

Neonode, Inc  
Form 10-K/A  
May 12, 2010

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K/A

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

For the fiscal year ended December 31, 2009

or

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

For the transition period from to

Commission File No. 0-8419

**NEONODE INC.**

(Exact name of Registrant as specified in its  
charter)

Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization)

94-1517641  
(I.R.S. Employer  
Identification Number)

Sweden Linnegatan 89, SE-115 23 Stockholm, Sweden  
USA 651 Byrdee Way, Lafayette, CA 94549  
(Address of principal executive offices and Zip Code)

Sweden + 46 8 667 17 17  
USA + 1 925 768 0620  
(Registrant's Telephone Numbers, including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

| Title of Each Class | Name of Each Exchange on Which<br>Registered |
|---------------------|--|
| Common Stock        | NONE   |

Securities registered pursuant to Section 12(g) of the Act: None

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

|                         |                          |                           |                                     |
|-------------------------|--------------------------|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/> | Accelerated filer         | <input type="checkbox"/>            |
| Non-accelerated filer   | <input type="checkbox"/> | Smaller reporting company | <input checked="" type="checkbox"/> |

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

The approximate aggregate market value of the common stock held by non-affiliates of the registrant, based on the closing price for the registrant's common stock on June 30, 2009 (the last business day of the second quarter of the registrant's current fiscal year) as reported on the Nasdaq Capital Markets, was \$3,861,252.

The number of shares of the registrant's common stock outstanding as of May 8, 2010, was 426,985,185.

The number of shares of the registrant's Series A Preferred stock outstanding as of May 8, 2010 was 68,120.

The number of shares of the registrant's Series B Preferred stock outstanding as of May 8, 2010 was 9,875.

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DOCUMENTS INCORPORATED BY REFERENCE

Exhibits incorporated by reference are referred to in Part IV.

NEONODE INC.

2009 ANNUAL REPORT ON FORM 10-K/A

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## EXPLANATORY NOTE

This Form 10-K/A of Neonode Inc. (the “Company”) constitutes Amendment No. 1 (“Amendment No. 1”) to the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2009, originally filed with the Securities and Exchange Commission on March 29, 2010 (the “Original Report”).

The primary purpose of this Amendment No. 1 is to include the audited financial statements for the fiscal years ended December 31, 2009, along with the reports of KMJ Corbin & Company, LLP, our current registered independent public accounting firm, and BDO Sweden AB, our predecessor independent registered public accounting firm on such financial statements. As a result of the completion of the 2009 audit, the 2009 financial statements have been revised from the unaudited financial statements included in the Original Report. In addition, Amendment No. 1 includes the re-consent of BDO Sweden AB to include their opinion on the financial statements as of December 31, 2008 and for the year then ended.

In accordance with the rules of the Securities and Exchange Commission, the Company has set forth herein the complete texts of Item 6 (Management’s Discussion and Analysis or Plan of Operation), Item 7 (Financial Statements) and Item 13 (Exhibits) in their entirety. This Amendment No. 1 is limited to the items of the Original Report set forth above and, other than these changes and the correction of minor typographical and grammatical errors, does not amend, update, or change any other items or disclosures contained in the Original Report, or reflect events occurring after the Original Report. Except for the foregoing amended or added information, this Amendment continues to speak as of the date of filing of the Original Report and the Company has not otherwise updated disclosures contained therein or herein to reflect events that occurred at a later date.

This Amendment has been signed as of a current date, and also includes as exhibits currently dated certifications of the Company’s Chief Executive Officer and Chief Financial Officer, as required by Sections 302 and 906 of the Sarbanes Oxley Act of 2002.

The filing of this Amendment No. 1 shall not be deemed an admission that the Original Report, when filed, included any untrue statement of a material fact or omitted to state a material fact necessary to make a statement therein not misleading.

