% of the target award if all criteria are met at the stretch objective level each year. The calculation is based upon a weighted average calculation using the weighting percentages specified by the Board of Directors. Valuation of the 2005 Grants was $4.88 per share, based upon the closing price on the date of the grant, July 26, 2005. No performance grant shares vested in 2005. Of the 392,500 performance share units awarded in respect of the base case 2005 Grant, 92,500 performance share units were forfeited because of early Terminations, as defined in the LTIP as of June 30, 2006.

The 2006 Grants of performance share unit grants were awarded by the Compensation Committee of the Board of Directors during the first quarter of 2006. The 2006 Grants reserved 1,250,000 performance share units in respect of base performance and 2,500,000 in respect to achievement of stretch objectives. Each performance share unit is equivalent to one share of common stock, assuming vesting. Performance share units are performance plus service based, and vest over a one, two, and three year period (20% in 2006, 30% in 2007 and 50% in 2008, respectively), assuming both performance targets and service requirements are met. These grants are valued at $6.86, the weighted average of the closing price of the Company s stock as reported by the American Stock Exchange on the date of the grant. The range of the grants that vest are from 0 to 200%, based upon relative achievement of the goals. To date, not all performance share units reserved have been awarded. For the first and second quarters, expense was not recognized for shares reserved for anticipated new hires (including hires after June 30, 2006) and consultants, as well as planned Terminations, as defined in the LTIP. Thus, 352,500 of 1,250,000 performance share units authorized in respect of base targets were not recognized as expense in the six months ended June 30, 2006. During the second quarter ended June 30, 2006, we issued 175,000 performance share units to new hires. Of the 908,625 performance share units awarded in respect of the base case 2006 Grants, 11,125 performance share units were forfeited because of early Terminations, as of June 30, 2006.

A summary of the status of performance share units granted under our LTIP as of June 30, 2006, and changes during the six month period ended June 30, 2006, are presented below:

	Six Months Ended June 30, 2006	
(performance share unit data in thousands)	**Performance Share Units**	**Weighted-Average Grant Date Fair Value**
Outstanding at beginning of year	392.5	$ 4.88
Granted	908.6	$ 6.86
Vested and released		
Forfeited/cancelled	(103.6)	$ 5.10
Outstanding at end of period	1,197.5	$ 6.36

Due to the variable number of shares that may be issued under the LTIP, we reevaluate the LTIP expectations on a quarterly basis and adjust the number of shares to be awarded based upon our results at the time of reevaluation and the expectations for change in performance as compared to the goals that must be achieved. Adjustments to the number of shares expected to be awarded, and the corresponding compensation expense, are made on a cumulative basis at the date of adjustment based upon the probable number of shares to be awarded.

Compensation cost for both restricted shares and performance share units is calculated by taking the pro-rata portion of the number of shares expected to vest in the current fiscal year multiplied by the fair-value price on the date of the grant and amounted to $938,273 for the six months ended June 30, 2006. During the six months ended June 30, 2005, we did not award any restricted stock or performance share units under the LTIP (which had not yet been authorized by our Shareholders), and accordingly, no equivalent expense was charged to earnings.

In December 2005, grants of 195,000 restricted shares were made, which vest equally over 3 years, beginning January 1, 2006, and are based solely on service. These grants were valued at $6.06 per share, the closing price on the date of the grant. These shares will be issued only upon satisfaction of the vesting conditions. On April 1, 2006, a grant of 15,000 restricted shares was made to an executive which vest in equal installments on January 1, 2007, January 1, 2008 and January 1, 2009, provided the executive remains in our employ. This grant was valued at $6.91 per share. A grant of 20,000 shares was made to an executive, which grant vests in equal installments over a three year period beginning June 1, 2006, provided the executive remains in the our employ. This grant was valued at $6.57 per share. Prior to his becoming a director, a grant of 5,000 shares was made to a consultant (who became a director in June 2006) for services provided. The shares issued to the consultant vested at the date of grant were valued at $6.34 per share. Compensation expense for the restricted stock is $238,014 for the six months ended June 30, 2006. There was no share based compensation expense for the six months ended June 30, 2005.

The fair value of restricted stock issued pursuant to the Company s LTIP is determined based on the market value of the common stock on the grant date. A summary of the status of restricted stock activity granted under our LTIP for the six month period ended June 30, 2006, is summarized below:

	Restricted Stock (in thousands)		**Weighted Average Grant-Date Fair Value**	
Non-vested at December 31, 2005	195		$	6.06
Granted	40		$	6.67
Vested	(5	)	6.34	
Forfeited				
Non-vested at June 30, 2006	230		$	6.16

Note 6 Commitments and Contingencies

Mr. Arleth, our President and Chief Executive Officer, signed an employment agreement on May 1, 2003. The agreement is for a three-year term, with an initial salary of $10,000 per month that was increased to $15,000 per month beginning in January 2004 and $20,833 beginning January 2006. Under the terms of the agreement, Mr. Arleth is entitled to 24 months severance pay in the event of a change of position or change in control of the Company. The agreement contains an evergreen provision, which automatically extends the term of Mr. Arleth s agreement for a two-year period if the agreement is not terminated by notice by either party at least 60 days prior to the end of the stated term.

Mr. Pennington, our Executive Vice President and Chief Financial Officer, signed an employment agreement on June 1, 2006. The initial salary is $190,000 per year. Under the terms of the agreement, Mr. Pennington is entitled to 12 months severance pay in the event of a change of position or change in control of the Company. The agreement contains an evergreen provision, which automatically extends the term of Mr. Pennington s agreement for a two-year period if the agreement is not terminated by notice by either party at least 60 days prior to the end of the initial stated term which is one year.

Mr. Schultz, our Vice President of Production, signed an employment agreement on April 1, 2006. The initial salary is $165,000 per year. Under the terms of the agreement, Mr. Schultz is entitled to six months severance pay in the event of a change of position or change in control of the Company. The agreement contains an evergreen provision, which automatically extends the term of Mr. Schultz s agreement for a two-year period if the agreement is not terminated by notice by either party at least 60 days prior to the end of the initial stated term, which is one year.

We have entered into a three-year lease for office space, which expires in April 30, 2009. Contractual commitments under this lease are $31,847 for 2006, $63,694 for 2007, $66,412 for 2008, and $23,043 for 2009.

During 2005, we established a Simple IRA plan, allowing for the deferral of employee income. The plan provides for us to match employee contributions up to 3% of gross awards. For the three and six months ended June 30, 2006, we contributed $12,952 and $19,197 to such plan, respectively.

Note 7 Subsequent Event

On July 27, 2006, we announced that we closed a public offering of 2,300,000 shares of our common stock, which was priced on July 27, 2006 at $5.20 per share. Total shares delivered at closing included the underwriter s over-allotment option to purchase 300,000 additional common shares, which was exercised at closing. We received net proceeds from the offering of $11.04 million. The Company intends to use the proceeds raised from the offering for working capital, acquisitions and general corporate purposes.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

FORWARD LOOKING STATEMENTS

With the exception of historical matters, the matters discussed herein are forward looking statements that involve risks and uncertainties. Forward looking statements include, but are not limited to, statements concerning anticipated trends in revenues, and may include words or phrases such as will likely result, are expected to, will continue, is anticipated, estimate, projected, intends to, or similar expressions, which are intended to identify forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Our actual results could differ materially from the results discussed in such forward-looking statements. There is absolutely no assurance that we will achieve the results expressed or implied in forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, market prices for natural gas and oil, economic and competitive conditions, regulatory changes, estimates of proved reserves, potential failure to achieve production from development projects, capital expenditures and other uncertainties, our ability to successfully implement our strategy to acquire additional oil and gas properties and our ability to successfully manage and operate our newly acquired oil and gas properties or any properties subsequently acquired by us as well as those factors discussed below and in our Annual Report on Form 10-K for the year ended December 31, 2005, under the subsection Caution Forward-Looking Statements in the Management s Discussion and Analysis of Financial Condition and Results of Operations section, all of which are difficult to predict. In light of these risks, uncertainties and assumptions, the forward-looking events discussed may not occur.

Management Discussion And Analysis

Overview

Teton Energy Corporation (the Company, Teton, we, or us) was formed in November 1996 and is incorporated in the State of Delaware. We a an independent energy company engaged primarily in the development, production, and marketing of natural gas and oil in North America. Our strategy is to increase shareholder value by profitably growing reserves and production, primarily through acquiring under-valued properties with reasonable risk-reward potential and by participating in or actively conducting drilling operations in order to exploit our properties. We seek high-quality exploration and development projects with potential for providing long-term drilling inventories that generate high returns.

Accomplishments and Highlights, Quarter Ended June 30, 2006

Our current operations are located in the Rocky Mountain region of the United States.

Financial and operational highlights for the quarter ended June 30, 2006 include the following:

- Our net loss decreased to $1,526,345 ($.13 per share) for the three month period ended June 30, 2006 from $1,669,180 ($.17 per share) for the same period in 2006.

- Our revenue from the sale of natural gas was $650,234, which is based on the sale of 131,343 mcf of natural gas at an average price of $4.95 per mcf after a total deduction of $101,797 for gathering, fuel, transportation and marketing expenses, net to the Company.

- We participated in the drilling of six wells in the current quarter to total depth on its acreage in the Piceance Basin of Colorado. We also completed seven wells in the quarter of which five wells were drilled in 2005 and two wells were drilled pt; BACKGROUND-COLOR: #ffffff" noWrap> 157,253 (126,111

)

-80

%

$(161,955

)

$155,548 $(317,503

)

-204

%

Interest income for the years ended December 31, 2015 and 2014 consisted of bank interest.

Interest expense for the year ended December 31, 2015 represented the amortized original issue discount, the amortized debt discount from the warrant liabilities, and the interest charge under a promissory note we issued in September 2015.

During the fourth quarters of 2013 and 2014 and third quarter of 2015, we issued various warrants that contained derivative liabilities. Such derivative liabilities are required to be marked-to-market each reporting period.

LIQUIDITY AND CAPITAL RESOURCES

Operating activities overview

Net cash used for operations during the year ended December 31, 2015 was approximately $15,560,000. Items of note were as follows:

Negative cash flows from the purchase of software licenses of $12,000,000 and other inventory of approximately $337,000

Negative cash flows related to an increase in accounts receivable, less movements in prepayments, accounts payable, and accrued expenses of approximately $1,804,000, due to working capital management, and

Net positive cash flows related to the adjustments for depreciation, amortization, share-based compensation, debt discount, and fair value adjustments of approximately $442,000

Investing activities overview

Net cash used for investing activities during the year ended December 31, 2015 was approximately $3,000 and was due to the purchase of capital expenditures.

Financing activities overview

Net cash provided by financing activities during the year ended December 31, 2015 was approximately $19,041,000 and attributable primarily to the following:

Positive cash flows from the issuance of shares of preferred stock and warrants of approximately $19,500,000, net of dividends and financing costs of approximately $459,000.

CAPITAL RESOURCES

Since our inception, our capital needs have been principally met through proceeds from the sale of equity and debt securities. We expect capital expenditures to be less than $100,000 during the next twelve months. We do not currently maintain a line of credit or term loan with any commercial bank or other financial institution.

The following sets forth our primary sources of capital during the previous two years:

As of December 2011, we entered into a 24-month accounts receivable factoring arrangement with a financial institution (the “Factor”). Pursuant to the terms of this arrangement, from time to time, we sell to the Factor certain of our accounts receivable balances on a non-recourse basis for credit approved accounts. The Factor remits 35% of the foreign and 75% of the accounts receivable balance to us (the “Advance Amount”), with the remaining balance, less fees to be forwarded to the Company once the Factor collects the full accounts receivable balance from the customer. In addition, the Company, from time to time, receives over advances from the factor. Factoring fees range from 2.75% to 21% of the face value of the invoice factored and are determined by the number of days required for collection of the invoice. In April 2012, the terms were updated from monthly to quarterly, and the 24-month arrangement was extended to August 1, 2014. In July of 2014, the arrangement was extended to July 31, 2016. We expect to continue to use this factoring arrangement periodically to assist with our general working capital requirements due to contractual requirements.

In November 2014, we issued an aggregate of 7,974,999 shares of our common stock and warrants to purchase an additional 11,962,499 shares of common stock for an aggregate purchase price of $1,595,000 prior to a deduction for expenses. The warrants have a term of five years and an exercise price of $0.30 per share.

On September 23, 2015, we issued a promissory note and a warrant to purchase 833,333 shares of common stock for an aggregate principal sum of $250,000. The warrants have a term of five years and have an exercise price of $0.30 per share. The note was repaid in full in October 2015.

On October 22 and 29, 2015, we issued 84,500 shares (the “Series A-1 Shares”) of Series A-1 Convertible Preferred Stock at a purchase price of $100.00 per share, for aggregate gross proceeds of $8,450,000. The Series A-1 Shares are convertible at any time at the option of the holder into shares of common stock at an initial conversion price of $0.30 per share, subject to adjustment for stock dividends, stock splits, combinations, and reclassifications of our capital stock, and subject to a “blocker provision” which prohibits conversion if such conversion would result in the holder being the beneficial owner of in excess of 9.99% of our common stock. The Series A-1 Shares accrue dividends at the rate of 6% per annum payable quarterly on April 1, July, 1, October 1, and January 1 of each year payable in cash through October 1, 2017 and thereafter, in cash or kind through the issuance of additional shares of common stock having a value equal to the volume weighted average trading price of the Company's common stock for the ten (10) days preceding the applicable dividend payment date.

On November 11, 2015, we issued 105,000 shares (the "Series B-1 Shares") of Series B-1 Convertible Preferred Stock at a purchase price of $100.00 per share, for gross proceeds of $10,500,000, and 5,500 additional shares of Series A-1 Convertible Preferred Stock at a purchase price of $100.00 per share, for gross cash proceeds of $550,000. The Series B-1 Shares are convertible at any time at the option of the holder into shares of common stock at an initial conversion price of $0.30 per share, subject to adjustment for stock dividends, stock splits, combinations, and reclassifications of our capital stock, and subject to a "blocker provision" which prohibits conversion if such conversion would result in the holder being the beneficial owner of in excess of 9.99% of our common stock. The Series B-1 Shares accrue dividends at the rate of 2.5% per annum payable quarterly on April 1, July, 1, October 1, and January 1 of each year payable in cash.

LIQUIDITY OUTLOOK

At December 31, 2015, our total cash and cash equivalents were approximately $4,321,000, as compared to approximately $844,000 at December 31, 2014.

As discussed above, we have historically financed our operations through access to the capital markets by issuing secured and convertible debt securities, convertible preferred stock, common stock, and through factoring receivables. We currently require approximately $512,000 per month to conduct our operations, a monthly amount that we have been unable to consistently achieve through revenue generation. During 2015, we generated approximately $5,261,000 of revenue, which is below our average monthly requirements. With the addition of the dividend obligations for the Series A-1 and B-1 shares, our monthly amount will increase by approximately $67,000. With our recent fourth quarter capital raise, we believe our current cash resources are sufficient to fund our operations for at least the next twelve months.

If we are unable to generate sufficient revenue to fund current operations or 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. We may, therefore, need to obtain additional financing through the issuance of debt or equity securities.

Due to several factors, including our history of losses and limited revenue, our independent auditors have included an explanatory paragraph in their opinion related to our annual financial statements as to the substantial doubt about our ability to continue as a going concern. Our long-term viability and growth will depend upon the successful commercialization of our technologies and our ability to obtain adequate financing. To the extent that we require such additional financing, no assurance can be given that any form of additional financing will be available on terms acceptable to us, that adequate financing will be obtained to meet our needs, or that such financing would not be dilutive to existing stockholders. If available financing is insufficient or unavailable or we fail to continue to generate sufficient revenue, we may be required to further reduce operating expenses, delay the expansion of operations, be unable to pursue merger or acquisition candidates, or continue as a going concern.

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements that have, or are in the opinion of management reasonably likely to have, a current or future effect on our financial condition or results of operations.

CRITICAL ACCOUNTING POLICIES

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Our actual results may differ significantly from these estimates under different assumptions or conditions. There have been no material changes to these estimates for the periods presented in this Annual Report on Form 10-K.

We believe that of our significant accounting policies, which are described in Note A of the notes to our consolidated financial statements included in this Annual Report on Form 10-K, the following accounting policies involve a greater degree of judgment and complexity. Accordingly, these are the policies we believe are the most critical to aid in fully understanding and evaluating our financial condition and results of operations.

1. Revenue Recognition

Revenues from software licensing are recognized in accordance with ASC 985-605, “Software Revenue Recognition." Accordingly, revenue from software licensing is recognized when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is probable.

The Company intends to enter into arrangements with end users for items which may include software license fees, and services or various combinations thereof. For each arrangement, revenues will be recognized when evidence of an agreement has been documented, the fees are fixed or determinable, collection of fees is probable, delivery of the product has occurred and no other significant obligations remain.

Multiple-Element Arrangements: For multiple-element arrangements, the Company applies the residual method in accordance with ASC 985-605. The residual method requires that the portion of the total arrangement fee attributable to the undelivered elements be deferred based on its VSOE of fair value and subsequently recognized as the service is delivered. The difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements, which is generally the software license. VSOE of fair value for all elements in an arrangement is based upon the normal pricing for those products and services when sold separately. VSOE of fair value for support services is additionally determined by the renewal rate in customer contracts. The Company has established VSOE of fair value for support as well as consulting services.

License Revenues: Amounts allocated to license revenues are recognized at the time of delivery of the software and all other revenue recognition criteria discussed above have been met.

Revenue from licensing software, which requires significant customization and modification, is recognized using the percentage of completion method, based on the hours of effort incurred by the Company in relation to the total estimated hours to complete. In instances where third party hardware, software or services form a significant portion of a customer's contract, the Company recognizes revenue for the element of software customization by the percentage of completion method described above. Otherwise, third party hardware, software, and services are recognized upon shipment or acceptance as appropriate. If the Company makes different judgments or utilizes different estimates of the total amount of work expected to be required to customize or modify the software, the timing and revenue recognition, from period to period, and the margins on the project in the reporting period, may differ materially from amounts reported. Anticipated contract losses are recognized as soon as they become known and are estimable.