## SPECIAL NOTE ON FORWARD LOOKING STATEMENTS

Certain statements set forth in or incorporated by reference in this Annual Report on Form 10-K/A constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements include, without limitation, our expectations regarding the adequacy of anticipated sources of cash, planned capital expenditures, the effect of interest rate increases, and trends or expectations regarding our operations. Words such as “may,” “will,” “should,” “believes,” “anticipates,” “expects,” “intends,” “plans,” “estimates” and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Such statements are based on currently available operating, financial and competitive information and are subject to various risks and uncertainties. Readers are cautioned that the forward-looking statements reflect management’s estimates only as of the date hereof, and we assume no obligation to update these statements, even if new information becomes available or other events occur in the future. Actual future results, events and trends may differ materially from those expressed in or implied by such statements depending on a variety of factors, including, but not limited to those set forth under “Item 1A Risk Factors” and elsewhere in this Annual Report on Form 10-K/A.



## PART I

### ITEM 1. BUSINESS

We provide optical touchscreen solutions for handheld consumer and industrial electronic devices. We license our touchscreen technology to Original Equipment Manufacturers (OEMs) and Original Design Manufacturers (ODMs) who imbed our touchscreen technology into electronic devices that they develop and sell, such as mobile phones, e-book readers, mobile internet devices, global positioning systems (GPS), digital picture frames and micro PCs. The cornerstone of our solution is our innovative optical infrared touchscreen technology, zForce™. We believe that keyboards and keypads with moving parts will become obsolete for handheld devices and that our touchscreen solutions will be at the forefront of a new wave of finger-based and pen input technologies that will enable the user to interact and operate everything from small mobile devices to large industrial applications using a combination of touches, swipes, and hand gestures.

#### Our History

Neonode Inc. (the Company), formerly known as SBE, Inc., was incorporated in the State of Delaware on September 4, 1997.

On August 10, 2007, SBE, Inc. consummated a reverse merger transaction with Neonode Inc., and SBE, Inc.'s name was subsequently changed to "Neonode Inc." on the completion of the Merger. Neonode Inc. prior to the Merger was incorporated in the State of Delaware in 2006 and was the parent of Neonode AB, a company founded in February 2004 and incorporated in Sweden. Following the closing of the Merger, the business and operations of Neonode Inc. prior to the Merger became the primary business and operations of the newly-combined company. The newly-combined company's headquarters was located in Stockholm, Sweden.

Through our previous wholly owned subsidiary, Neonode AB, we developed our touchscreen technology and an optical touchscreen mobile phone product, the N2. We began shipping the N2 to our first customers in July 2007 but faced difficult circumstances in finding a viable market for our N2 mobile phone. We did not generate sufficient cash flow from the sale of N2 mobile phones to continue operations and Neonode AB filed for liquidation under the Swedish bankruptcy laws on December 9, 2008. As of that date, Neonode AB ceased to be owned and operated by Neonode Inc. Effective with Neonode AB's bankruptcy filing on December 9, 2008, Neonode Inc. ceased to have any financial obligations related to the accounts payable or other debts of Neonode AB. The operations of Neonode AB for the period January 1, 2008 through December 9, 2008 are included in the consolidated accounts of Neonode Inc. for the year ended December 31, 2008.

#### 2008 Corporate Restructuring

AB Cypresen AB nr 9683 (Cypresen) (subsequently renamed Neonode Technologies AB), a company incorporated in Sweden, was acquired by Neonode Inc. on December 29, 2008 and became a wholly owned subsidiary of Neonode Inc. on that date. Neonode Inc. issued shares of its Series A Preferred stock to the stockholders of Neonode Technologies AB in exchange for all of the outstanding stock of Neonode Technologies AB. The Neonode Technologies AB stockholders were employees of the Company and/or Neonode AB and, as such, are related parties. Neonode Technologies AB did not have any operations in 2008. The Consolidated Balance Sheet of the Company as of December 31, 2008 includes the accounts of Neonode Technologies AB which is comprised of cash totaling approximately \$12,000. The acquisition of Neonode Technologies AB by Neonode Inc. does not qualify as a business combination, and accordingly the fair value of the shares of Series A Preferred Stock issued to the sellers of Neonode Technologies AB shares are accounted for as compensation. As there is an 18-month service requirement related to the Neonode Inc. shares issued to the Neonode Technologies AB shareholders, the value of the Series A Preferred

Stock is amortized over the 18 month service period beginning December 31, 2008.