Service Revenues: Revenues from services are comprised of maintenance and consulting and implementation services. Maintenance revenues include providing for unspecified when-and-if available product updates and customer telephone support services, and are recognized ratably over the term of the service period. Consulting services are generally sold on a time-and-materials basis and include a range of services including installation of software and assisting in the design of interfaces to allow the software to operate in customized environments. Services are generally separable from other elements under the arrangement since performance of the services are not essential to the functionality of any other element of the transaction and are described in the contract such that the total price of the arrangement would be expected to vary as the result of the inclusion or exclusion of the services. Revenues from services are generally recognized as the services are performed.

The Company provides customers, free of charge or at a minimal cost, testing kits which potential licensing customers may use to test compatibility/acceptance of the Company's technology with the customer's intended applications.

Costs and other expenses: Includes professional compensation and other direct contract expenses, as well as costs attributable to the support of client service professional staff, depreciation and amortization costs related to assets used in revenue-generating activities, and other costs attributable to serving the Company's client base. Professional compensation consists of payroll costs and related benefits including stock-based compensation and bonuses. Other direct contract expenses include costs directly attributable to client engagements, such as out-of-pocket costs including travel and subsistence for client service professional staff, costs of hardware and software and costs of subcontractors. The allocation of lease and facilities charges for occupied offices is included in costs of service.

The Company accounts for its warranties under the FASB ASC 450 "Contingencies." The Company generally warrants that its products are free from defects in material and workmanship for a period of one year from the date of initial delivery to its customers. The warranty does not cover any losses or damage that occurs as a result of improper installation, misuse or neglect or repair or modification by anyone other than the Company or its authorized repair agent. The Company's policy is to accrue anticipated warranty costs based upon historical percentages of items returned for repair within one year of the initial sale. The Company's repair rate of products under warranty has been minimal, and a historical percentage has not been established. The Company's software license agreements generally include certain provisions for indemnifying customers against liabilities if the Company's software products infringe upon a third party's intellectual property rights. The Company has not provided for any reserves for warranty liabilities as it was determined to be immaterial.

2. Impairment or Disposal of Long Lived Assets, including Intangible Assets

We review our long-lived assets, including intangible assets subject to amortization, whenever events or changes in circumstances indicate that the carrying amount of such an asset may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amount to the future undiscounted cash flows the assets are expected to generate. If such assets are considered impaired, the impairment to be recognized is equal to the amount by which the carrying value of the assets exceeds their fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique. In assessing recoverability, we must make assumptions regarding estimated future cash flows and discount factors. If these estimates or related assumptions change in the future, we may be required to record impairment charges. Intangible assets with determinable lives are amortized over their estimated useful lives, based upon the pattern in which the expected benefits will be realized, or on a straight-line basis, whichever is greater. We did not record any impairment charges in any of the years presented.

3. Research and Development Expenditures

Research and development expenses include costs directly attributable to the conduct of research and development programs primarily related to the development of our software products and improving the efficiency and capabilities of our existing software. Such costs include salaries, payroll taxes, employee benefit costs, materials, supplies, depreciation on research equipment, services provided by outside contractors, and the allocable portions of facility costs, such as rent, utilities, insurance, repairs and maintenance, depreciation and general support services. All costs associated with research and development are expensed as incurred.

4. Income Taxes

The provision for, or benefit from, income taxes includes deferred taxes resulting from the temporary differences in income for financial and tax purposes using the liability method. Such temporary differences result primarily from the differences in the carrying value of assets and liabilities. Future realization of deferred income tax assets requires sufficient taxable income within the carryback, carryforward period available under tax law. The Company evaluates, on a quarterly basis whether, based on all available evidence, if it is probable that the deferred income tax assets are realizable. Valuation allowances are established when it is more likely than not that the tax benefit of the deferred tax asset will not be realized. The evaluation, as prescribed by ASC 740-10, "Income Taxes," includes the consideration of all available evidence, both positive and negative, regarding historical operating results including recent years with reported losses, the estimated timing of future reversals of existing taxable temporary differences, estimated future taxable income exclusive of reversing temporary differences and carryforwards, and potential tax planning strategies which may be employed to prevent an operating loss or tax credit carryforward from expiring unused. Because of the Companies historical performance and estimated future taxable income a full valuation allowance has been established.

5. Accounting for Stock-Based Compensation

The Company accounts for share based compensation in accordance with the provisions of ASC 718-10, "Compensation — Stock Compensation," which requires measurement of compensation cost for all stock awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest. The majority of our share-based compensation arrangements vest over either a three or four year vesting schedule. The Company expenses its share-based compensation under the ratable method, which treats each vesting tranche as if it were an individual grant. The fair value of stock options is determined using the Black-Scholes valuation model, and requires the input of highly subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them (the "expected option term"), the estimated volatility of our common stock price over the option's expected term, the risk-free interest rate over the option's expected term, and the Company's expected annual dividend yield. Changes in these subjective assumptions can materially affect the estimate of fair value of stock-based compensation and consequently, the related amount recognized as an expense in the consolidated statements of operations. As required under the accounting rules, we review our valuation assumptions at each grant date and, as a result, are likely to change our valuation assumptions used to value employee stock-based awards granted in future periods. The values derived from using the Black-Scholes model are recognized as expense over the service period, net of estimated forfeitures (the number of individuals that will ultimately not complete their vesting requirements). The estimation of stock awards that will ultimately vest requires significant judgment. We consider many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results, and future changes in estimates, may differ substantially from our current estimates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See financial statements appearing at pages 40-66 of this report

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

N/A

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), evaluated the effectiveness of our disclosure controls and procedures as of December 31, 2015. The term "disclosure controls and procedures," as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on the evaluation of our disclosure controls and procedures as of December 31, 2015, our CEO and CFO concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Management's Annual Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rule 13a-15(f). Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, the risk. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our CEO and CFO, we have conducted an evaluation of the effectiveness of our internal control over financial reporting as of December 31, 2015, based upon the framework in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management has concluded that our internal control over financial reporting was effective as of December 31, 2015.

As the Company is a smaller reporting company, this annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit the company to provide only management's report in this annual report.

Changes in Internal Control Over Financial Reporting

No change in our internal control over financial reporting occurred during the fiscal quarter ended December 31, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following sets forth certain information about each director, executive officer, and key employee of the Company.

NAME	AGE	POSITIONS HELD
Michael W. DePasquale	61	Chairman of the Board of Directors and Chief Executive Officer
Charles P. Romeo (a)	74	Director
John Schoenherr (b)	63	Director
Thomas E. Bush, III (a) (c)	63	Director
Thomas Gilley (c)	55	Director
Wong Kwok Fong	52	Director
Yao Jianhui	43	Director
Cecilia Welch	56	Chief Financial Officer
Mira K. LaCous	54	Chief Technology Officer
Renat Zhdanov	53	Vice President, Chief Scientist
James Sullivan	56	Senior Vice President of Global Sales

(a) Compensation Committee Member

(b) Audit Committee Member

(c) Nominating Committee Member

Directors

We believe that our board of directors should be composed of individuals with sophistication and experience in many substantive areas that impact our business. We believe that experience, qualifications, or skills in the following areas are most important: legal/regulatory and government affairs; accounting and finance; design, innovation and engineering; strategic planning; and human resources and development practices; and board practices of other corporations. These areas are in addition to the personal qualifications described in this section. We believe that our current board members possess the professional and personal qualifications necessary for board service, and have highlighted particularly noteworthy attributes for each board member below. The principal occupation and business experience, for at least the past five years, of each current director is as follows:

MICHAEL W. DEPASQUALE has served as our Chief Executive Officer and a Director since January 3, 2003, and Chairman of the Board since January 29, 2014. He served as Co-Chief Executive Officer of the Company from July 2005 to August 2006. Mr. DePasquale brings more than 27 years of executive management, sales and marketing experience to the Company. Prior to joining us, 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 multimedia curriculum. Prior to Jostens, 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. He serves on the Board of Directors and as Treasurer of the International Biometrics and Identification Industry Association. Mr. DePasquale has extensive general management experience in the technology sector and has served as a Director for number of non-profit organizations and private companies.

CHARLES P. ROMEO has served as a Director since February 28, 2005 and from January 29, 2003 to April 19, 2004. From April 2004 until February 2005, he served as our Vice President of Sales, Public Safety Division. From November 2005 to November 2007, Mr. Romeo served as the Vice President of Sales and Marketing for UNICOM, a Rhode Island systems integrator. From September 2002 until April 2004, Mr. Romeo was the President and Chief Executive Officer of FreedomBridge Technologies, Inc., a Rhode Island-based consulting firm to technology companies in the homeland security industry specializing in implementing direct and channel selling programs, strategic alliances and partnerships in the law enforcement market. Prior to founding FreedomBridge, Mr. Romeo had a 33 year sales and marketing management career with Digital Equipment Corporation, Compaq Computer Corporation and Hewlett Packard. During his career, Mr. Romeo served as Vice President of Service Sales for a $500 million business unit, and Director of Public Sector Sales for a $275 million division of Hewlett Packard. Mr. Romeo authored The Sales Manager’s Troubleshooter, Prentice Hall 1998, which was named as one of the “top 10 must reads” by Sales and Marketing Magazine. Mr. Romeo earned a Bachelor of Science degree in Mathematics and Economics from the University of Massachusetts and an Executive MBA from Babson College. Mr. Romeo has significant sales and marketing management experience in the infrastructure and computer hardware and software industries.

JOHN SCHOENHERR has served as a Director since December 30, 2004. Mr. Schoenherr served as Vice President of Corporate Performance Management for Oracle Corporation from 1995 through 2006. Prior to Oracle he served as Senior Vice President of Business Intelligence and Analytics at Information Resources, Inc. Mr. Schoenherr has over 25 years of experience in the area of business intelligence and strategic planning. His career includes a number of product development and management positions. Mr. Schoenherr has extensive product management and information services experience in both the large and small enterprise sectors.

THOMAS E. BUSH, III has served as a Director of the Company since January 29, 2014. Since 2009, Mr. Bush has provided business consulting services through his firm, Tom Bush Consulting. Prior to that, Mr. Bush served with the Federal Bureau of Investigation for over 33 years. Mr. Bush joined the FBI in September 1975, ultimately becoming the Director of the CJIS division, with over 2,500 employees and a budget of approximately one billion dollars. Mr. Bush is known for providing critical services in support of the criminal justice community, with two significant IT projects; Next Generation Identification and N-Dex, were awarded by CJIS with early increments delivered during his tenure at the FBI. He was the recipient of many awards during his tenure, most notably a Presidential Rank Award for Meritorious Service in 2007. Mr. Bush's extensive experience in law enforcement, security matters, and the use of biometric technologies in the government sector provides the Board with a unique perspective on security and public sector matters.

THOMAS GILLEY has served as a Director of the Company since January 29, 2014. Mr. Gilley is an entrepreneur, hands on technologist for mobile technologies, digital media, internet of things and social computing. Mr. Gilley served at Apple Computer, in the Advance Technology Group and Portable Products Group. Before and after Apple, Mr. Gilley founded several successful companies including PicoStar, a Silicon Valley incubator-technology investment company where he has been CEO since 1996. In New York City Mr. Gilley served as a strategic advisor, investor and technology company founder. Most recently, Mr. Gilley sold his on-demand web media company to Vignette and acted as CTO throughout the transaction and through the company's ultimate acquisition by OpenText. Mr. Gilley’s substantial experience in starting, operating and financing technology companies provides the Board with a deep knowledge of the sales and development cycles applicable to growth businesses in the technology industry

WONG KWOK FONG has served as a Director of the Company since December 4, 2015. He is the co-founder of China Goldjoy Group (previously World Wide Touch Technology Holdings Limited), a Company listed on The Stock Exchange of Hong Kong. From 1997 until August 2015, Mr. Wong served as the Chairman of China Goldjoy Group and currently serves as its Chief Technology Officer. During this time, Mr. Wong played a significant role in the substantial growth of the business. Mr. Wong brings over 14 years of senior management experience in manufacturing, supply chain, and marketing functions in the electronics and technology industries, including establishing manufacturing plants in Hong Kong and China, and building an extensive network in the electronics and technology industries. Mr. Wong’s substantial experience in the technology industry, including biometrics and payment systems, and serving the Asian markets, broadens and strengthens the Board’s collective qualifications, skills, and experience.

YAO JIANHUI has served as a Director of the Company since December 4, 2015. He has served as the Chairman of the Board of Directors and Chief Executive Officer of the China Goldjoy Group Ltd., a Company listed on The Stock Exchange of Hong Kong, since August 2015. Since June 2006, Mr. Yao has served as the Chairman of the Board of Directors of Baoneng Holding (China) Co. Ltd., a company principally engaged in property development. From July 2010 to October 2014, Mr. Yao was the General Manager and Chairman of the Board of Directors of Baocheng Investment Co. Ltd., a company listed on Shanghai Stock Exchange principally engaged in the manufacturing of cables as well as the hotel and trading business. Mr. Yao has held senior management positions with a number of enterprises and listed companies across a wide range of industries including food, construction materials, real estate, commerce, agriculture and forestry, logistics, technology and finance. Mr. Yao's extensive industry experience, particularly in serving the Asian markets, further broadens and strengthens the Board's collective qualifications, skills, and experience.

Executive Officers

CECILIA WELCH has served as our Chief Financial Officer since December 21, 2009. Ms. Welch joined us in 2007 as our Corporate Controller. Prior to joining us, from January 2006 to December 2006, she was the Controller for Savaje Technologies (acquired by Sun Microsystems), a developer of advanced mobile telephone software. From October 2004 to January 2006, she was Controller for Crystal Systems, a manufacturer of sapphire crystals used for industrial, semiconductor, defense and medical applications. From December 1988 to July 2004, she was the Controller for ATN Microwave (acquired by Agilent Technologies), a manufacturer of automated test equipment. Ms. Welch has a Bachelor's degree in Accounting from Franklin Pierce University.

MIRA K. LACOUS has served as Chief Technology Officer of the Company since March 13, 2014. Prior to her appointment as Chief Technology Officer, she served as our Senior Vice President of Technology & Development since 2012, and as our Vice President of Technology and Development since 2000. Ms. LaCous has over 28 years of product/project management, solution architecture, software development, team leadership and customer relations experience, with a background that includes successfully bringing numerous technologies to market, including automated voice response systems, automated building control systems, software piracy protection, intranet training materials and testing, page layout and design software, image scanning software and systems, biometric security, biometric algorithms and more. Ms. LaCous is also the author of six US patented technologies, multiple international patents, and other patent pending solutions. She has been an officer or director of two other companies; National Computer Systems (NCS), and TEL-Line Systems. Ms. LaCous has a Bachelor's in Computer Science from North Dakota State University. Ms. LaCous also served on the Board of Directors of the Minnesota Sinfonia, a not-for-profit arts and education organization, as well as its chairperson for two years.

Key Employees

RENAT Z. ZHDANOV has served as our Chief Scientist since November 2001. He has over fifteen years of academic experience in various fields of mathematics and physics; fifteen years of image processing, pattern recognition, and big data analysis algorithm development experience and more than ten years of software development experience ranging from database programming to statistical and analytical programming. Dr. Zhdanov is a recognized expert in mathematical physics and is the author of two books and more than 130 papers published in leading mathematics and physics journals. Before joining us, he worked as Chief Mathematician and Visiting Scientist in universities in Ukraine, Germany, Great Britain, Sweden and Spain. Dr. Zhdanov has two PhD degrees in Mathematical Physics and Differential Equations from the Institute of Mathematics in Kiev, Ukraine. He serves as the member of the Editorial Board of the "Journal of Applied Mathematics".

JAMES SULLIVAN has served as our Senior Vice President of Global Sales since August 2015, and is a recognized expert in biometric authentication for consumer and mobile applications. In over 10 years at BIO-key, Mr. Sullivan has directly worked with dozens of BIO-key's customers, including AT&T, LexisNexis, NCR and McKesson on large-scale biometric-centered identity management projects that interface daily with millions of corporate and consumer users. Mr. Sullivan holds a Computer Science degree from Brown University, and has 24 years of experience in IT projects and implementation, 14 of them directly working with identity management solutions at BIO-key, Computer Associates, Platinum Technology, and Memco Software.

Directors' Terms of Office

Mr. DePasquale was initially elected as a director in 2003, and was re-elected in 2004. Mr. Schoenherr was initially elected as a director in 2004. Mr. Romeo was initially elected as a director in 2005. Mr. Bush and Mr. Gilley were initially appointed as directors in 2014. Mr. Wong and Mr. Yao were initially appointed as directors in 2015. Each such director was elected to serve until the Company's next annual meeting or until his or her successor is duly elected and qualified in accordance with the By-laws of the Company.

Audit Committee

The Audit Committee is comprised solely of John Schoenherr. The Board has determined that Mr. Schoenherr is an "audit committee financial expert" under the applicable rules adopted by the Securities and Exchange Commission. Additionally, the Audit Committee has the ability on its own to retain independent accountants or consultants whenever it deems appropriate.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the U.S. Securities and Exchange Act of 1934, as amended (the "Exchange Act"), requires the Company's officers and directors and persons who own more than ten percent (10%) of the Company's Common Stock to file with the Securities and Exchange Commission ("SEC") initial reports of ownership and reports of changes in ownership of the Company's Common Stock. Such officers, directors and ten percent (10%) stockholders are also required by applicable SEC rules to furnish the Company with copies of all forms filed with the SEC pursuant to Section 16(a) of the Exchange Act. Based solely on its review of the copies of such forms received by it, or written representations from such persons that no other reports were required for such persons, the Company believes that during the fiscal year ended December 31, 2015, all Section 16(a) filing requirements applicable to the Company's officers, directors and ten percent (10%) stockholders were satisfied in a timely fashion, except for the late filing of the following forms:

Form 4 by Mr. Bush with respect to the issuance of common shares in payment of board fees on November 9, 2015
Form 4 by Mr. Gilley with respect to the issuance of common shares in payment of board fees on November 9, 2015
Form 4 by Mr. Romeo with respect to the issuance of common shares in payment of board fees on November 9, 2015
Form 4 by Mr. Schoenherr with respect to the issuance of common shares in payment of board fees on November 9, 2015
Form 4 by Mr. Gilley with respect to a private acquisition of common shares on November 19, 2015
Form 3 by Mr. Yao in connection with his appointment to the board of directors.

Code of Ethics

We have adopted a Code of Ethics that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. Our Code of Ethics is designed to deter wrongdoing and promote: (i) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships; (ii) full, fair, accurate, timely and understandable disclosure in reports and documents that we file with, or submit to, the SEC and in our other public communications; (iii) compliance with applicable governmental laws, rules, and regulations; (iv) the prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and (v) accountability for adherence to the code. The Company intends to disclose amendments or waivers of the Code of Ethics on its website within four business days. Any person may obtain a copy of our Code of Ethics free of charge by sending a written request for such to the attention of the Chief Financial Officer of the Company, 3349 Highway 138, Building A Suite E, Wall, NJ 07719.

Internet Address and SEC Reports

We maintain a website with the address www.BIO-key.com. We are not including the information contained on our website as a part of, or incorporating it by reference into, this Annual Report on Form 10-K. We make available free of charge through our website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the SEC. Our SEC filings are also available over the Internet at the SEC’s website www.sec.gov. Members of the public may read and copy any materials the Company files with the SEC at the SEC’s public reference room at 100 F Street, NE, Washington, DC 20549. Information on the operation of the public reference room is available by calling the SEC on 1-800-SEC-0330.

ITEM 11. EXECUTIVE COMPENSATION

The following table sets forth a summary of the compensation paid to or accrued by our chief executive officer (principal executive officer) and the two most highly compensated executive officers other than the principal executive officer, who were serving as executive officers at the end of December 31, 2015, for the fiscal years ended December 31, 2015 and 2014:

SUMMARY COMPENSATION TABLE

Name	Fiscal Year	Salary ($)	Option Awards ($)		All Other Compensation ($)	Total ($)
Michael W. DePasquale	2015	250,000	35,650	(1)	739	286,389
Chief Executive Officer	2014	250,000	82,300	(1)	739	333,039
Mira K. LaCous	2015	202,000	14,250	(1)	642	216,892
Chief Technology Officer (2)	2014	192,903	49,380	(1)	545	242,828
Cecilia Welch	2015	144,000	14,260	(1)	532	158,792
Chief Financial Officer	2014	144,000	49,380	(1)	432	193,812

(1) The aggregate grant date fair value of the option awards was estimated using the Black-Scholes option pricing model, with the assumptions listed in Note A to the Company's financial statements. The amount shown in this column represents the grant date fair value calculated under ASC 718.

(2) Ms. LaCous was appointed as our Chief Technology Officer on March 31, 2014. Prior to her appointment as our Chief Technology Officer, she served as our Vice President of Technology & Development.

Narrative Disclosure to Summary Compensation Table

Compensation for BIO-key's executives is comprised of three main components: base salary, annual performance-based cash bonus, and long-term equity awards. We do not target a specific weighting of these three components or use a prescribed formula to establish pay levels. Rather, the board of directors and compensation committee considers changes in the business, external market factors and our financial position each year when determining pay levels and allocating between long-term and current compensation for the named executive officers.

Cash compensation is comprised of base salary and an annual performance-based cash bonus opportunity. The committee generally seeks to set a named executive officer's targeted total cash compensation opportunity within a range that is the average of the applicable peer company and/or general industry compensation survey data, adjusted as appropriate for individual performance and internal pay equity and labor market conditions. Due to limited cash resources, we did not pay any cash bonuses over the past two years.

In setting cash compensation levels, we favor a balance in which base salaries are generally targeted at slightly below the peer average and a bonus opportunity that is targeted at slightly above the average. The committee believes that this higher emphasis on performance-based cash bonuses places an appropriate linkage between a named executive officer's pay, his or her individual performance and the achievement of specific business goals by placing a higher proportion of annual cash compensation at risk, thereby aligning executive opportunity with the interests of stockholders.

We include an equity component as part of our compensation package because we believe that equity-based compensation aligns the long-term interests of our named executive officers with those of stockholders.

These cash and equity compensation components of pay are supplemented by various benefit plans that provide health, life, accident, disability and severance benefits, most of which are the same as the benefits provided to all of our US based employees.

Employment Agreements

On March 26, 2010, the Company entered into an employment agreement, effective as of March 25, 2010, with Michael W. DePasquale to serve as the Chief Executive Officer of the Company until March 24, 2011. The agreement automatically renews for subsequent one-year terms, unless the employment relationship is terminated by either party, or modified in accordance with the terms and conditions of the Agreement. Under the Agreement, Mr. DePasquale will be paid an annual base salary of $250,000, subject to adjustment by the Board or Compensation Committee. In addition to the Base Salary, a “Performance Bonus” may be awarded to Mr. DePasquale on the basis of the Company achieving certain corporate and strategic performance goals, as determined by the Board in its sole discretion. The employment agreement contains standard and customary confidentiality, non-solicitation and “work made for hire” provisions as well as a covenant not to compete which prohibits Mr. DePasquale from doing business with any current or prospective customer of the Company or engaging in a business competitive with that of the Company during the term of his employment and for the one year period thereafter. This agreement also contains a number of termination and change in control provisions as described in “Termination and Change in Control Arrangements” in this Item.

On March 13, 2014, in connection with her appointment as Chief Technology Officer, the Company amended and restated Ms. LaCous’ employment agreement to increase Ms. LaCous’ annual base salary to $202,000. The employment agreement contains standard and customary confidentiality, technical invention provisions, as well as a covenant not to compete, which prohibits Ms. LaCous from doing business with any current or prospective customer of the Company or engaging in a business competitive with that of the Company during the term of her employment and for the one year period thereafter. This agreement also contains a number of termination provisions as described in “Termination and Change in Control Arrangements” in this Item.

On May 15, 2013, the Company entered into an employment agreement with Cecilia Welch to serve as the Chief Financial Officer of the Company until May 2014. The agreement automatically renews for subsequent one-year terms, unless the employment relationship is terminated by either party, or modified in accordance with the terms and conditions of the agreement. The employment agreement contains standard and customary confidentiality, technical invention provisions, as well as a covenant not to compete, which prohibits Ms. Welch from doing business with any current or prospective customer of the Company or engaging in a business competitive with that of the Company during the term of her employment and for the one year period thereafter. This agreement also contains a number of termination provisions as described in “Termination and Change in Control Arrangements” in this Item.

Stock Option Grants

In the event of any change in the outstanding shares of our common stock by reason of a stock dividend, stock split, combination of shares, recapitalization, merger, consolidation, transfer of assets, reorganization, conversion or what the board deems to be similar circumstances, the number and kind of shares subject to outstanding options, and the exercise price of such options shall be appropriately adjusted in a manner to be determined in the sole discretion of the board. Furthermore, these option agreements contain a change of control provision as described in “Termination Arrangements” in this Item.

OUTSTANDING EQUITY AWARDS AT FISCAL YEAR END

DECEMBER 31, 2015

The following table sets forth for each named executive officer, information regarding outstanding equity awards as at December 31, 2015. The option awards and per share amounts for all periods reflect BIO-key's 1-for-2 reverse stock split, which was effective February 3, 2015.

Name	**Option Awards** **Number of securities underlying unexercised options exercisable (#)**	**Number of securities underlying unexercised options unexercisable (#)**		**Option exercise price ($)**	**Option expiration date**
Michael W. DePasquale	250,000	—		0.174	2/27/2016
	333,333	166,667	(1)	0.348	3/27/2020
	83,333	166,667	(2)	0.410	3/13/2021
	—	250,000	(3)	0.180	8/12/2022
Mira LaCous	170,000	—		0.920	1/7/2017
	37,500	—		0.280	5/11/2018
	41,667	20,833	(1)	0.348	3/27/2020
	50,000	100,000	(2)	0.410	3/13/2021
	—	100,000	(3)	0.180	8/12/2022
Cecilia Welch	75,000	—		0.280	5/11/2018
	50,000	25,000	(1)	0.348	3/27/2020
	50,000	100,000	(2)	0.410	3/13/2021
	—	100,000	(3)	0.180	8/12/2022

(1) The options vest equally in three annual installments commencing March 27, 2014
(2) The options vest equally in three annual installments commencing March 14, 2015
(3) The options vest equally in three annual installments commencing August 13, 2016

Narrative Disclosure to Outstanding Equity Awards at Fiscal Year End Table

The following are the material terms of each agreement, contract, plan or arrangement that provide for payments to one or more of our named executive officers at, following or pursuant to their resignation, retirement or termination, or in connection with a change in control of the Company.

Termination Arrangements

Our employment agreement with Mr. DePasquale automatically renews for subsequent one-year terms, unless the employment relationship is terminated by either party, or modified in accordance with the terms and conditions of the Agreement. We may terminate the Agreement at any time with or without cause. In the event of termination by us without cause, we will continue to pay Mr. DePasquale his then current base salary for the greater of nine months from the date of such termination or the number of months remaining until the end of the term of the Agreement.

We may terminate our employment agreement with Ms. LaCous at any time with or without cause. In the event of termination by us without cause, we will continue to pay Ms. LaCous her then current base salary for nine months from the date of such termination.

Our employment agreement with Ms. Welch automatically renews for subsequent one-year terms, unless the employment relationship is terminated by either party, or modified in accordance with the terms and conditions of the Agreement. We may terminate our employment agreement with Ms. Welch at any time with or without cause. In the event of termination by us without cause, we will continue to pay Ms. Welch her then current base salary for the greater of six months from the date of such termination or the number of months remaining until the end of the term of the Agreement.

Change in Control Provisions

Awards under the Company's 2015 Equity Incentive Plan (the "2015 Plan") may be subject to acceleration of vesting and exercisability upon or after a "Change in Control" as may be provided in the award agreement for such award but in the absence of such provision, no such acceleration shall occur. A Change in Control under the 2015 Plan generally means (i) the acquisition by a person or entity of more than 50% of our combined voting power other than by merger, consolidation or similar transaction; (ii) a consummated merger, consolidation or similar transaction immediately after which our stockholders cease to own more than 50% of the combined voting power of the surviving entity; (iii) a complete dissolution or liquidation of the company, except for a liquidation into a parent corporation; (iv) a consummated sale, lease or exclusive license or other disposition of all or substantially of our consolidated assets; or (v) when a majority of our board of directors becomes composed of individuals whose nomination, appointment, or election was not approved by a majority of our board members or their approved successors. As of the date of this report, no awards have been issued under the 2015 Plan.

The Company's 1999 Stock Option Plan and 2004 Stock Incentive Plan (the "1999 Plan" and together with the 2004 Plan, the "Plans") provide for the acceleration of the vesting of unvested options upon a "Change in Control" of the Company. A Change in Control is defined in the Plans to include (i) a sale or transfer of substantially all of the Company's assets; (ii) the dissolution or liquidation of the Company; (iii) a merger or consolidation to which the Company is a party and after which the prior shareholders of the Company hold less than 50% of the combined voting power of the surviving corporation's outstanding securities; (iv) the incumbent directors cease to constitute at least a majority of the Board of Directors; or (v) a change in control of the Company which would otherwise be reportable under Section 13 or 15(d) of the Exchange Act.

In the event of a "Change In Control" each Plan provides for the immediate vesting of all options issued thereunder. The 1999 Plan provides for the Company to deliver written notice to each optionee under the 1999 Plan fifteen (15) days prior to the occurrence of a Change in Control during which all options issued under the 1999 Plan may be exercised. Thereafter, all options issued under the 1999 Plan which are neither assumed nor substituted in connection with such transaction, automatically expire unless otherwise determined by the Board. The 2004 Plan enables the Board to provide that all outstanding options be assumed, or equivalent options be substituted by the acquiring or succeeding corporation upon the occurrence of a "Reorganization Event" as defined. If such Reorganization Event also constitutes a Change In Control, then such assumed or substituted options shall be immediately exercisable in full. If the acquiring or succeeding corporation does not agree to assume, or substitute for such options, then the Board, upon written notice to the Participants, may provide that all unexercised options become exercisable in full as of a specified time prior to the Reorganization Event and terminate prior to the consummation of the Reorganization Event. Alternatively, if under the terms and conditions of the Reorganization Event, holders of common stock will receive a cash payment for their shares, then the Board may provide that all Participants receive a cash payment equal to the difference between the Acquisition Price and the Option Price multiplied by the number of options held by such Participants.

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

Our employment agreement with Mr. DePasquale contains a change in control provision that is triggered if Mr. DePasquale is not offered continued employment with us or any successor, or within five years following such Change of Control, we or any successor terminates Mr. DePasquale's employment without cause. If this occurs, then we will pay Mr. DePasquale his base salary and benefits earned but unpaid through the date of termination, and any prorated bonus earned during the then current bonus year, plus two times his then current base salary.

DIRECTOR COMPENSATION FOR THE FISCAL YEAR ENDED

DECEMBER 31, 2015

The following table sets forth for each director, information regarding their compensation for the year ended December 31, 2015:

Name (1)	**Fees earned or paid in cash ($)**	**Stock Awards ($) (2)**	**Option Awards ($) (3)**	**Total ($)**
Thomas E. Bush, III	—	4,000	3,565	7,565
Thomas Gilley	3,000	5,000	3,565	11,565
Charles P. Romeo	—	3,000	3,565	6,565
John Schoenherr	3,000	5,000	3,565	11,565
Barbara Rivera (4)	3,000	—	—	3,000
Wong Kwok Fong (Kelvin) (5)	—	—	—	—
Yau Jianhui (5)	—	—	—	—

(1) Mr. DePasquale has been omitted from the above table because he does not receive any additional compensation for serving on our Board of Directors.

(2) The aggregate fair value of the common stock issued was calculated based on the closing price of our common stock on the date of issuance.

(3) The aggregate grant date fair value of the option awards was estimated using the Black-Scholes option pricing model, with the assumptions listed in Note A to the Company's financial statements. The amount shown in this column represents the grant date fair value calculated under ASC 718

(4) Ms. Rivera resigned from the Company's Board of Directors on July 15, 2015.

(5) Appointed effective December 4, 2015. Did not receive any fees for the year ended December 31, 2015.

Narrative Disclosure to Director Compensation Table

During 2014, the Company had a policy to pay to each non-employee director $3,000 per board meeting and $1,000 per telephonic board meeting attended and to make an annual grant of options in the discretion of the Board upon recommendation of the Compensation Committee. In August 2015, the Company modified its director compensation policy such that fees for attendance at regularly quarterly board meetings held during the first three quarters of each fiscal year are paid through the issuance of shares of common stock and payment for the last meeting of the year is paid in cash or, at the option of the director, in shares of common stock. In 2015, we granted to four of our non-employee directors an option to purchase 25,000 shares of common stock. The options vest in three equal annual installments and expire seven years after the date of grant.

We reimburse each of our non-employee directors for their reasonable expenses incurred in connection with attending meetings of the board of directors and related committees.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth, as of March 28, 2016 information with respect to the securities holdings of all persons which the Company, pursuant to filings with the Securities and Exchange Commission, has reason to believe may be deemed the beneficial owners of more than five percent (5%) of the Company's outstanding common stock. The following table also sets forth, as of such date, the beneficial ownership of the Company's common stock by all officers and directors, individually and as a group. Unless otherwise indicated, the address of each person listed below is c/o BIO-key International, Inc., 3349 Highway 138, Building A, Suite E, Wall, NJ 07719. The share amounts reflect BIO-key's 1-for-2 reverse stock split, which was effective February 3, 2015

Name and Address of Beneficial Owner	**Amount and Nature of Beneficial Ownership(1)**		**Percentage of Class(1)**
Michael W. DePasquale	1,024,998	(2)	1.6
Mira LaCous	403,333	(3)	*
Cecilia Welch	283,332	(4)	*
John Schoenherr	155,555	(5)	*
Thomas Gilley	132,054	(6)	*
Charles P. Romeo	106,944	(7)	*
Thomas E. Bush, III	74,999	(8)	*
Wong Kwok Fong Flat C, 27/F, Block 5 Grand Pacific Views Siu Lam, Hong Kong N7	7,262,763	(9)	9.9
Yao Jianhui Suites 2601-2, 26/F Tower 2, Nina Tower 8 Yeung UK Road Tsuen Wan, Hong Kong TWTL 353	18,750	(10)	-
Perkins Capital Management Inc. 730 Lake St. E Wayzata, MN 55391	4,625,000	(11)	7.0
Giant Leap International, Ltd. Cricket Square, Hutchins Drive	7,262,763	(12)	9.9

P.O. Box 2681				
Grand Cayman, Cayman Islands KY7-1111 Micron Technology Development Limited				
5/F., SPA Centre, 53-55 Lockhart Road	7,262,763	(12)	9.9	
Wanchai, Hong Kong 999077				
All officers and directors as a group (9) persons	9,462,728		14.3	%

*Less than 1%

(1) The securities "beneficially owned" by an individual are determined in accordance with the definition of "beneficial ownership" set forth in the regulations promulgated under the Securities Exchange Act of 1934 and, accordingly, may include securities owned by or for, among others, the spouse and/or minor children of an individual and any other relative who has the same home as such individual, as well as, other securities as to which the individual has or shares voting or investment power or which each person has the right to acquire within 60 days through the exercise of options or otherwise. Beneficial ownership may be disclaimed as to certain of the securities. This table has been prepared based on 66,198,482 shares of common stock outstanding as of March 28, 2016.

(2) Includes 999,998 issuable on exercise of options and 25,000 shares of common stock. Does not include 250,002 shares issuable upon exercise of options subject to vesting.