In 2008, as a result of our inability to sell a sufficient number of mobile phones to support our operations, we took the following actions to restructure and refinance the Company:

- On October 22, 2008, Neonode Inc.'s previously wholly owned Swedish subsidiary, Neonode AB, filed for company reorganization in compliance with the Swedish Reorganization Act (1996:764). Mr. Anders W. Bengtsson of the Stockholm-based law firm Nova was appointed to administer the process. In accordance with §16 of the Swedish Reorganization Act, a Neonode AB creditors' meeting was held at the district court of Stockholm, Sweden on November 11, 2008;
- On October 22, 2008, we terminated our agreement with Distribution Management Consolidators Worldwide, LLC (DMC Worldwide) and dissolved Neonode USA, which had been created for the sole purpose of distributing the N2 in the US and China and licensing our technology worldwide;
- On December 1, 2008, we transferred the intellectual property of Neonode AB, including all patents, copyrights and trademarks to Neonode Inc. pursuant to an intercompany debt pledge agreement.
- On December 9, 2008, Neonode AB filed a petition for bankruptcy in compliance with the Swedish Bankruptcy Act (1987:672) as a direct result of the failure to reach a satisfactory settlement agreement with the creditors of Neonode AB. Mr. Hans Ödén of the Stockholm-based Ackordscentralen AB, a consultancy firm specializing in insolvency, was appointed by the district court of Stockholm to administer the process. Under Swedish bankruptcy law, effective with the bankruptcy filing we no longer have an ownership interest in Neonode AB, and, as such, we are no longer responsible for the liabilities of Neonode AB and we no longer have title or an ownership interest in the assets of Neonode AB. The Swedish bankruptcy court appointed a Swedish legal firm as receiver with the expressed duty to liquidate all the assets of Neonode AB and enter into final settlements with the creditors of Neonode AB.
- On December 29, 2008, we entered into a Share Exchange Agreement with Neonode Technologies AB, a Swedish engineering company, and the stockholders of Neonode Technologies AB: Iwo Jima SARL, Wirelesstoy AB, and Athemis Ltd. (the "Neonode Technologies AB Stockholders"), pursuant to which we agreed to acquire all of the issued and outstanding shares of Neonode Technologies AB in exchange for the issuance of shares of Neonode Inc. Series A Preferred Stock to the Neonode Technologies AB Stockholders. Pursuant to the terms of the Share Exchange Agreement, upon the closing of the transaction, Neonode Technologies AB became a wholly owned subsidiary of the Company;
- On December 30, 2008, we entered into a restructuring transaction in which we converted the majority of the outstanding warrants and convertible debt that had been issued in previous financing transactions to shares of Series A and B Preferred stock, respectively, that are convertible into shares of our common stock in accordance with the Company's Certificate of Designations filed with the Delaware Secretary of State;
- On December 30, 2008, we entered into a financing transaction in which we raised approximately \$1.1 million as of December 31, 2008 through the sale of shares of Series A Preferred Stock that are convertible into shares of our common stock in accordance with the Company's Certificate of Designations filed with the Delaware Secretary of State;

#### 2009 Corporate Financing

- On January 21, 2009, we entered into a settlement agreement with Alpha Capital Anstalt (Alpha) whereby we issued shares of our common stock to settle a claim that Alpha made that we had failed to issue certain stock certificates pursuant to the terms and conditions of certain prior investment

subscription agreements;

- On January 23, 2009, we issued shares of our common stock to vendors of Neonode Inc. in settlement of approximately \$53,000 in outstanding Neonode Inc. accounts payable;
- On September 8, 2009, we entered into a private placement financing transaction and issued approximately \$987,000 in notes with a 7% annual interest rate, due December 31, 2010, that are convertible into approximately 49.4 million shares of our common stock. We also issued warrants that, if exercised, are convertible into 24.7 million shares of our common stock at an exercise price of \$0.04 per share.

We have not generated sufficient cash from the sale of our products or licensing of our technology to support our operations and have incurred significant losses. During the years ended December 31, 2008 and 2009, we raised approximately \$8.6 million and \$2.0 million, respectively, net cash proceeds through the sale of our securities and convertible debt. Unless we are able to increase our revenues and/or decrease expenses substantially in addition to securing additional sources of financing, we will not have sufficient cash to support our operations through June 2010.