(3) Consists of shares issuable upon exercise of options. Does not include 116,667 shares issuable upon exercise of options subject to vesting.

(4) Consists of shares issuable upon exercise of options. Does not include 116,668 shares issuable upon exercise of options subject to vesting.

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(5) Includes 108,333 issuable on exercise of options and 47,222 shares of common stock. Does not include 29,167 shares issuable upon exercise of options subject to vesting.

(6) Includes 33,332 issuable on exercise of options and 98,722 shares of common stock. Does not include 29,168 shares issuable upon exercise of options subject to vesting.

(7) Includes 83,333 issuable on exercise of options and 23,611 shares of common stock. Does not include 29,167 shares issuable upon exercise of options subject to vesting.

(8) Includes 33,332 issuable on exercise of options and 41,667 shares of common stock. Does not include 29,168 shares issuable upon exercise of options subject to vesting.

(9) Consists of shares issuable upon conversion of Series A-1 Convertible Preferred Stock and 18,750 shares of common stock.

(10) Does not include 7,262,673 shares of common stock issuable upon conversion of Series B-1 Convertible Preferred Stock owned of record by Giant Leap International, Ltd. Also does not include 1,066,500 shares of common stock owed of record by China Goldjoy Limited, the parent company of Giant Leap International, Ltd. As the Chairman of the board of directors of China Goldjoy Limited, Mr. Yao shares voting and dispositive power over these shares.

(11) Based on a Schedule 13G/A filed with the United States Securities and Exchange Commission on February 4, 2016, Richard W. Perkins has sole voting and dispositive power with respect to the shares. Includes 2,125,000 shares issuable upon exercise of warrants.

(12) Consists of shares issuable upon conversion of Series B-1 Convertible Preferred Stock.

The following table sets forth, as of December 31, 2015, information with respect to securities authorized for issuance under equity compensation plans. The shares and per share amounts reflect BIO-key’s 1-for-2 reverse stock split, which was effective February 3, 2015

EQUITY COMPENSATION PLAN INFORMATION

	Number of	**Weighted-**

	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	—	—	8,000,000
Equity compensation plans not approved by security holders	4,378,833	$ 0.32	—
Total	4,378,833	$ 0.32	8,000,000

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

The 1999 Plan is currently administered by the Board of Directors of the Company (the "Plan Administrator"). The Plan Administrator is authorized to construe the 1999 Plan and any option issued under the 1999 Plan, select the persons to whom options may be granted, and determine the number of shares to be covered by any option, the exercise price, vesting schedule and other material terms of such option. Under the 1999 Plan 1,000,000 shares of common stock were reserved for issuance to officers, employees, directors and consultants of the Company at exercise prices not less than 85% of the last sale price of the Company's common stock as reported on the OTC Bulletin Board on the date of grant. Options have terms of not more than 10 years from the date of grant, are subject to vesting as determined by the Plan Administrator and are not transferable without the permission of the Company except by will or the laws of descent and distribution or pursuant to a domestic relations order. Options terminate three (3) months after termination of employment or other association with the Company or one (1) year after termination due to disability, death or retirement. In the event that termination of employment or association is for a cause, as that term is defined in the 1999 Plan, options terminate immediately upon such termination. The Plan Administrator has the discretion to extend options for up to three years from the date of termination or disassociation with the Company.

The 1999 Plan provides for the immediate vesting of all options in the event of a "Change In Control" of the Company. In the event of a Change In Control, the Company is required to deliver written notice to each optionee under the 1999 Plan fifteen (15) days prior to the occurrence of a Change in Control, during which time all options issued under 1999 Plan may be exercised. Thereafter, all options issued under the 1999 Plan which are neither assumed nor substituted in connection with such transaction, automatically expire, unless otherwise determined by the Board. Under the 1999 Plan, a "Change In Control" is defined to include (i) a sale or transfer of substantially all of the Company's assets; (ii) the dissolution or liquidation of the Company; (iii) a merger or consolidation to which the Company is a party and after which the prior shareholders of the Company hold less than 50% of the combined voting power of the surviving corporation's outstanding securities; (iv) the incumbent directors cease to constitute at least a majority of the Board of Directors; or (v) a change in control of the Company which would otherwise be reportable under Section 13 or 15(d) of the Exchange Act. The 1999 Plan expired in August 2009.

As of December 31, 2015, there were outstanding options under the 1999 Plan to purchase 250,000 post-split shares of common stock, and no shares were available for future grants.

On October 12, 2004, the Board of Directors of the Company approved the 2004 Stock Option Plan (the 2004 Plan). The 2004 Plan has not yet been presented to stockholders for approval and thus incentive stock options are not available under this plan. Under the terms of this plan, 2,000,000 post-split shares of common stock are reserved for issuance to employees, officers, directors, and consultants of the Company at exercise prices which may not be below 85% of fair market value. The term of stock options granted may not exceed ten years. Options issued under the 2004 Plan vest pursuant to the terms of stock option agreements with the recipients. In the event of a change in control, as defined, all options outstanding vest immediately. The 2004 Plan expired in October 2014.

As of December 31, 2015, there were outstanding options under the 2004 Plan to purchase 1,020,000 post-split shares of common stock, and no shares were available for future grants.

On December 4, 2015, the Board of Directors of the Company adopted the 2015 Equity Incentive Plan (the 2015 Plan), which the stockholders approved on January 27, 2016. The material features of the 2015 Plan are outlined below.

The 2015 Plan is administered by the Compensation Committee of our Board of Directors. Subject to the terms of the 2015 Plan, the plan administrator may determine the recipients, numbers and types of awards to be granted, and terms and conditions of the awards, including the period of their exercisability and vesting. The terms of the 2015 Plan provide for the grant of incentive stock options (ISOs), nonstatutory stock options (NSOs), restricted stock awards, restricted stock unit awards, stock appreciation rights, other stock awards, and performance awards that may be settled in stock, or other property. Under the terms of this plan, 8,000,000 shares of common stock are reserved for issuance to employees, non-employee directors, and consultants at exercise prices which may not be less than 100%-110% of the fair market value of the common stock subject to the stock option on the date of grant. A maximum of 400,000 shares of our common stock may be granted to any one participant during any one calendar year pursuant to stock options, stock appreciation rights or other stock awards. The term of stock options granted may not exceed ten years. If a stock award granted under the 2015 Plan, or any portion thereof, expires, is forfeited or otherwise terminates without all of the shares covered by the stock award having been issued, such expiration, termination or settlement will not reduce or otherwise offset the number of shares available for issuance under the 2015 Plan. In the event of a change in control, a stock award under the 2015 Plan may be subject to additional acceleration of vesting and exercisability. Unless terminated sooner by our Board of Directors, the 2015 Plan will automatically terminate on December 3, 2025.

As of December 31, 2015, there were outstanding options under the 2015 Plan to purchase 0 post-split shares of common stock, and 8,000,000 shares were available for future grants.

In addition to options issued under the 1999, 2004 and 2015 Plans, the Company has issued options to employees, officers, directors and consultants to purchase common stock under the non-plan. As of December 2015, there were outstanding options under the non-plan to purchase 3,108,833 post-split shares of common stock. The terms of outstanding options under the non-plan are substantially similar to the provisions of the 1999 Plan and options issued thereunder.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Employment Arrangements

The Company has entered into employment agreements with Michael W. DePasquale, Mira LaCous, and Cecilia Welch. See **"EXECUTIVE COMPENSATION—Employment Agreements."**

Consulting Arrangement with Thomas J. Colatosti

In connection with his appointment to the Board of Directors in September 2002, and as acting Chief Financial Officer from November 2008 to December 2009, the Company had entered into a number of consulting arrangements with Thomas Colatosti. Under the most recent arrangement, which was entered into on January 12, 2010, Mr. Colatosti provided services to the Company and its subsidiaries and affiliates for the two-year term ended December 31, 2011 at a rate of $5,000 per month. All amounts owing to Mr. Colatosti were paid during 2014.

Licensing Agreement with Subsidiaries of China Goldjoy Group Limited.

In November 2015, our subsidiary BIO-key Hong Kong Limited entered into a license purchase agreement with certain subsidiaries of China Goldjoy Group Limited ("CGG"). The license agreement provides for the grant of a perpetual, irrevocable, exclusive, worldwide, fully-paid license to all software and documentation regarding the software code, toolkit, electronic libraries and related technology currently known as or offered under the Finger Q name, together with perpetual license under all related patents held by the licensors and any other intellectual property rights owned by the licensors related to the forgoing software. We made a one-time payment of $12,000,000 to the licensors. Mr. Yao Jianhu is the chairman and chief executive officer of CGG. Mr. Wong Kwok Fong is the chief technology officer of CGG and the beneficial owner of 9.9% of our common stock.

October – November 2015 Private Placements

On October 22, October 29, and November 11, 2015, Wong Kwok Fong purchased 90,000 shares of our Series A-1 Convertible Preferred Stock at a purchase price of $100.00 per share for gross proceeds of $9,000,000. Shares of the Series A-1 Convertible Preferred Stock are convertible at any time at the option of the holder into shares of common stock at an initial conversion price of $0.30 per share, subject to a “blocker provision” which prohibits conversion if such conversion would result in the holder being the beneficial owner of in excess of 9.99% of the Issuer’s outstanding shares of common stock. Holders of shares of our Series A-1 Convertible Preferred Stock are entitled to elect one director to our board. Wong Kwok Fong is a director of the Company, beneficially owns in excess of 5% of our common stock, and also serves as the chief technology officer of CGG.

On November 11, 2015, Giant Leap International, Ltd., which is a subsidiary of CGG, purchased 30,000 shares of our Series B-1 Convertible Preferred Stock at a purchase price of $100.00 per share for gross proceeds of $3,000,000. Shares of the Series B-1 Convertible Preferred Stock are convertible at any time at the option of the holder into shares of common stock at an initial conversion price of $0.30 per share, subject to a “blocker provision” which prohibits conversion if such conversion would result in the holder being the beneficial owner of in excess of 9.99% of the Issuer’s outstanding shares of common stock. Holders of shares of our Series B-1 Convertible Preferred Stock are entitled to elect one director to our board. Yao Jianhui is a director of the Company, and serves as the chairman of the board of directors of CGG.

Director Independence

The Board applies the definition of independent director as set forth in NASDAQ Stock Market Rule 5605 (a)(2), as well as Rule 10A-3 under the Securities Exchange Act of 1934, as amended.

In accordance with this guidance, the Board considers Mr. Schoenherr, Mr. Romeo, Mr. Bush and Mr. Gilley, to be independent. Mr. Schoenherr is the sole member of the Company’s Audit Committee, while Mr. Romeo, and Mr. Bush are the members of the Company’s Compensation Committee.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table shows fees for professional services and quarterly audit fees billed to us by Rotenberg Meril Solomon Bertiger & Guttilla, P.C. (“RMSBG”) for the audit of our annual consolidated financial statements for the years ended December 31, 2015 and 2014:

	2015	**2014**
Audit Fees	$80,167	$75,000
Audit-Related Fees	17,346	7,128
Tax Fees	27,300	12,000
Total Fees	$124,813	$94,125

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 our auditors in connection with statutory and regulatory filings or engagements. Audit fees also include fees for services provided in connection with registration of securities, comfort letters, and review of documents filed with the SEC.

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 our financial statements and which are not reported under audit fees. These services relate primarily to the due diligence related to registration statements filed by the Company.

Tax Fees consist of fees billed for professional services for tax compliance assistance rendered during the fiscal year.

Audit Committee Pre-Approval Procedures

The Audit Committee of our Board of Directors consisted solely of John Schoenherr from July 15, 2015, when Barbara Rivera resigned from the Company’s Board of Directors. The Audit Committee approves the engagement of our independent auditors to render audit and non-audit services before they are engaged. All of the fees for 2015 and 2014 shown above were pre-approved by the Audit Committee.

The Audit Committee pre-approves all audit and other permitted non-audit services provided by our independent auditors. Pre-approval is generally provided for up to one year, is detailed as to the particular category of services and is subject to a monetary limit. Our independent auditors and senior management periodically report to the Audit Committee the extent of services provided by the independent auditors in accordance with the pre-approval, and the fees for the services performed to date. The Audit Committee may also pre-approve particular services on a case-by-case basis.

Our audit committee will not approve engagements of our independent registered public accounting firm to perform non-audit services for us if doing so will cause our independent registered public accounting firm to cease to be independent within the meaning of applicable SEC rules. In other circumstances, our audit committee considers, among other things, whether our independent registered public accounting firm is able to provide the required services in a more or less effective and efficient manner than other available service providers.

ITEM 15. EXHIBITS

(a) The following documents are filed as part of this Report. Portions of Item 15 are submitted as separate sections of this Report:

(1) Financial statements filed as part of this Report:

Reports of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as at December 31, 2015 and 2014

Consolidated Statements of Operations—Years ended December 31, 2015 and 2014

Consolidated Statement of Stockholders' Equity—Years ended December 31, 2015 and 2014

Consolidated Statements of Cash Flows—Years ended December 31, 2015 and 2014

(b) The exhibits listed in the Exhibits Index immediately preceding such exhibits are filed as part of this Report

ITEM 8—FINANCIAL STATEMENTS

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

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

BIO-key International, Inc.

Wall, NJ

We have audited the accompanying consolidated balance sheets of BIO-key International, Inc. and Subsidiaries (the “Company”) as of December 31, 2015 and 2014, and the related consolidated statements of operations, stockholders’ equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management as well as evaluating the overall consolidated financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2015 and 2014, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As disclosed in the consolidated financial statements, the Company has suffered substantial net losses in recent years, has an accumulated deficit at December 31, 2015 and is dependent on debt and equity financing to fund its operations, all of which raise substantial doubt about the Company’s ability to continue as a going concern. Management’s plans regarding these matters are disclosed in Note A. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Rotenberg Meril Solomon Bertiger & Guttilla,

P.C.

ROTENBERG MERIL SOLOMON BERTIGER &
GUTTILLA, P.C.
Saddle Brook, New Jersey
March 30, 2016

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BIO-key International, Inc. and Subsidiaries

CONSOLIDATED BALANCE SHEETS

	December 31, 2015	2014
ASSETS		
Cash and cash equivalents	$4,321,078	$843,632
Accounts receivable, net	3,391,405	625,341
Due from factor	37,421	76,657
Inventory	348,645	11,825
Software license rights	5,000,000	-
Prepaid expenses and other	97,203	236,429
Total current assets	13,195,752	1,793,884
Software license rights	7,000,000	-
Equipment and leasehold improvements, net	63,877	103,509
Deposits and other assets	8,712	8,712
Intangible assets—less accumulated amortization	147,738	161,344
Total non-current assets	7,220,327	273,565
TOTAL ASSETS	$20,416,079	$2,067,449
LIABILITIES		
Accounts payable	$1,158,555	$347,311
Accrued liabilities	626,918	488,617
Deferred revenue	376,405	429,233
Warrant liabilities	104,284	43,227
Total current liabilities	2,266,162	1,308,388
TOTAL LIABILITIES	2,266,162	1,308,388
Commitments and Contingencies		
STOCKHOLDERS' EQUITY		
Series A-1 convertible preferred stock: authorized, 100,000 (liquidation preference of $100 per share); issued and outstanding 90,000 and 0 of $.0001 par value at December 31, 2015 and December 31, 2014, respectively	9	-
Series B-1 convertible preferred stock: authorized, 105,000 (liquidation preference of $100 per share); issued and outstanding 105,000 and 0 of $.0001 par value at December 31, 2015 and December 31, 2014, respectively	11	-
Common stock — authorized, 170,000,000 shares; issued and outstanding; 66,098,482 and 66,001,260 of $.0001 par value at December 31, 2015 and December 31, 2014, respectively	6,610	6,600
Additional paid-in capital	76,754,737	57,506,605
Accumulated deficit	(58,611,450)	(56,754,144)
TOTAL STOCKHOLDERS' EQUITY	18,149,917	759,061
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$20,416,079	$2,067,449

All BIO-key shares issued and outstanding for all periods reflect BIO-key's 1-for-2 reverse stock split, which was effective February 3, 2015.

The accompanying notes are an integral part of these statements.

BIO-key International, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years ended December 31,	
	2015	**2014**
Revenues		
Services	$931,394	$1,489,820
License fees and other	4,329,831	2,516,036
	5,261,225	4,005,856
Costs and other expenses		
Cost of services	260,436	445,803
Cost of license fees and other	1,019,085	302,947
	1,279,521	748,750
Gross Profit	3,981,704	3,257,106
Operating expenses		
Selling, general and administrative	4,121,030	3,670,090
Research, development and engineering	1,556,025	1,626,136
	5,677,055	5,296,226
Operating loss	(1,695,351)	(2,039,120)
Other income (deductions)		
Interest income	14	7
Interest expense	(192,199)	-
Gain on derivative liabilities	31,142	157,253
Income taxes	(912)	(1,712)
	(161,955)	155,548
Net loss	$(1,857,306)	$(1,883,572)
Basic and Diluted Loss per Common Share	$(0.03)	$(0.03)
Weighted Average Shares Outstanding:		
Basic and Diluted	66,032,523	59,047,282

All per-share amounts and BIO-key shares outstanding for all periods reflect BIO-key’s 1-for-2 reverse stock split, which was effective February 3, 2015.

The accompanying notes are an integral part of these statements.