### Touchscreen Product Solutions

We develop touchscreen technologies that enrich the user's experience in interacting with the user's mobile computing, communications, and entertainment devices. Our innovative touchscreen technology can be engineered to accommodate many diverse platforms and our experience in human factors and usability can be utilized to improve the features and functionality of our solutions. Our extensive array of technology includes software, mechanical and electrical designs, and pattern recognition and touch sensing technologies.

Our touchscreen solutions for our customers include sensor design, module layout, and software features for which we provide design support and device testing. This allows us to be a one-stop supplier for complete touchscreen design from the early design stage to testing and support. Through our technologies and expertise, we seek to provide our customers with solutions that address their individual design issues and that will result in high-performance, feature-rich, and reliable touchscreen interface solutions.

### Technologies

Our touchscreen solutions are based on our patented zForce™ and Neno™ hardware and software technology. zForce™ is our optical infrared touchscreen technology that supports one-handed navigation, allowing the user to operate the functionality with finger gestures passing over the screen. Neno™ is our software-based user interface.

zForce™ has been patented in several countries and is patent-pending in the US. It uses infrared light that is projected as a grid over the screen. The infrared light pulses 120 times per second so that the grid is constantly being refreshed. Coordinates are produced on the screen and are then converted into mathematical algorithms when a user's fingers move across the screen. This input method is unique to Neonode and is enabled by the zForce™ technology.

Currently, there are two dominant types of touchscreen technologies available in the market - capacitive and resistive. Capacitive technology is the technology that the Apple iPhone uses and resistive technology is what is found on most stylus-based PDAs. Resistive technology is pressure sensitive technology. Best used for detailed work and for selection of a particular spot on a screen, resistive technology is not useful for sweeping gestures or motion, such as zooming in and out. Capacitive technology, which is used on a laptop computer mouse pad, is very good for sweeping gestures and motion. The screen actually reacts to the finger's tiny electric impulses. Capacitive touchscreens work only if the user has unimpeded contact between his finger and the screen.

Our zForce™ optical touchscreen technology has a number of key advantages over each of these technologies, including:

- No additional layers are added to the screen that may dilute the screen resolution and clarity. Layering technology is required to activate the capacitive and resistive technologies and can be very costly;
- The zForce™ grid technology is more responsive than the capacitive screen technology and, as a result, is quicker and less prone to misreads. It allows movement and sweeping motions as compared to point-sensitive, stylus-based resistive screens;
- zForce™, an abbreviation for zero force necessary, obviates the need to use any force to select or move items on the screen as would be the case with a stylus;

- zForce™ is cost-efficient due to the lower cost of materials and extremely simple manufacturing process when compared to the expensive layered capacitive and resistive screens; and
- zForce™ allows multiple methods of input, such as simple finger taps to hit keys, sweeps to zoom in or out, and gestures to write text or symbols directly on the screen.

zForce™ incorporates some of the best functionalities of both the capacitive and resistive touchscreen technologies. It works in all climates and, unlike the competing technologies, can be used with gloves. In addition, zForce™ allows for waterproofing of the device.

Because of its uniqueness and flexibility, we believe that our zForce™ technology presents a tremendous licensing opportunity for Neonode. The market is vast, given the current rapid increase in touchscreen-based devices such as cell phones, PCs, media players, and GPS navigation devices.

Our software user interface, Neno™, runs on Windows CE and is completely unique. Neno™ is designed to operate complex and full feature applications on a small screen. It allows for a number of input methods and is designed to deliver high precision, fast response, and ease of use on a complex device.

Neno™ includes the following features:

- Media players for streaming video, movies and music that support all the standard applications, including WMA, WMV, MP3, WAV, DivX and AVI MPEG4;
- Internet explorer 6.0 browser;
- Image viewer with camera preview and capture;
- Organizer with calendar and task with Microsoft Outlook synchronization;
- Calendar, alarm, calculator and call list;
- Telephony manager for voice calls;
- Messaging manager for SMS, MMS, IM and T9;
- File manager;
- Task manager for switching between applications;
- Notebook; and
- Games.