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BIO-key International, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Series A-1 Preferred Stock		**Series B-1 Preferred Stock**		**Common Stock**		**Additional Paid-in**	**Accumulated**	
	Shares	**Amount**	**Shares**	**Amount**	**Shares**	**Amount**	**Capital**	**Deficit**	**Total**
Balance as of December 31, 2013	—	$ —	—	$ —	**57,921,258**	**$5,792**	**$55,915,715**	**$(54,870,572)**	**$1,050,935**
Issuance of common stock and warrants pursuant to security purchase agreements					7,974,999	797	1,594,203	—	1,595,000
Issuance of common stock in exchange for cashless exercise of warrants					76,830	8	(8)	—	—
Issuance of common stock in exchange for cashless exercise of options					28,173	3	(3)	—	—
Reclassification of derivative liability					—	—	42,597	—	42,597
Repurchase of warrants					—	—	(150,000)	—	(150,000)
Stock issuance costs					—	—	(103,157)	—	(103,157)
Share-based compensation					—	—	207,258	—	207,258
Net loss					—	—	—	(1,883,572)	(1,883,572)
Balance as of December 31, 2014	—	$ —	—	$ —	**66,001,260**	**$6,600**	**$57,506,605**	**$(56,754,144)**	**$759,061**

Issuance of common stock for directors' fees					97,222	10	16,990		17,000
Issuance of series A-1 and B-1 preferred stock	90,000	9	105,000	11			19,499,980		19,500,000
Dividends declared on preferred stock							(133,851)		(133,851)
Issuance of warrants for investment advisor							51,026		51,026
Stock issuance costs							(459,102)		(459,102)
Share-based compensation							273,089		273,089
Net loss								(1,857,306)	(1,857,306)
Balance as of December 31, 2015	**90,000**	**$ 9**	**105,000**	**$ 11**	**66,098,482**	**$ 6,610**	**$ 76,754,737**	**$ (58,611,450)**	**$ 18,149,917**

All BIO-key share amounts for all periods reflect BIO-key's 1-for-2 reverse stock split, which was effective February 3, 2015.

The accompanying notes are an integral part of these statements.

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BIO-key International, Inc. and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years ended December 31,	
	2015	**2014**
CASH FLOW FROM OPERATING ACTIVITIES:		
Net loss	$(1,857,306)	$(1,883,572)
Adjustments to reconcile net loss to cash used for operating activities:		
Allowance for doubtful accounts	(6,741)	-
Depreciation	42,996	40,186
Amortization of:		
Intangible assets	13,606	13,606
Debt discount	92,199	-
Share and warrant-based compensation for employees and consultants	324,115	207,258
Gain on derivative liabilities	(31,142)	(157,253)
Stock issued to Directors	17,000	-
Change in assets and liabilities:		
Accounts receivable	(2,759,323)	(341,316)
Due from factor	39,236	(74,208)
Inventory	(336,820)	(2,449)
Software license rights	(12,000,000)	
Prepaid expenses and other	139,226	(162,947)
Accounts payable	811,244	(193,601)
Accrued liabilities	4,450	150,296
Deferred revenue	(52,828)	(98,927)
Net cash used for operating activities	(15,560,088)	(2,502,927)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(3,364)	(18,633)
Net cash used for investing activities	(3,364)	(18,633)
CASH FLOW FROM FINANCING ACTIVITIES:		
Proceeds from issuances of preferred stock	19,500,000	-
Proceeds from issuances of common stock	-	1,595,000
Proceeds from issuance of note payable	250,000	-
Repayment of note payable	(250,000)	-
Repurchase of outstanding warrants	-	(150,000)
Costs to issue preferred and common stock and note payable	(459,102)	(103,157)
Net cash provided by financing activities	19,040,898	1,341,843
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	3,477,446	(1,179,717)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	843,632	2,023,349
CASH AND CASH EQUIVALENTS, END OF YEAR	$4,321,078	$843,632

The accompanying notes are an integral part of these statements.

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SUPPLEMENTARY DISCLOSURES OF CASH FLOW INFORMATION

	Years ended December 31, 2015	2014
Cash paid for:		
Interest	$100,000	$—
Noncash investing and financing activities:		
Reclassification of derivative liability to additional paid-in capital	$-	$42,597
Issuance of warrants for financing raise	92,199	-
Accrual of dividends	133,851	-

The accompanying notes are an integral part of these statements.

BIO-key International, Inc. and Subsidiaries

NOTES TO THE FINANCIAL STATEMENTS

December 31, 2015 and 2014

NOTE A —THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

The Company, founded in 1993, develops and markets proprietary fingerprint identification biometric technology and software solutions. The Company also delivers advanced identification solutions and information services to law enforcement departments, public safety agencies and other government and private sector customers. Our mobile wireless technology provides first responders with critical, reliable, real-time data and images from local, state and national databases.

Basis of Presentation

The Company has incurred significant losses to date, and at December 31, 2015, it had an accumulated deficit of approximately $59 million. In addition, broad commercial acceptance of the Company's technology is critical to the Company's success and ability to generate future revenues. At December 31, 2015, total cash and cash equivalents were approximately $4,321,000, as compared to approximately $844,000 at December 31, 2014.

As discussed below, the Company has financed itself in the past through access to the capital markets by issuing secured and convertible debt securities, convertible preferred stock, common stock, and through factoring receivables. The Company currently requires approximately $512,000 per month to conduct operations, a monthly amount that it has been unable to achieve through revenue generation. With the addition of the dividend obligations for the Series A-1 and B-1 shares, the monthly amount will increase by approximately $67,000, to $579,000.

If the Company is unable to generate sufficient revenue to meet our goals, it will need to obtain additional third-party financing to (i) conduct the sales, marketing and technical support necessary to execute its 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 financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America ("GAAP"), 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 of business. The matters described in the preceding paragraphs raise substantial doubt about the Company’s ability to continue as a going concern. Recoverability of a major portion of the recorded asset amounts shown in the accompanying balance sheet is dependent upon the Company’s ability to meet its financing requirements on a continuing basis, and become profitable in its future operations. The accompanying 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 in existence.

Effective February 3, 2015, the Company implemented a reverse stock split of its outstanding common stock at a ratio of 1 - for - 2 shares. All share figures and results are reflected on a post-split basis. See Note O.

Summary of Significant Accounting Policies

A summary of the significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows:

1. *Basis of Consolidation*

The accompanying consolidated financial statements include the accounts of BIO-key International, Inc. and its wholly-owned subsidiaries (collectively, the “Company”). Intercompany accounts and transactions have been eliminated in consolidation.

2. *Use of Estimates*

Our consolidated financial statements are prepared in accordance with GAAP as set forth in the Financial Accounting Standards Board's (FASB) Accounting Standards Codification (ASC) and consider the various staff accounting bulletins and other applicable guidance issued by the U.S. Securities and Exchange Commission (SEC). These accounting principles require us to make certain estimates, judgments and assumptions. The Company believes that the estimates, judgments and assumptions upon which it relies are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, its consolidated financial statements will be affected. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting among available alternatives would not produce a materially different result.

3. *Revenue Recognition*

Revenues from software licensing are recognized in accordance with ASC 985-605, "Software Revenue Recognition." Accordingly, revenue from software licensing is recognized when all of the following criteria are met: persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable, and collectability is probable.

The Company intends to enter into arrangements with end users for items which may include software license fees, and services or various combinations thereof. For each arrangement, revenues will be recognized when evidence of an agreement has been documented, the fees are fixed or determinable, collection of fees is probable, delivery of the product has occurred and no other significant obligations remain.

Multiple-Element Arrangements: For multiple-element arrangements, the Company applies the residual method in accordance with ASC 985-605. The residual method requires that the portion of the total arrangement fee attributable to the undelivered elements be deferred based on its vendor-specific objective evidence ("VSOE") of fair value and subsequently recognized as the service is delivered. The difference between the total arrangement fee and the amount deferred for the undelivered elements is recognized as revenue related to the delivered elements, which is generally the software license. VSOE of fair value for all elements in an arrangement is based upon the normal pricing for those products and services when sold separately. VSOE of fair value for support services is additionally determined by the renewal rate in customer contracts. The Company has established VSOE of fair value for support as well as consulting services.

License Revenues: Amounts allocated to license revenues are recognized at the time of delivery of the software and all other revenue recognition criteria discussed above have been met.

Revenue from licensing software, which requires significant customization and modification, is recognized using the percentage of completion method, based on the hours of effort incurred by the Company in relation to the total estimated hours to complete. In instances where third party hardware, software or services form a significant portion of a customer's contract, the Company recognizes revenue for the element of software customization by the percentage of completion method described above. Otherwise, third party hardware, software, and services are recognized upon shipment or acceptance as appropriate. If the Company makes different judgments or utilizes different estimates of the total amount of work expected to be required to customize or modify the software, the timing and revenue recognition, from period to period, and the margins on the project in the reporting period, may differ materially from amounts reported. Anticipated contract losses are recognized as soon as they become known and are estimable.

Service Revenues: Revenues from services are comprised of maintenance and consulting and implementation services. Maintenance revenues include providing for unspecified when-and-if available product updates and customer telephone support services, and are recognized ratably over the term of the service period. Consulting services are generally sold on a time-and-materials basis and include a range of services including installation of software and assisting in the design of interfaces to allow the software to operate in customized environments. Services are generally separable from other elements under the arrangement since performance of the services are not essential to the functionality of any other element of the transaction and are described in the contract such that the total price of the arrangement would be expected to vary as the result of the inclusion or exclusion of the services. Revenues from services are generally recognized as the services are performed.

The Company provides customers, free of charge or at a minimal cost, testing kits which potential licensing customers may use to test compatibility/acceptance of the Company's technology with the customer's intended applications.

Costs and other expenses: Includes professional compensation and other direct contract expenses, as well as costs attributable to the support of client service professional staff, depreciation and amortization costs related to assets used in revenue-generating activities, and other costs attributable to serving the Company's client base. Professional compensation consists of payroll costs and related benefits including stock-based compensation and bonuses. Other direct contract expenses include costs directly attributable to client engagements, such as out-of-pocket costs including travel and subsistence for client service professional staff, costs of hardware and software and costs of subcontractors. The allocation of lease and facilities charges for occupied offices is included in costs of service.

The Company accounts for its warranties under the FASB ASC 450, "Contingencies." The Company generally warrants that its products are free from defects in material and workmanship for a period of one year from the date of initial receipt by its customers. The warranty does not cover any losses or damage that occurs as a result of improper installation, misuse or neglect or repair or modification by anyone other than the Company or its authorized repair agent. The Company's policy is to accrue anticipated warranty costs based upon historical percentages of items returned for repair within one year of the initial sale. The Company's repair rate of products under warranty has been minimal, and a historical percentage has not been established. The Company's software license agreements generally include certain provisions for indemnifying customers against liabilities if the Company's software products infringe upon a third party's intellectual property rights. The Company has not provided for any reserves for warranty liabilities as it was determined to be immaterial.

4. *Cash Equivalents*

Cash equivalents consist of liquid investments with original maturities of three months or less. At December 31, 2015 and 2014, cash equivalents consisted of a money market account.

5. *Accounts Receivable*

Accounts receivable are carried at original amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful receivables by regularly evaluating individual customer receivables and considering a customer's financial condition, credit history, and current economic conditions. Accounts receivable are written off when deemed uncollectible. Recoveries of accounts receivable previously written off are recorded when received. Accounts receivable at December 31, 2015 and 2014 consisted of the following:

	December 31,	
	2015	**2014**

Accounts receivable	$3,405,190	$645,867
Allowance for doubtful accounts	(13,785)	(20,526)
Accounts receivable, net of allowances for doubtful accounts	$3,391,405	$625,341

The allowance for doubtful accounts for the years ended December 31, 2015 and 2014 is as follows:

	Balance at Beginning of Year	Charged to Costs and Expenses	Deductions From Reserves	Balance at End of Year
Year Ended December 31, 2015				
Allowance for Doubtful Accounts	$ 20,526	$ -	$ (6,741)	$13,785
Year Ended December 31, 2014				
Allowance for Doubtful Accounts	$ 20,526	$ -	$ -	$20,526

6. *Software License Rights*

Software license rights acquired for re-sale to end users are recorded as assets when purchased. and are stated at the lower of cost or estimated net realizable value.

The cost of the software license rights has been initially allocated pro-rata to the maximum number of resalable end-user licenses in the rights contract and are charged to cost of sales ratably as each end user license is resold to a customer. Management re-evaluates the total sub-licenses it expects to sell during the term of the contract and will adjust the ratable costs charged to cost of sales accordingly.

The rights are also evaluated by management on a periodic basis to determine if estimated future net revenues, on a per sub-license basis, support the recorded basis of each license. If the estimated net revenues are less than the current carrying value of the capitalized software license rights, the Company will reduce the rights to their net realizable value.

Capitalized software license rights expected to be sold to customers in the succeeding year are classified as current assets.

7. *Equipment and Leasehold Improvements, Intangible Assets and Depreciation and Amortization*

Equipment and leasehold improvements are stated at cost. Depreciation is provided for in amounts sufficient to relate the cost of depreciable assets to operations over the estimated service lives, principally using straight-line methods. Leasehold improvements are amortized over the shorter of the life of the improvement or the lease term, using the straight-line method.

The estimated useful lives used to compute depreciation and amortization for financial reporting purposes are as follows:

	2015	
Equipment and leasehold improvements		
Equipment (years)	3-	5
Furniture and fixtures (years)	3-	5
Software (years)	3	
Leasehold improvements	life or lease term	

Intangible assets consist of patents. Patent costs are capitalized until patents are awarded. Upon award, such costs are amortized using the straight-line method over their respective economic lives. If a patent is denied, all costs are charged to operations in that year.

8. *Impairment or Disposal of Long Lived Assets, including Intangible Assets*

The Company reviews long-lived assets, including intangible assets subject to amortization, whenever events or changes in circumstances indicate that the carrying amount of such an asset may not be recoverable. Recoverability of these assets is measured by comparison of their carrying amount to the future undiscounted cash flows the assets are expected to generate. If such assets are considered impaired, the impairment to be recognized is equal to the amount by which the carrying value of the assets exceeds their fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique. In assessing recoverability, the Company must make assumptions regarding estimated future cash flows and discount factors. If these estimates or related assumptions change in the future, the Company may be required to record impairment charges. Intangible assets with determinable lives are amortized over their estimated useful lives, based upon the pattern in which the expected benefits will be realized, or on a straight-line basis, whichever is greater. We did not record any impairment charges in any of the years presented.

9. *Advertising Expense*

The Company expenses the costs of advertising as incurred. Advertising expenses for 2015 and 2014 were approximately $339,000 and $252,000, respectively.

10. *Deferred Revenue*

Deferred revenue includes customer advances and amounts that have been billed per the contractual terms but have not been recognized as revenue. The majority of these amounts are related to maintenance contracts for which the revenue is recognized ratably over the applicable term, which generally is 12 months from the date the customer is delivered the products.

11. *Research and Development Expenditures*

Research and development expenses include costs directly attributable to the conduct of research and development programs primarily related to the development of our software products and improving the efficiency and capabilities of our existing software. Such costs include salaries, payroll taxes, employee benefit costs, materials, supplies, depreciation on research equipment, services provided by outside contractors, and the allocable portions of facility costs, such as rent, utilities, insurance, repairs and maintenance, depreciation and general support services. All costs associated with research and development are expensed as incurred.

12. *Earnings Per Share of Common Stock ("EPS")*

The Company's EPS is calculated by dividing net income (loss) applicable to common stockholders by the weighted-average number of common shares outstanding during the reporting period. Diluted EPS includes the effect from potential issuances of common stock, such as stock issuable pursuant to the conversion of preferred stock, exercise of stock options and warrants, when the effect of their inclusion is dilutive. See Note S - Earnings Per Share "EPS" for additional information.

13. *Accounting for Stock-Based Compensation*

The Company accounts for share based compensation in accordance with the provisions of ASC 718-10, "Compensation — Stock Compensation," which requires measurement of compensation cost for all stock awards at fair value on date of grant and recognition of compensation over the service period for awards expected to vest. The majority of its share-based compensation arrangements vest over either a three or four year vesting schedule. The Company expenses its share-based compensation under the ratable method, which treats each vesting tranche as if it were an individual grant. The fair value of stock options is determined using the Black-Scholes valuation model, and requires the input of highly subjective assumptions. These assumptions include estimating the length of time employees will retain their vested stock options before exercising them (the "expected option term"), the estimated volatility of its common stock price over the option's expected term, the risk-free interest rate over the option's expected term, and the Company's expected annual dividend yield. Changes in these subjective assumptions can materially affect the estimate of fair value of stock-based compensation and consequently, the related amount recognized as an expense in the consolidated statements of operations. As required under the accounting rules, the Company reviews its valuation assumptions at each grant date and, as a result, the Company is likely to change its valuation assumptions used to value employee stock-based awards granted in future periods. The values derived from using the Black-Scholes model are recognized as expense over the service period, net of estimated forfeitures (the number of individuals that will ultimately not complete their vesting requirements). The estimation of stock awards that will ultimately vest requires significant judgment. The Company considers many factors when estimating expected forfeitures, including types of awards, employee class, and historical experience. Actual results, and future changes in estimates, may differ substantially from current estimates.

The compensation expense recognized under ASC 718 amounted to $273,089 and $207,258 for 2015 and 2014, respectively.

The following table presents share-based compensation expenses included in the Company's consolidated statements of operations:

	Year ended December 31,	
	2015	**2014**
Selling, general and administrative	$134,047	$161,466
Research, development and engineering	139,042	45,792
	$273,089	$207,258

Valuation Assumptions for Stock Options

For 2015 and 2014, 1,428,000 and 1,835,000 stock options were granted, respectively. The fair value of each option was estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Year ended December 31,	
	2015	**2014**
Weighted average Risk free interest rate	1.46%	1.34%
Expected life of options (in years)	4.5	4.5
Expected dividends	0 %	0 %
Weighted average Volatility of stock price	117 %	119 %

The stock volatility for each grant is determined based on the review of the experience of the weighted average of historical daily price changes of the Company's common stock over the expected option term. The expected term was determined using the simplified method for estimating expected option life, which qualify as "plain-vanilla" options; and the risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected life of the option.

14. *Derivative Liabilities*

In connection with the issuances of equity instruments or debt, the Company may issue options or warrants to purchase common stock. In certain circumstances, these options or warrants may be classified as liabilities, rather than as equity. In addition, the equity instrument or debt may contain embedded derivative instruments, such as conversion options or listing requirements, which in certain circumstances may be required to be bifurcated from the associated host instrument and accounted for separately as a derivative liability instrument. The Company accounts for derivative liability instruments under the provisions of FASB ASC 815, "Derivatives and Hedging."