## Intellectual Property

We believe that innovation in product engineering, sales, marketing, support, and customer relations, and protection of this proprietary technology and knowledge, will impact our future success. In addition to certain patents that are pending, we rely on a combination of copyright, trademark, trade secret laws and contractual provisions to establish and protect the proprietary rights in our products.

We have applied for patent protection of our invention named “On a substrate formed or resting display arrangement” in six countries through a patent cooperation treaty (PCT) application and in 24 designated countries through an application to the European Patent Office (EPO). We applied for a patent in Sweden relating to a mobile phone and have also applied for a patent in the United States regarding software named “User Interface.”

We have been granted trademark protection for the word NEONODE in the European Union (EU), Sweden, Norway, and Australia. In addition, we have been granted protection for the figurative mark NEONODE in Sweden. Additional applications for the figurative trademark are still pending in Switzerland, China, Russia, and the United States.

Our “User Interface” may also be protected by copyright laws in most countries, especially Sweden and the EU (which do not grant patent protection for the software itself), if the software is new and original. Protection can be claimed from the date of creation.

Consistent with our efforts to maintain the confidentiality and ownership of our trade secrets and other confidential information, and to protect and build our intellectual property rights, we require our employees and consultants, and certain customers, manufacturers, suppliers and other persons with whom we do business or may potentially do business, to execute confidentiality and invention assignment agreements upon commencement of a relationship with us, typically extending for a period of time beyond termination of the relationship.

#### Distribution, Sales and Marketing

We consider both OEMs and ODMs and their contract manufacturers to be our primary customers. Both the OEMs, ODMs and their contract manufacturers may determine the design and pricing requirements and make the overall decision regarding the use of our user interface solutions in their products. The use and pricing of our interface solutions will be governed by a technology licensing agreement.

Our sales staff solicits prospective customers and our sales personnel receive substantial technical assistance and support from our internal engineering resources because of the highly technical nature of our product solutions. We expect that sales will frequently result from multi-level sales efforts that involve senior management, design engineers, and our sales personnel interacting with our potential customers’ decision-makers throughout the product development and order process.

Our sales are normally negotiated and executed in U.S. Dollars or Euros.

Our sales force and marketing operations are managed out of our corporate headquarters in Stockholm, Sweden, and our current sales force is comprised of consultants located in Stockholm, Korea and Australia.

#### Research and Development

We continue to invest in research and development of current and emerging technologies that we deem critical to maintaining our competitive position in the touchscreen user interface markets. Many factors are involved in determining the strategic direction of our product development focus, including trends and developments in the marketplace, competitive analyses, market demands, business conditions, and feedback from our customers and strategic partners. In fiscal years 2009 and 2008, we spent \$1.0 million and \$3.3 million, respectively, on research and development activities.

We carefully monitor innovations in other technologies and are constantly seeking new areas for application of zForce™. We have developed a technology roadmap that we believe will result in a steady stream of new innovations and areas of use. We no longer develop mobile phone products, but now focus our development efforts on our touchscreen technology.

Our research and development is predominantly in-house, but is also done in close collaboration with external partners and specialists. Our development areas can be divided into the following areas:

Software

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Optical

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Mechanical

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Electrical

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## Recent Developments

During the period from August 25, 2009 through December 31, 2009, we completed a private placement of convertible notes totaling \$987,000 that can be converted, at the holder's option, into 49,349,151 shares of our common stock at a conversion price of \$0.02 per share. The convertible note holders have the right to have the conversion price adjusted to equal the lower stock price if we issue stock or convertible notes at a lower conversion price than \$0.02 during the period that the notes are outstanding. These convertible notes are due on December 31, 2010 and bear an annual interest rate of 7%, payable on June 30 and December 31 of each year that the convertible notes are outstanding. In addition, we issued 24,674,576 three-year warrants to the convertible note holders with an exercise price of \$0.04 per share. The warrants may be exercised and converted to common stock, at the warrant holder's option, beginning on the six-month anniversary date of issuance until the warrant expiration date. We are not obligated to register the common stock related to the convertible debt or the warrants.

In the five months ended May 5, 2010, we received \$1.5 million cash proceeds and converted \$163,000 of accounts payable related to a private placement of convertible notes and stock purchase warrants that can be converted, at the holder's option, into 86,785,564 shares of our common stock at a conversion price of \$0.02 per share and 43,392,782 stock purchase warrants that have an exercise price of \$0.04 per share. The convertible note holders have the right to have the conversion price adjusted to equal the lower stock price if we issue stock or convertible notes at a lower conversion price than \$0.02 during the period that the notes are outstanding. These convertible notes are due on December 31, 2010 and bear an annual interest rate of 7%, payable on June 30 and December 31 of each year that the convertible notes are outstanding. The warrants may be exercised and converted to common stock, at the warrant holder's option, beginning on the six-month anniversary date of issuance until the warrant expiration date. We are not obligated to register the common stock related to the convertible debt or the warrants. On March 21, 2010, we issued 875,000 shares of our common stock and a warrant to purchase 875,000 of our common stock an exercise price of \$0.04 per share to Davisa Ltd for services provided for the private placement of convertible note and warrant in the March 2010 financing transaction.

## Overview of the Touchscreen Market and Competition

### Competing Touchscreen Technologies:

Today there are different touchscreen technologies available in the market; All of them with different or slightly different profiles, level of maturity, and cost price:

- Resistive -- uses conductive and resistive layers separated by thin space;
- Surface acoustic wave -- uses ultrasonic waves that pass over the touchscreen panel;
- Capacitive and projected capacitive -- a capacitive touchscreen panel is coated with a material, typically indium tin oxide, that conducts a continuous electrical current across the sensor. When the sensor's 'normal' capacitance field (its reference state) is altered by another capacitance field, e.g., someone's finger, electronic circuits located at each corner of the panel measure the resultant 'distortion' in the sine wave characteristics to detect a touch;
- Infrared -- uses infrared beams that are broken by finger or heat from the finger sensed from a camera to detect a touch;
- Strain gauge -- uses a spring mounted on the four corners and strain gauges are used to determine deflection when the screen is touched;
- Optical imaging -- uses two or more image sensors placed around the edges (mostly the corners) of the screen and a light source to create a shadow of the finger;
- In-cell optical touch technology -- embeds photo sensors directly into an LCD glass. By integrating the touch function directly into an LCD glass, the LCD acts like a low resolution camera to "see" the shadow of the

finger;

- Dispersive signal technology -- uses sensors to detect the mechanical energy in the glass that occur due to a touch; and
- Acoustic pulse recognition -- uses more than two piezoelectric transducers located at some positions of the screen to turn the mechanical energy of a touch (vibration) into an electronic signal.

The following are the advantages and disadvantages of the most common competing touchscreen technologies:

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Resistive Touchscreen Technology:

1. Uses conductive and resistive layers separated by a thin space.
2. Touch creates contact between resistive circuit layers closing a switch.
3. A controller layer is inserted between layers to determine touch coordinates.

Advantages:

- § High resolution
- § Low cost
- § Proven solution for low cost touchscreen applications
- § Support for large screen sizes

Disadvantages:

- § Not fully transparent (more backlight needed, which requires high power consumption; reflections; loss of colors)
  - § Requires frequent recalibration to work properly
- § Large frame size (limited active area of the total display area and outer dimensions of the device)
  - § Sensitive to scratches

Surface Capacitive Touchscreen Technology:

1. Two sides of a glass substrate are coated with uniform conductive indium tin oxide coating (ITO). Silicon dioxide hard coating is coated on the front side of ITO coating layer. There are electrodes on the four corners for launching electric current.
  2. Voltage is applied to the electrodes on the four corners.
  3. A finger touches the screen and draws a minute amount of current to the point of contact.
4. The controller precisely calculates the proportion of the current passed through the four electrodes and calculates the X/Y coordinate of a touch point.