15. *Deferred Costs*

Costs incurred with obtaining and executing debt arrangements are capitalized and amortized to interest expense using the effective interest method over the term of the related debt.

16. *Income Taxes*

The provision for, or benefit from, income taxes includes deferred taxes resulting from the temporary differences in income for financial and tax purposes using the liability method. Such temporary differences result primarily from the differences in the carrying value of assets and liabilities. Future realization of deferred income tax assets requires sufficient taxable income within the carryback, carryforward period available under tax law. The Company evaluates, on a quarterly basis whether, based on all available evidence, if it is probable that the deferred income tax assets are realizable. Valuation allowances are established when it is more likely than not that the tax benefit of the deferred tax asset will not be realized. The evaluation, as prescribed by ASC 740-10, “Income Taxes,” includes the consideration of all available evidence, both positive and negative, regarding historical operating results including recent years with reported losses, the estimated timing of future reversals of existing taxable temporary differences, estimated future taxable income exclusive of reversing temporary differences and carryforwards, and potential tax planning strategies which may be employed to prevent an operating loss or tax credit carryforward from expiring unused. Because of the Company’s historical performance and estimated future taxable income, a full valuation allowance has been established.

The Company accounts for uncertain tax provisions in accordance with ASC 740-10-05, “Accounting for Uncertainty in Income Taxes.” The ASC clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements. The ASC prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The ASC provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

17. *Recent Accounting Pronouncements*

In May 2014, ASU No. 2014-09, “Revenue from Contracts with Customers” was issued. The comprehensive new standard will supersede existing revenue recognition guidance and require revenue to be recognized when promised goods or services are transferred to customers in amounts that reflect the consideration to which the Company expects to be entitled in exchange for those goods or services. The guidance will also require that certain contract costs incurred to obtain or fulfill a contract, such as sales commissions, be capitalized as an asset and amortized as revenue is recognized. Adoption of the new rules could affect the timing of both revenue recognition and the incurrence of contract costs for certain transactions. The guidance permits two implementation approaches, one requiring retrospective application of the new standard with restatement of prior years and one requiring prospective application of the new standard with disclosure of results under old standards. The new standard was scheduled to be effective for reporting periods beginning after December 15, 2017 and early adoption is not permitted. In August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of Effective Date" ("ASU 2015-14") which defers the effective date of ASU 2014-09 by one year. ASU 2014-09 is now effective for annual reporting periods after December 15, 2018 including interim periods within annual periods beginning after December 15, 2019. The Company is currently evaluating the impact of adoption and the implementation approach to be used.

Effective January 1, 2015, the Company adopted ASU No. 2015-01, “Income Statement – Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary items” (“ASU 2015-01”) was issued. ASU 2015-01 eliminates from GAAP the concept of extraordinary items. ASU 2015-01 is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively. The adoption of ASU 2014-15 did not have a material effect on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, “Interest-Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs.” ASU 2015-03 requires debt issuance costs related to a debt liability measured at amortized cost to be reported in the balance sheet as a direct deduction from the face amount of the debt liability. ASU 2015-03 is effective for interim and annual periods beginning January 1, 2016 with early adoption permitted, and is applied on a retrospective basis. The adoption of ASU 2015-03 is not expected to materially impact the Company’s consolidated financial statements.

In July 2015 the FASB issued ASU No. 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory" ("ASU 2015-11"). The amendments in ASU 2015-11 clarifies the measurement of inventory to be the lower of cost or realizable value and would only apply to inventory valued using the FIFO or average costing methods. ASU 2015-11 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. The reporting entity should apply the amendments prospectively with earlier application permitted as of the beginning of an interim or annual reporting period. The Company is currently evaluating the effects of adopting ASU 2015-11 on its consolidated financial statements but the adoption is not expected to have a significant impact.

In September 2015, FASB issued ASU 2015-16, “Simplifying the Accounting for Measurement-Period Adjustments” (“ASU 2015-16”). This standard requires an acquirer to recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. ASU 2015-16 also requires separate presentation on the face of the income statement, or disclosure in the notes, of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amount had been recognized as of the acquisition date. ASU 2015-16 is effective for the Company beginning January 1, 2016. The Company does not believe that this will have a material impact on its consolidated financial statements.

In November 2015, FASB issued ASU 2015-17, “Balance Sheet Classification of Deferred Taxes” (“ASU 2015-17”). This standard requires entities to present deferred tax assets and deferred tax liabilities as noncurrent in a classified balance sheet. It may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. The amendments are effective for financial statements issued for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Earlier application is permitted for all entities as of the beginning of an interim or annual reporting period. In the fourth quarter of 2015, the Company elected to early adopt using the prospective method. Therefore, no prior periods were retrospectively adjusted. The adoption did not have a material impact on the Company's consolidated financial statements.

Management does not believe that any other recently issued, but not yet effective, accounting standard if currently adopted would have a material effect on the accompanying consolidated financial statements.

NOTE B—FACTORING

Due from factor consisted of the following as of December 31:

	Original Invoice Value	Factored Amount	Factored Balance due
Year Ended December 31, 2015			
Factored accounts receivable	$149,680	$112,259	$37,421
Year Ended December 31, 2014			
Factored accounts receivable	$306,625	$229,968	$76,657

As of December 2011, the Company entered into a 24 month accounts receivable factoring arrangement with a financial institution (the “Factor”). Pursuant to the terms of the arrangement, the Company, from time to time, sells to the Factor certain of its accounts receivable balances on a non-recourse basis for credit approved accounts. The Factor remits 35% of the foreign and 75% of the domestic accounts receivable balance to the Company (the “Advance Amount”), with the remaining balance, less fees to be forwarded to the Company once the Factor collects the full accounts receivable balance from the customer. In addition, the Company, from time to time, receives over advances from the factor. Factoring fees range from 2.75% to 21% of the face value of the invoice factored, and are determined by the number of days required for collection of the invoice. In April 2012, the terms were updated from monthly to quarterly, and the 24-month arrangement was extended to August 1, 2014. In July of 2014, the arrangement was extended to July 31, 2016. The cost of factoring is included in selling, general and administrative expenses. The cost of factoring was as follows:

	Years Ended December 31,	
	2015	**2014**
Factoring fees	$383,629	$188,904

NOTE C—FAIR VALUES OF FINANCIAL INSTRUMENTS

Cash and cash equivalents, accounts receivable, inventory, due from factor, accounts payable and accrued liabilities are carried at, or approximate, fair value because of their short-term nature.

The fair value of the warrant liabilities is measured at fair value using the following assumptions:

	2015
Risk free interest rate	0.54% - 1.70%
Expected term	0.82 - 4.73
Expected dividends	0
Volatility of stock price	84.5% - 114.9%

For the embedded derivatives that were bifurcated from the associated host instruments, the Company utilized the Monte Carlo simulation. The stock volatility for each grant is determined based on the review of the experience of the weighted average of historical daily price changes of the Company's common stock over the expected term and the risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for periods corresponding with the expected term of the derivative.

The warrant and derivative liabilities are considered Level 3 liabilities on the fair value hierarchy as the determination of fair value includes various assumptions about future activities and the Company's stock prices and historical volatility as inputs.

The table below provides a reconciliation of the beginning and ending balances for the liabilities measured at fair value using significant unobservable inputs (Level 3). There were no assets as of or during the years ended December 31, 2015 and 2014 measured using significant unobservable inputs.

Fair Value Measurements Using

Significant Unobservable Inputs (Level 3):

Warrants issued Under October and November 2013 PI SPA (Note N2b)	
Fair value at January 1, 2015	43,227
Gain on derivative	(35,749)
Value at December 31, 2015	7,478
Warrant issued under September 2015 SPA (Note H)	
Fair value at January 1, 2015	-
Fair value at issuance	92,199
Loss on derivative	4,607
Value at December 31, 2015	96,806
Balance, December 31, 2015	$104,284

NOTE D—CONCENTRATION OF RISK

Financial instruments which potentially subject the Company to risk primarily consist of cash and accounts receivables.

The Company maintains its cash and cash equivalents with various financial institutions, which, at times may exceed the amounts insured by the Federal Deposit Insurance Corporation. The exposure to the Company is solely dependent upon daily bank balances and the respective strength of the financial institutions. The Company has not incurred any losses on these accounts. At December 31, 2015 and 2014, amounts in excess of insured limits were approximately $4,073,000 and $586,000, respectively.

The Company extends credit to customers on an unsecured basis in the normal course of business. The Company's policy is to perform an analysis of the recoverability of its receivables at the end of each reporting period and to establish allowances where appropriate. The Company analyzes historical bad debts and contract losses, customer concentrations, and customer credit-worthiness when evaluating the adequacy of the allowances.

The Company had certain customers whose revenue individually represented 10% or more of the Company's total revenue, as follows:

	Years Ended December 31,	
	2015	**2014**
Customer A	37 %	*
Customer B	*	11 %
Customer C	*	10 %
Customer D	*	44 %

* Less than 10% of total revenue

The Company had certain customers whose accounts receivable balances individually represented 10% or more of the Company's total accounts receivable, as follows:

As of December 31,

	2015	2014
Customer A	62 %	-
Customer B	14 %	-
Customer C	11 %	*
Customer D	-	62 %

* Less than 10% of total accounts receivable

Customer A's receivable of $2,070,000 has been past due per the terms of the invoice for six months as of December 31, 2015. Based on prior history with this customer the Company feels the amount is fully collectable and has determined that a reserve is not necessary.

NOTE E—INVENTORY

Inventory is stated at the lower of cost, determined on a first in, first out basis, or market, and consists primarily of fabricated assemblies and finished goods. Inventory is comprised of the following as of December 31:

	2015	**2014**
Current		
Finished goods	246,475	11,825
Fabricated assemblies	102,170	-
Total current inventory	$348,645	$11,825

NOTE F—SOFTWARE LICENSE RIGHTS

On November 11, 2015, the Company entered into a license agreement for the rights to all software and documentation regarding the technology currently known as or offered under the FingerQ name (refer to Note K - Related Party). The license agreement grants the Company the exclusive right to reproduce, create derivative works and distribute copies of the FingerQ software and documentation, create new FingerQ related products, and grant sub-licenses of the licensed technology to end users. The license rights have been granted to the Company in perpetuity, with a stated number of end-user resale sub-licenses allowed under the contract. As of December 31, 2015, the Company has not sold any sub-licenses.

The Company made a one-time payment of $12,000,000 to the licensors. The cost of sub-license rights expected to be sold to customers in the succeeding year is $5,000,000 and is classified as a current asset.

NOTE G—EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Equipment and leasehold improvements consisted of the following as of December 31:

	2015	**2014**
Equipment	$398,910	$395,546
Furniture and fixtures	139,779	139,779

Software	28,624	28,624
Leasehold improvements	53,948	53,948
	621,261	617,897
Less accumulated depreciation and amortization	(557,384)	(514,388)
Total	$63,877	$103,509

Depreciation and amortization were $42,996 and $40,186 for 2015 and 2014, respectively.

NOTE H—INTANGIBLE ASSETS

Intangible assets consisted of the following as of December 31:

	2015 Gross Carrying Amount	2015 Accumulated Amortization	2015 Net Carrying Amount	2014 Gross Carrying Amount	2014 Accumulated Amortization	2014 Net Carrying Amount
Patents and patents pending	$287,248	$ (139,510)	$147,738	$287,248	$ (125,904)	$161,344
Total	$287,248	$ (139,510)	$147,738	$287,248	$ (125,904)	$161,344

Aggregate amortization expense for both 2015 and 2014 was $13,606. The estimated aggregate amortization expense of intangible assets for the years following December 31, 2015 is approximately $14,000 per year for 2016 through 2020, and approximately $78,000 thereafter.

NOTE I—NOTE PAYABLE

Securities Purchase Agreement dated September 23, 2015

On September 23, 2015 the Company issued a promissory note due seven months from the date of issuance and a warrant to purchase 833,333 shares of common stock in net consideration after the original issue discount, of $250,000. The principal sum due under the note is the aggregate purchase price of $250,000 plus an original issue discount of approximately 20% of the purchase price and a one-time interest charge of 12% of the purchase price. The principal sum and all other amounts owing under the note were fully paid by the Company following the initial closing of the October 2015 Series A-1 Convertible Preferred Stock offering. The warrants are immediately exercisable at an exercise price of $0.30 per share and have a term of five years.

The warrants have customary anti-dilution protections including a "full ratchet" anti-dilution adjustment provision which are triggered in the event the Company sells or grants any additional shares of common stock, options, warrants or other securities that are convertible into common stock at a price lower than $0.30 per share, The anti-dilution adjustment provision is not triggered by certain "exempt issuances" which among other issuances, includes the issuance of shares of common stock, options or other securities to officers, employees, directors, consultants or service providers.

Based on an evaluation as discussed in FASB ASC 815-15, “Embedded Derivatives” and FASB ASC 815-40-15, “Contracts in Entity’s Own Equity - Scope and Scope Exceptions,” the Company determined that the full ratchet anti-dilution feature in the common stock issued was not considered indexed to its own stock because neither the occurrence of a sale of equity securities by the issuer at market nor the issuance of another equity contract with a lower strike price is an input to the fair value of a fixed-for-fixed option or forward on equity shares. As such, the full ratchet anti-dilution feature should be bifurcated from the common stock and accounted for as a derivative liability.

The Company did not value the derivative liability. One of the key determinants of the Company’s decision to not value the derivative liability was the high likelihood that a future financing would not occur that would trigger the down round feature. Whether a future equity financing would occur would be determined by the cash needs of the Company and management’s willingness to trigger the down round feature. The Company’s reasons were based on the issuance of Series A and Series B preferred stock in October and November of 2015, issued at a conversion price of $0.30.

The cashless exercise features contained in the warrants are considered to be derivatives and the Company recorded warrant liabilities on the consolidated balance sheet. The Company initially recorded a debt discount of $92,199 and a warrant liability in the same amount. The debt discount is being amortized over the term of the loan. The total amortized debt discount including interest expense was $192,199 for the year ended December 31, 2015. The warrants issued by the Company are valued using the Black-Scholes option-pricing model. The Company is required to mark-to-market the warrant liabilities at the end of each reporting period. For the year ended December 31, 2015, the Company recorded a loss on the change in fair value of the cashless exercise features of $4,607. December 31, 2015, the fair value of the cashless exercise features was $96,806.

NOTE J—ACCRUED LIABILITIES

Accrued liabilities consisted of the following as of December 31:

	2015	**2014**
Compensation	$78,016	$203,349
Compensated absences	113,996	116,439
Dividends payable – preferred stock	133,851	3,435
Accrued legal and accounting fees	141,000	92,000
Sales tax payable	48,255	55,436
Other	111,800	17,958
Total	$626,918	$488,617

NOTE K—RELATED PARTY

Consulting Arrangement with Thomas J. Colatosti

In connection with his appointment to the Board of Directors in September 2002, and as acting Chief Financial Officer from November 2008 to December 2009, we had entered into a number of consulting arrangements with Thomas Colatosti. Under the most recent arrangement, which was entered into on January 12, 2010, Mr. Colatosti provided services to the Company and its subsidiaries and affiliates for the two-year term ended December 31, 2011 at a rate of $5,000 per month. All amounts owing to Mr. Colatosti were paid during 2014.

Licensing Agreement with Subsidiaries of China Goldjoy Group Limited.

On November 11, 2015 our subsidiary BIO-key Hong Kong Limited entered into a license purchase agreement with certain subsidiaries of China Goldjoy Group Limited (“CGG”). The license agreement provides for the grant of a perpetual, irrevocable, exclusive, worldwide, fully-paid license to all software and documentation regarding the software code, toolkit, electronic libraries and related technology currently known as or offered under the Finger Q name, together with perpetual license under all related patents held by the licensors and any other intellectual property rights owned by the licensors related to the forgoing software. We made a one-time payment of $12,000,000 to the licensors. Mr. Yao Jianhu is the chairman and chief executive officer of CGG and a director of the Company. Mr. Wong Kwok Fong is the chief technology officer of CGG, the beneficial owner of 9.9% of our common stock, and a director of the Company.

NOTE L—DEFERRED REVENUE

Deferred revenue represents unearned revenue on maintenance contracts. Maintenance contracts include provisions for unspecified when-and-if available product updates and customer telephone support services, and are recognized ratably over the term of the service period. At December 31, 2015 and 2014, amounts in deferred revenue were approximately $376,000 and $429,000, respectively.

NOTE M—SEGMENT INFORMATION

The Company has determined that its continuing operations are one discrete segment consisting of Biometric products. Geographically, North American sales accounted for approximately 51% and 91% of the Company’s total revenues for 2015 and 2014, respectively.

NOTE N—COMMITMENTS AND CONTINGENCIES

Operating Leases

The Company does not own any real estate but conducts operations from three leased premises. These non-cancelable operating leases expire at various dates through 2018. In addition to base rent, the Company pays for property taxes, maintenance, insurance and other occupancy expenses according to the terms of the individual leases.

Future minimum rental commitments of non-cancelable operating leases are approximately as follows:

Years ending December 31,	
2016	147,732
2017	152,364
2018	103,829
	$403,925

Rental expense was approximately $170,000 and $174,000 during 2015 and 2014, respectively.

Contingency

On or about March 13, 2014, LifeSouth Community Blood Centers, Inc. ("LifeSouth"), filed a lawsuit against the Company in the Superior Court of Monmouth County, New Jersey (MON-L-1042-14) alleging a breach of a license agreement and seeking return of all amounts paid under the license in the amount of $718,500. On August 21, 2015, the Company and LifeSouth entered into a settlement agreement to discontinue and end litigation.

NOTE O— EQUITY

1. Preferred Stock

Within the limits and restrictions provided in the Company's Certificate of Incorporation, the Board of Directors has the authority, without further action by the shareholders, to issue up to 5,000,000 shares of preferred stock, $.0001 par value per share, in one or more series, and to fix, as to any such series, any dividend rate, redemption price, preference on liquidation or dissolution, sinking fund terms, conversion rights, voting rights, and any other preference or special rights and qualifications. As of December 31, 2015, 100,000 shares of preferred stock have been designated as Series A-1 Convertible Preferred Stock, of which 90,000 shares are issued and outstanding, and 105,000 shares of preferred stock have been designated as Series B-1 Convertible Preferred Stock, all of which are outstanding.

Series A-1 Convertible Preferred Stock

On October 22 and 29, 2015, the Company issued 84,500 shares of Series A-1 Convertible Preferred Stock at a purchase price of $100.00 per share, for aggregate gross proceeds of $8,450,000. On November 11, 2015, 5,500 additional shares of Series A-1 Convertible Preferred Stock were issued at a purchase price of $100.00 per share, for gross cash proceeds of $550,000.

Shares of the Series A-1 Convertible Preferred Stock are convertible at any time at the option of the holder into shares of common stock by dividing the Series A-1 Original Issue Price by an initial conversion price of $0.30 per share, subject to adjustment for stock dividends, stock splits, combinations, and reclassifications of the Company's capital stock, and subject to a "blocker provision" which prohibits conversion if such conversion would result in the holder being the beneficial owner of in excess of 9.99% of the Company's common stock. The Series A-1 Shares accrue dividends at the rate of 6% per annum payable quarterly on April 1, July, 1, October 1, and January 1 of each year. Until October 1, 2017, the dividends are payable in cash provided that if payment in cash would be prohibited under applicable Delaware corporation law or cause the Company to breach any agreement for borrowed money, such dividends are payable in kind through the issuance of additional shares of common stock having a value equal to the volume weighted average trading price of the Company's common stock for the ten (10) days preceding the applicable dividend payment date. Commencing January 1, 2018, dividends are payable at the option of the Company in cash or kind through the issuance of additional shares of common valued as described above.

The holders of the Series A-1 shares are entitled to designate one person to serve on the Board of Directors of the Company. The holders of the Series A-1 Shares are entitled to vote on an as converted to common stock basis together with the holders of our common stock on all matters presented to our stockholders. Upon any liquidation or dissolution of the Company, any merger or consolidation involving the Company or any subsidiary of the Company in which the shares of capital stock of the Company outstanding immediately prior to such merger or consolidation do not represent immediately following such merger or consolidation at least a majority of the voting power of the capital stock of the resulting or surviving corporation, or the sale of all or substantially all assets in a single transaction or a series of related transactions, unless the holders of at least a majority of the outstanding Series A-1 Shares elect otherwise, holders of Series A-1 Shares shall be entitled to receive prior to any payment to any holders of the Company's common stock an amount per share equal to $100.00 per share plus any declared and unpaid dividends (pari-passu with the Series B-1 holders). As at December 31, 2015 $97,392 of dividends were accrued for the holders of the Series A-1 shares. This amount was paid January 6, 2016.

The Series A-1 Preferred Stock contains options that based on an evaluation of FASB ASC 815-15, "Embedded Derivatives" and FASB ASC 815-40-15, "Contracts in Entity's Own Equity - Scope and Scope Exceptions," are considered embedded features: Preferred Stock's conversion option: The Preferred Stock is convertible at the Holder's option at any time at the fixed conversion price of $0.30 per share; Quarterly Dividend Conversion Option: From issuance until December 31, 2017, the majority of Holders may elect to have the Stock's Quarterly dividend payment made in shares of Common Stock, having a value equal to the volume weighted average trading price of the Common Stock during the ten (10) trading day period preceding the applicable dividend payment date. These features were analyzed by the Company and determined that they were not required to be bifurcated from the preferred stock and recorded as derivatives as they are clearly and closely related to an equity host.

Series B-1 Convertible Preferred Stock

On November 11, 2015, the Company issued 105,000 shares of Series B-1 Convertible Preferred Stock at a purchase price of $100.00 per share, for gross proceeds of $10,500,000. Shares of the Series B-1 Convertible Preferred Stock are convertible at any time at the option of the holder into shares of common stock by dividing the Series B-1 Original Issue Price by an initial conversion price of $0.30 per share, subject to adjustment for stock dividends, stock splits, combinations, and reclassifications of the Company's capital stock, and subject to a "blocker provision" which prohibits conversion if such conversion would result in the holder being the beneficial owner of in excess of 9.99% of the Company's common stock. The Series B-1 Shares accrue dividends at the rate of 2.5% per annum payable quarterly on April 1, July, 1, October 1, and January 1 of each year payable in cash provided that if payment in cash would be prohibited under applicable Delaware corporation law or cause the Company to breach any agreement for borrowed money, or if the majority of the outstanding shares of the Series B-1 Shares elect otherwise, such dividends are payable in kind through the issuance of additional shares of common stock having a value equal to the volume weighted average trading price of the Company's common stock for the ten (10) days preceding the applicable dividend payment date.

The holders of the Series B-1 shares are entitled to designate one person to serve on the Board of Directors of the Company. The holders of the Series B-1 Shares are entitled to vote on an as converted to common stock basis together with the holders of our common stock on all matters presented to our stockholders. Upon any liquidation or dissolution of the Company, any merger or consolidation involving the Company or any subsidiary of the Company in which the shares of capital stock of the Company outstanding immediately prior to such merger or consolidation do not represent immediately following such merger or consolidation at least a majority of the voting power of the capital stock of the resulting or surviving corporation, or the sale of all or substantially all assets in a single transaction or a series of related transactions, unless the holders of at least a majority of the outstanding Series B-1 Shares elect otherwise, holders of Series B-1 Shares shall be entitled to receive prior to any payment to any holders of the Company’s common stock an amount per share equal to $100.00 per share plus any declared and unpaid dividends (pari-passu with the Series A-1 holders). As at December 31, 2015 $36,459 of dividends were accrued for the holders of the Series B-1 shares. This amount was paid on January 5, 2016.

The Series B-1 Preferred Stock contains options that based on an evaluation of FASB ASC 815-15, “Embedded Derivatives” and FASB ASC 815-40-15, “Contracts in Entity’s Own Equity - Scope and Scope Exceptions,” are considered embedded features: Preferred Stock’s conversion option: The Preferred Stock is convertible at the Holder’s option at any time at the fixed conversion price of $0.30 per share; Quarterly Dividend Conversion Option: The majority of Holders may elect to have the Stock’s Quarterly dividend payment made in shares of Common Stock, having a value equal to the volume weighted average trading price of the Common Stock during the ten (10) trading day period preceding the applicable dividend payment date. These features were analyzed by the Company and determined that they were not required to be bifurcated from the preferred stock and recorded as derivatives as they are clearly and closely related to an equity host.

Stock Issuance Costs

Costs of approximately $375,000 were incurred in relation to the issuance of both the Series A-1 and Series B-1 preferred stock.

2. Common Stock

Effective February 3, 2015, the Company implemented a reverse stock split of its outstanding common stock at a ratio of 1 - for - 2. The number of authorized shares and the par value of the Company's common stock and preferred stock were not affected by the reverse stock split. Stockholders who otherwise would be entitled to receive fractional shares were rounded up to the nearest whole share. The reverse stock split became effective on the OTCQB at the opening of trading on February 6, 2015.

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

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

Issuances of Common Stock

a) Securities Purchase Agreement dated November 13, 2014

Pursuant to a Securities Purchase Agreement, dated November 13, 2014, by and between the Company and a number of private and institutional investors (the "November 2014 Private Investor SPA"), the Company issued to certain private investors 7,974,999 post-split shares of common stock and warrants to purchase an additional 11,962,501 post-split shares of common stock for aggregate gross proceeds of $1,595,000. In addition, for each share purchased in this offering, the investors surrendered to the Company for cancellation a warrant to acquire one share of our common stock which we previously issued in a private placement transaction in November 2013. This resulted in the cancellation of warrants to purchase an aggregate of 7,974,999 post-split shares of common stock.

The common stock has a purchase price reset feature. If at any time prior to the two year anniversary of the effective date of the registration statement covering the public resale of such shares, the Company sells or issues shares of common stock or securities that are convertible into common stock at a price lower than $0.20 per share, the Company will be required to issue additional shares of common stock for no additional consideration.

Based on an evaluation as discussed in FASB ASC 815-15, “Embedded Derivatives” and FASB ASC 815-40-15, “Contracts in Entity’s Own Equity - Scope and Scope Exceptions,” the Company determined that the purchase price reset feature in the common stock issued was not considered indexed to its own stock because neither the occurrence of a sale of equity securities by the issuer at market nor the issuance of another equity contract with a lower strike price is an input to the fair value of a fixed-for-fixed option or forward on equity shares. As such, the purchase price reset feature should be bifurcated from the common stock and accounted for as a derivative liability.

The Company valued the purchase price reset feature using a Monte Carlo simulation at the date of issuance, and December 31, 2014, and determined that the purchase price reset feature had no value as the calculated price of the common stock was not below $0.20 per share. At December 31, 2015 the calculated price was below $0.20, however the Company did not value the reset feature based on the issuance of Series A and Series B preferred stock in October and November of 2015, issued at a conversion price of $0.30.

The warrants have a term of five years and an exercise price of $0.30 per post-split share. Warrants to purchase 5,981,251 post-split shares of common stock were immediately exercisable. The remaining warrants to purchase 5,981,250 post-split shares of common stock became exercisable on the completion of a 1 - for - 2 reverse split of the Company's common stock in February 2015.

The warrants have customary anti-dilution protections including a “full ratchet” anti-dilution adjustment provision which are triggered in the event the Company sells or grants any additional shares of common stock, options ,warrants or other securities that are convertible into common stock at a price lower than $0.30 per share, The anti-dilution adjustment provision is not triggered by certain “exempt issuances” which among other issuances, includes the issuance of shares of common stock, options or other securities to officers, employees, directors, consultants or service providers.

The warrants are exercisable on a cashless basis if at any time there is no effective registration statement covering the resale of the shares of common stock underlying the warrants. See below.

Based on an evaluation as discussed in FASB ASC 815-15, “Embedded Derivatives” and FASB ASC 815-40-15, “Contracts in Entity’s Own Equity - Scope and Scope Exceptions,” the Company determined that the full ratchet anti-dilution feature in the warrants issued were not considered indexed to its own stock because neither the occurrence of a sale of equity securities by the issuer at market nor the issuance of another equity contract with a lower strike price is an input to the fair value of a fixed-for-fixed option or forward on equity shares. As such, the full ratchet anti-dilution feature should be bifurcated from the warrants and accounted for as a derivative liability.

The Company did not value the derivative liability. One of the key determinants of the Company's decision to not value the derivative liability was the high likelihood that a future financing would not occur that would trigger the down round feature. Whether a future equity financing would occur would be determined by the cash needs of the Company and management's willingness to trigger the down round feature. The Company's reason was based on the issuance of Series A and Series B preferred stock in October and November of 2015, issued at a conversion price of $0.30.

Under GAAP, the Company is required to mark-to-market the derivative liability at the end of each reporting period. The Company did not value the derivative liability at the date of issuance, December 31, 2014 or December 31, 2015. At such dates, the Company determined that it was highly unlikely that an equity financing would occur that would trigger the down round feature. Such conclusion was based upon the discussion noted above.

The Company filed a registration statement on Form S-1 with the SEC to register the public resale of 13,956,250 of the shares of common stock issued in the November 2014 Private Investor SPA. The registration statement was declared effective on January 29, 2015. Post reverse split, the Company filed a registration statement on Form S-1 with the SEC to register the balance of the shares of common stock issued under the November 2014 Private Investor SPA which was declared effective on May 4, 2015.

b) Derivative Liabilities: Securities Purchase Agreements dated October 25, 2013 and November 8, 2013

Pursuant to a series of Private Investors Securities Purchase Agreements (the "PI SPA"), on October 25, 2013 and November 8, 2013, the Company issued to certain private investors an aggregate of 12,323,668 units consisting of 12,323,668 post-split shares of common stock (the "Shares") and warrants to purchase an additional 12,323,668 post-split shares of common stock (the "Warrants") for an aggregate purchase price of $3,697,100. The warrants are immediately exercisable at an exercise price of $0.50 per post-split share, have a term of three years, and were exercisable on a cashless basis if at any time following the nine month anniversary of the issuance date, there is not an effective registration statement covering the public resale of the shares of Common Stock underlying the warrants. The Company filed a registration statement on November 22, 2013 and such registration was declared effective on December 31, 2013.

In connection with the share issuances described above, and pursuant to a placement agency letter agreement, the Company paid the placement agent cash commissions equal to 8% of the gross proceeds of the offering, reimbursed the placement agent for its reasonable out of pocket expenses, and issued to the placement agent warrants (the “Placement Agent Warrants”) to purchase an aggregate of 985,893 post-split shares of common stock. The Placement Agent Warrants have substantially the same terms as the warrants issued to the investors, except the Placement Agent Warrants are immediately exercisable on a cashless basis.

The cashless exercise features contained in the warrants are considered to be derivatives and the Company recorded warrant liabilities on the consolidated balance sheet. The Company initially recorded the warrant liabilities equal to their estimated fair value of $325,891. Such amount was also recorded as a reduction of additional paid-in capital. The Company is required to mark-to-market the warrant liabilities at the end of each reporting period. For the year ended December 31, 2015, the Company recorded a gain on the change in fair value of the cashless exercise features of $35,749. As of December 31, 2015, the fair value of the cashless exercise features was $7,478. The fair value of the cashless exercise features was $43,227 as of December 31, 2014.

c) Employees’ exercise options

During the year ended December 31, 2014, 54,166 stock options were exercised resulting in the cashless issuance of 28,173 post-split shares of common stock. No stock options were exercised during the year ended December 31, 2015.

3. Warrants

The Company has issued warrants to certain creditors, investors, investment bankers and consultants. A summary of warrant activity is as follows:

	Total Warrants	Weighted average exercise price	Weighted average remaining life (in years)	Aggregate intrinsic value

Outstanding, as of January 1, 2014	19,334,579	$ 0.52	2.79	
Granted	11,962,501	0.30		
Exercised	(150,000)	0.20		
Forfeited	(7,974,999)	0.50		
Expired	(125,000)	0.60		
Repurchased	(4,000,000)	0.60		
Outstanding, as of December 31, 2014	19,047,081	0.37	3.91	—
Granted	1,408,333	0.26		
Exercised	—	—		
Forfeited	—	—		
Expired	—	—		
Outstanding, as of December 31, 2015	20,455,414	0.37	3.02	—
Vested or expected to vest at December 31, 2015	20,455,414	0.37	3.02	—
Exercisable at December 31, 2015	20,311,664	$ 0.37	3.01	—

On January 27, 2014, the Company repurchased a warrant for the purchase of 4,000,000 post-split shares of common stock from the Shaar Fund Ltd. at a purchase price of $150,000. The warrant was exercisable at a strike price of $0.60 per post-split share through December 31, 2015.

On March 9, 2015, the Company issued a warrant to purchase 575,000 shares of common stock to a consultant which vests in equal quarterly installments over one year and is exercisable at $0.21 per share through March 8, 2020.

The fair value of the warrants was initially estimated on the date of grant at $98,065 using the Black-Scholes option-pricing model. The warrant valuation is required to be mark-to-market at each reporting period, and at December 31, 2015, the fair value was estimated to be $68,035 with the following assumptions: risk free interest rate: 1.58%, expected remaining life of options in years: 4.19, expected dividends: 0, volatility of stock price: 115.9%.

Share based expense related to the value of the stock warrants is recorded over the requisite service period, which is generally the vesting period for each tranche. For the year ended December 31, 2015, the Company recorded an expense of $51,026 related to the stock warrants.

On September 23, 2015, the Company issued a warrant to purchase 833,333 shares of common stock in connection with the issuance of a promissory note. Refer to Note I for details.

NOTE P—STOCK OPTIONS

1999 Stock Option Plan

During 1999, the Board of Directors of the Company adopted the 1999 Stock Option Plan (the 1999 Plan). The 1999 Plan was not presented to stockholders for approval and thus incentive stock options are not available under the plan. Under the 1999 Plan, 1,000,000 shares of common stock are reserved for issuance to employees, officers, directors, and consultants of the Company at exercise prices which may not be below 85% of fair market value. The term of nonstatutory stock options granted may not exceed ten years. Options issued under the Plan vest pursuant to the terms of stock option agreements with the recipients. In the event of a change in control, as defined, all options outstanding vest immediately. The 1999 Plan expired in August 2009.

2004 Stock Option Plan

On October 12, 2004, the Board of Directors of the Company approved the 2004 Stock Option Plan (the 2004 Plan). The 2004 Plan has not yet been presented to stockholders for approval and thus incentive stock options are not available under this plan. Under the terms of this plan, 2,000,000 post-split shares of common stock are reserved for issuance to employees, officers, directors, and consultants of the Company at exercise prices which may not be below 85% of fair market value. The term of stock options granted may not exceed ten years. Options issued under the Plan vest pursuant to the terms of stock option agreements with the recipients. In the event of a change in control, as defined, all options outstanding vest immediately. The Plan expired in October 2014.

2015 Stock Option Plan

On January 27, 2016, the shareholders approved the 2015 Equity Incentive Plan (the 2015 Plan). Under the terms of this plan, 8,000,000 post-split shares of common stock are reserved for issuance to employees, officers, directors, and consultants of the Company at exercise prices which may not be below 100-110% of fair market value. The term of stock options granted may not exceed ten years. Options issued under the Plan vest pursuant to the terms of stock option agreements with the recipients. In the event of a change in control, certain stock awards issued under this plan may be subject to additional acceleration of vesting as may be provided in the participants' written agreement. The Plan expires in December 2025.

Non-Plan Stock Options

Periodically, the Company has granted options outside of the 1999 and 2004 Plans to various employees and consultants. In the event of change in control, as defined, certain of the non-plan options outstanding vest immediately.

Stock Option Activity

Information summarizing option activity is as follows:

	Number of Options				**Weighted average exercise price**	**Weighted average remaining life (in years)**	**Aggregate intrinsic value**
	1999 Plan	**2004 Plan**	**Non Plan**	**Total**			
Outstanding, as of December 31, 2013	250,000	1,845,304	600,000	2,695,304	$ 0.33		
Granted	—	—	1,835,000	1,835,000	0.39		
Exercised	—	(54,166)	—	(54,166)	0.25		
Forfeited	—	(129,168)	(225,000)	(354,168)	0.34		
Expired	—	(26,665)	—	(26,665)	0.29		
Outstanding, as of December 31, 2014	**250,000**	**1,635,305**	**2,210,000**	**4,095,305**	**$ 0.36**	**4.45**	**$ 24,325**
Granted	—	—	1,428,000	1,428,000	0.18		
Exercised	—	—	—	—			
Forfeited	—	(41,667)	(462,585)	(504,252)	0.31		

Expired	—	(573,638)	(66,582)	(640,220)	0.25		
Outstanding, as of December 31, 2015	**250,000**	**1,020,000**	**3,108,833**	**4,378,833**	**$ 0.32**	**4.57**	**$ 240**
Subject to vesting at December 31, 2015				**3,628,853**	**$ 0.34**	**4.22**	**$ 129**
Exercisable at December 31, 2015				**1,931,653**	**$ 0.38**	**2.94**	**$ 0**

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The options outstanding and exercisable at December 31, 2015 were in the following exercise price ranges:

	Options Outstanding			**Options Exercisable**	
Range of exercise prices	**Number of shares**	**Weighted average exercise price**	**Weighted average remaining life (in years)**	**Number exercisable**	**Weighted average exercise price**
$0.15-0.40	2,893,000	$ 0.24	4.68	1,244,167	$ 0.28
0.41-0.79	1,280,833	0.41	5.18	482,486	0.41
0.80-0.92	205,000	0.90	1.02	205,000	0.90
$0.15-0.92	4,378,833			1,931,653	

The aggregate intrinsic value in the table above represents the total intrinsic value, based on the Company's closing stock price of $0.16 as of December 31, 2015, which would have been received by the option holders had all option holders exercised their options as of that date. The total number of in-the-money options exercisable as of December 31, 2015 was 0.

The weighted average fair value of options granted during the years ended December 31, 2015 and 2014 was $0.14 and $0.32 per share, respectively. The total intrinsic value of options exercised during the years ended December 31, 2015 and 2014 was $0 and 14,650, respectively. The total fair value of shares vested during the years ended December 31, 2015 and 2014 was $265,247 and $143,382 respectively.

As of December 31, 2015, future compensation cost related to nonvested stock options is $318,177 and will be recognized over an estimated weighted average period of 1.50 years.

NOTE Q—INCOME TAXES

There was no provision for federal or state taxes as at December 31, 2015 and 2014.

The Company has deferred taxes due to income tax credits, net operating loss carryforwards, and the effect of temporary differences between the carrying values of certain assets and liabilities for financial reporting and income tax purposes. Significant components of deferred taxes are as follows at December 31:

	2015	**2014**
Current asset:		
Accrued compensation	$75,000	$88,000
Accounts receivable allowance	5,000	8,000
Non-current asset (liability):		
Stock-based compensation	258,000	174,000
Basis differences in fixed assets	(16,000)	(26,000)
Basis differences in intangible assets	55,000	(63,000)
Net operating loss and credit carryforwards	17,994,000	17,540,000
Valuation allowances	(18,372,000)	(17,721,000)
	$—	$—

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The Company has a valuation allowance against the full amount of its net deferred taxes due to the uncertainty of realization of the deferred tax assets due to operating loss history of the Company. The Company currently provides a valuation allowance against deferred taxes when it is more likely than not that some portion, or all of its deferred tax assets will not be realized. The valuation allowance could be reduced or eliminated based on future earnings and future estimates of taxable income. Similarly, income tax benefits related to stock options exercised have not been recognized in the financial statements.

As of December 31, 2015, the Company has federal net operating loss carryforwards of approximately $50,700,000 subject to expiration between 2019 and 2035. These net operating loss carryforwards are subject to the limitations under Section 382 of the Internal Revenue Code due to changes in the equity ownership of the Company.

A reconciliation of the effective income tax rate on operations reflected in the Statements of Operations to the US Federal statutory income tax rate is presented below.

	2015		**2014**	
Federal statutory income tax rate	34	%	34	%
Permanent differences	—		—	)
Effect of net operating loss	(34	)	(34	)
Effective tax rate	—	%	—	%

The Company has not been audited by the Internal Revenue Service ("IRS") or any states in connection with income taxes. The Company files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. The periods from 2012 through 2015 remain open to examination by the IRS and state jurisdictions. The Company believes it is not subject to any tax audit risk beyond those periods. The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. The Company does not have any accrued interest or penalties associated with any unrecognized tax benefits, nor was any significant interest expense recognized during the years ended December 31, 2015 and 2014.

NOTE R—PROFIT SHARING PLAN

The Company has established a savings plan under section 401(k) of the Internal Revenue Code. All employees of the Company, after completing one day of service are eligible to enroll in the 401(k) plan. Participating employees may elect to defer a portion of their salary on a pre-tax basis up to the limits as provided by the IRS Code. The Company is not required to match employee contributions but may do so at its discretion. The Company made no contributions during the years ended December 31, 2015 and 2014.

NOTE S—EARNINGS PER SHARE (EPS)

The Company's basic EPS is calculated using net income (loss) available to common shareholders and the weighted-average number of shares outstanding during the reporting period. Diluted EPS includes the effect from potential issuance of common stock, such as stock issuable pursuant to the exercise of stock options and warrants and the assumed conversion of preferred stock.

The reconciliation of the numerator of the basic and diluted EPS calculations, due to the inclusion of preferred stock dividends was as follows for the following fiscal years ended December 31:

	2015	**2014**
Basic Numerator:		
Loss from continuing operations	$(1,857,306)	$(1,883,572)
Convertible preferred stock dividends	(133,851)	-
Net loss available to common stockholders (basic and diluted EPS)	$(1,991,157)	$(1,883,572)

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The following table summarizes the weighted average securities that were excluded from the diluted per share calculation because the effect of including these potential shares was antidilutive.

	Years ended December 31,	
	2015	**2014**
Preferred stock	10,309,132	-
Stock options	55,664	516,214
Warrants	-	2,013,491
Potentially dilutive securities	10,364,796	2,529,705

Items excluded from the diluted per share calculation because the exercise price was greater than the average market price of the common shares:

	Years ended December 31,	
	2014	**2014**
Stock options	2,838,333	1,615,000
Warrants	20,455,414	7,084,580
Total	23,293,747	8,699,580

NOTE T—SUBSEQUENT EVENTS

On January 27, 2016, holders of common stock, Series A-1 Preferred Stock, and Series B-1 Preferred Stock approved a proposal to effect a reverse split of the Company's issued and outstanding common stock at a ratio between 1-for-4 and 1-for-12, with the final decision of whether to proceed with the reverse stock split and the exact ratio and timing of the reverse split to be determined by the board of directors, in its discretion, no later than December 30, 2016.

The Company has reviewed subsequent events through the date of this filing.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BIO-KEY INTERNATIONAL, INC.

Date: March 30, 2016 By: /s/ MICHAEL W. DEPASQUALE
Michael W. DePasquale
CHIEF EXECUTIVE OFFICER

(Principal Executive Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities on the dates indicated.

Signature	**Title**	**Date**
/s/ MICHAEL W. DEPASQUALE Michael W. DePasquale	Chairman of the Board of Directors, Chief Executive Officer and Director (Principal Executive Officer)	March 30, 2016
/s/ CECILIA WELCH Cecilia Welch	Chief Financial Officer (Principal Accounting Officer)	March 30, 2016
/s/ JOHN SCHOENHERR John Schoenherr	Director	March 30, 2016
/s/ CHARLES P. ROMEO Charles P. Romeo	Director	March 30, 2016
/s/ THOMAS E. BUSH III Thomas E. Bush	Director	March 30, 2016
/s/ THOMAS GILLEY Thomas Gilley	Director	March 30, 2016

/s/ WONG KWOK FONG Wong Kwok Fong	Director	March 30, 2016
/s/ YAO JIANHUI Yao Jianhui	Director	March 30, 2016

EXHIBIT INDEX

Exhibit No.	Exhibit
3.1	Certificate of Incorporation of BIO-key International, Inc., a Delaware corporation (incorporated by reference to Exhibit 3.1 to the current report on Form 8-K, filed with the SEC on January 5, 2005)
3.2	Bylaws (incorporated by reference to Exhibit 3.3 to the current report on Form 8-K, filed with the SEC on January 5, 2005)
3.3	Certificate of Amendment to Certificate of Incorporation (incorporated by reference to Appendix A to the definitive proxy statement, filed with the SEC on January 18, 2006)
3.4	Certificate of Amendment of Certificate of Incorporation of Bio-key International, Inc., a Delaware corporation (incorporated by reference to Exhibit 3.4 to the annual report on Form 10-K, filed with the SEC on March 31, 2015)
3.5	Certificate of Elimination of BIO-key International, Inc. filed October 6, 2015 (incorporated by reference to Exhibit 3.5 to the registration statement on Form S-1 File No. 333-208747 filed with the SEC on December 23, 2015)
3.6	Certificate of Designation of Preferences, Rights and Limitations of Series A-1 Convertible Preferred Stock (incorporated by reference to Exhibit 3.1 to the current report on Form 8-K, filed with the SEC on November 2, 2015)
3.7	Certificate of Designation of Preferences, Rights and Limitations of Series B-1 Convertible Preferred Stock (incorporated by reference to Exhibit 3.1 to the quarterly report on Form 10-Q, filed with the SEC on November 16, 2015)
4.1	Specimen Stock Certificate (incorporated by reference to Exhibit 4.1 to the registration statement on Form SB-2, File No. 333-16451)
5.1	Opinion of Fox Rothschild LLP (incorporated by reference to Exhibit 5.1 to the registration statement on Form S-1 File No. 333-208747 filed with the SEC on December 23, 2015)
10.1	SAC Technologies, Inc. 1999 Stock Option Plan (incorporated by reference to Exhibit 10.24 to the annual report on Form 10-KSB, filed with the SEC on April 14, 2000)
10.2	Employment Agreement by and between BIO-key International, Inc. and Mira LaCous dated November 20, 2001 (incorporated by reference to Exhibit 10.39 to the current report on Form 8-K, filed with the SEC on January 22, 2002)

10.3	BIO-key International, Inc. 2004 Stock Incentive Plan (incorporated by reference to Exhibit 10.48 to amendment no. 1 the registrant’s registration statement on Form SB-2, File No. 33-120104, filed with the SEC on December

	14, 2004)
10.4	Options to Purchase 50,000 and 32,620 Shares of Common Stock issued to Charles Romeo (incorporated by reference to Exhibit 10.78 to the annual report on Form 10-K, filed with the SEC on March 11, 2009)
10.5	Options to Purchase 50,000 and 48,930 Shares of Common Stock issued to John Schoenherr incorporated by reference to Exhibit 10.79 to the annual report on Form 10-K, filed with the SEC on March 11, 2009)
10.6	Option to Purchase 500,000 Shares of Common Stock issued to Michael W. DePasquale (incorporated by reference to Exhibit 10.84 to the annual report on Form 10-K, filed with the SEC on March 11, 2009)
10.7	Option to Purchase 50,000 Shares of Common Stock issued to Charles Romeo (incorporated by reference to Exhibit 10.87 to the annual report on Form 10-K, filed with the SEC on March 11, 2009)
10.8	Option to Purchase 100,000 Shares of Common Stock issued to John Schoenherr (incorporated by reference to Exhibit 10.88 to the annual report on Form 10-K, filed with the SEC on March 11, 2009)
10.9	Employment Agreement, effective March 25, 2010, by and between the Company and Michael W. DePasquale (incorporated by reference to Exhibit 10.93 to the annual report on Form 10-K, filed with the SEC on March 26, 2010)

10.10	Omnibus Amendment and Waiver Agreement, dated as of December 30, 2010, by and between the Company and InterAct911 Mobile Systems, Inc., and SilkRoad Equity, LLC (incorporated by reference to Exhibit 10.40 to the annual report on Form 10-K, filed with the SEC on March 23, 2011)
10.11	Note Purchase Agreement, dated February 26, 2013, by and between the Company and DRNC Holdings, Inc. (incorporated by reference to Exhibit 10.1 to quarterly report on Form 10-Q, filed with the SEC on May 15, 2013)
10.12	Securities Purchase Agreement, dated February 26, 2013, by and between the Company and DRNC Holdings, Inc. (incorporated by reference to Exhibit 10.3 to the quarterly report on Form 10-Q, filed with the SEC on May 15, 2013)
10.13	Form of Securities Purchase Agreement, dated February 26, 2013, by and between the Company and certain investors (incorporated by reference to Exhibit 10.4 to the quarterly report on Form 10-Q, filed with the SEC on May 15, 2013)
10.14	Form of Securities Purchase Agreement, dated July 23, 2013, by and between the Company and certain investors (incorporated by reference to Exhibit 10.29 to the registration statement on Form S-1, filed with the SEC on July 26, 2013)
10.15	Form of Warrant (incorporated by reference to Exhibit 10.30 to the registration statement on Form S-1, filed with the SEC on July 26, 2013)
10.16	Form of Securities Purchase Agreement by and between the Company and certain investors dated October 25, 2013 and November 8, 2013 (incorporated by reference to Exhibit 10.1 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2013)
10.17	Form of Investor Warrant by and between the Company and certain investors dated October 25, 2013 and November 8, 2013 (incorporated by reference to Exhibit 10.2 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2013)
10.18	Form of Registration Rights Agreement by and between the Company and certain investors dated October 25, 2013 and November 8, 2013 (incorporated by reference to Exhibit 10.3 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2013)
10.19	Form of Supplement to Securities Purchase Agreement by and between the Company and certain investors dated November 8, 2013 (incorporated by reference to Exhibit 10.4 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2013)
10.20	Option to Purchase 25,000 Shares of Common Stock issued to Charles Romeo (incorporated by reference to Exhibit 10.35 to the annual report on Form 10-K, filed with the SEC on March 31, 2014)
10.21	Option to Purchase 25,000 Shares of Common Stock issued to John Schoenherr (incorporated by reference to Exhibit 10.36 to the annual report on Form 10-K, filed with the SEC on March 31, 2014)
10.22	

	Option to Purchase 500,000 Shares of Common Stock issued to Michael W. DePasquale (incorporated by reference to Exhibit 10.37 to the annual report on Form 10-K, filed with the SEC on March 31, 2014)
10.23	Option to Purchase 62,500 Shares of Common Stock issued to Mira LaCous (incorporated by reference to Exhibit 10.40 to the annual report on Form 10-K, filed with the SEC on March 31, 2014)
10.24	Option to Purchase 150,000 Shares of Common Stock issued to Cecilia Welch (incorporated by reference to Exhibit 10.41 to the annual report on Form 10-K, filed with the SEC on March 31, 2014)
10.25	Employment Agreement by and between BIO-key International, Inc. and Cecilia Welch dated May 15, 2013 (incorporated by reference to Exhibit 10.42 to the annual report on Form 10-K, filed with the SEC on March 31, 2014)
10.26	Third Amendment to Lease Agreement by and between BIO-key International, Inc. and Victor AOP, Inc. dated June 30, 2013 (incorporated by reference to Exhibit 10.43 to the annual report on Form 10-K, filed with the SEC on March 31, 2014)
10.27	First Amendment to Lease Agreement by and between BIO-key International, Inc. and BRE/DP MN LLC dated September 12, 2013 (incorporated by reference to Exhibit 10.44 to the annual report on Form 10-K, filed with the SEC on March 31, 2014)

10.28	Form of Securities Purchase Agreement by and between the Company and certain investors dated November 13, 2014 (incorporated by reference to Exhibit 10.1 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2014)
10.29	Form of Investor Warrant, by and between the Company and certain investors dated November 13, 2014 (incorporated by reference to Exhibit 10.2 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2014)
10.30	Form of Registration Rights Agreement by and between the Company and certain investors dated November 13, 2014 (incorporated by reference to Exhibit 10.3 to the quarterly report on Form 10-Q, filed with the SEC on November 14, 2014)
10.31	Form of Convertible Preferred Stock Purchase Agreement (incorporated by reference to Exhibit 10.1 to the current report on Form 8-K, filed with the SEC on November 2, 2015)
10.32	Form of Registration Rights Agreement (incorporated by reference to Exhibit 10.2 to the current report on Form 8-K, filed with the SEC on November 2, 2015)
10.33	Form of Securities Purchase Agreement (incorporated by reference to Exhibit 10.1 to the quarterly report on Form 10-Q, filed with the SEC on November 16, 2015)
10.34	Form of Registration Rights Agreement (incorporated by reference to Exhibit 10.2 to the quarterly report on Form 10-Q, filed with the SEC on November 16, 2015)

10.35	BIO-key International, Inc. 2015 Equity Incentive Plan (incorporated by reference to Appendix A to the definitive proxy statement filed with the SEC on December 15, 2015)
10.36	Software License Purchase Agreement Dated November 11, 2015 by and among BIO-key Hong Kong Limited, Shining Union Limited, WWTT Technology China, Golden Vast Macao Commercial Offshore Limited, Giant Leap International Limited (incorporated by reference to Exhibit 10.36 to the registration statement on Form S-1 File No. 333-208747 filed with the SEC on December 23, 2015)**
21.1*	List of subsidiaries of BIO-key International, Inc.
23.1*	Consent of RMSBG
31.1*	Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2*	Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101.INS*	XBRL Instance
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation
101.DEF*	XBRL Taxonomy Extension Definition
101.LAB*	XBRL Taxonomy Extension Labels
101.PRE*	XBRL Taxonomy Extension Presentation

* filed herewith

** Confidential treatment has been requested with respect to certain portions of this exhibit. Omitted sections have been filed separately with the Securities and Exchange Commission.