Advantages:

- § No “edge” or bezel on the top of the on the screen display
- § Medium to high resolution
- § Support for large screen sizes

Disadvantages:

- § Expensive, typically three to four times the cost of a resistive touchscreen solution
- § Not fully transparent (more backlight needed, which requires high power consumption; reflections; loss of colors)
  - § Cannot be used with gloves or pen. Only supports fingers
  - § Limited temperature range for operation
  - § Limited capturing speed (for gestures)
  - § No multi-touch support

Projected Capacitive Touchscreen Technology:

1. This touch technology requires one or more etched ITO layers forming multiple horizontal (X) and vertical (Y) electrodes, which derive drive from a sensing chip
2. AC signals drive one axis and the response through the screen cycles back via the other electrodes.
3. Position detection comes by measuring the distribution of the change in signals between the X and Y electrodes. Math algorithms then determine the XY coordinates of the touch by processing signal-level changes

Advantages:

- § No “edge” or bezel on the top of the on the screen display
- § Medium to high resolution
- § Multi-touch support

Disadvantages:

- § Very expensive, typically 10 times the cost of a resistive touchscreen solution, making it suitable only for high end devices
- § Not fully transparent (more backlight needed, which requires high power consumption; reflections; loss of colors)
  - § Cannot be used with gloves or pen (only support fingers)
  - § Limited temperature range for operation (not for car navigation systems, etc.)
  - § Limited capturing speed (no support for gestures)
- § Limited screen size (typical maximum 3-4 inches) due to poor signal to noise ratio (SNR)
  - § No pen support

Neonode zForce Touchscreen Technology:

1. zForce uses a small frame around the display with LEDs and photoreceptors on the opposite sides, hidden behind a infrared-transparent bezel.
2. A controller sequentially pulses the LEDs to create a grid of infrared light beams across the display.
3. A touch obstructs one or more of the beams which identify the X and Y coordinates, which also gives area information.
4. Interpolation with analog reading and processing of the signal give multiple touch readings/high speed gesture support.

Advantages:

- § Multi-touch support
- § Fully transparent (maximum display quality)
- § Fast capturing of movements (support for gestures)

- § Support for extended temperature range
- § Support for large screen sizes
- § Low cost for high performance

Disadvantages:

- § Bezel height of 0.5 mm (edge around the display)

The most inexpensive and widely used touchscreen solution on the market today is resistive touch. There are function limitations associated with resistive touch solutions, primarily that a user needs to press on a particular point on the screen and may be required to use a stylus or pen to touch the screen. Many consumer devices that incorporate touchscreen applications use resistive touch solutions, including GPS and mobile phone products. Capacitive touch solutions provide a more robust set of functions that use a finger instead of a stylus to activate. Capacitive touch allows the user to move around the screen quickly, zoom in and out, and change screen views very easily. Capacitive touch solutions are priced much higher than resistive touch solutions and, as a result, are found mainly in higher priced devices. The product most users identify with a capacitive touch solution is the Apple iPhone. Our optical infrared touch solution provides the robust functionality of capacitive touch, can be activated with a finger or stylus, and is priced much closer to resistive touch solutions.

Touchscreen Technologies Competitors:

| Company              | Technology  |
|----------------------|---|
| 3M                   | Surface Capacitive, Dispersive Signal Touch   |
| Synaptics            | Capacitive  |
| RPO                  | Optical wave guide with camera  |
| Nextwindow           | Optical with camera   |
| Zytronic             | Projective Capacitive   |
| Tyco Electronics     | Capacitive, Resistive, Surface Wave, Surface capacitive   |
| Touch International  | Resistive, Projected Capacitive, Surface Capacitive   |
| Mass Multimedia Inc. | All touchscreen technologies  |
| TPK                  | Acoustic Recognition, Force Intuition, Wire Resistive, Digital Wire Resistive (provide the capacitive touchscreen for the Apple iPhone) |

Technology License Agreements

As of December 31, 2009, we do not have any signed technology license agreements with customers. We are in the process of negotiating technology license agreements with two tier one OEMs and a tier one ODM that are incorporating our touch screen technology in eBooks and mobile phones. We have also developed prototype products and are engaged in product design discussions with several other tier one OEMs and ODMs who are in the process of qualifying our touch screen technology for incorporation in various products such as digital picture frames, GPS devices, eBook readers, Touch PC, mobile phones and mobile internet devices. The development and product release cycle for these products can take 6 months to one year.

Employees

On December 31, 2009, we had ten full-time employees and one part-time employee. We augment our staff with consultants on an “as needed” basis. Our full-time and our part-time employees are located in our corporate headquarters in Stockholm, Sweden, and one employee is located in a branch office in the United States. None of our employees is represented by a labor union. We have experienced no work stoppages. We believe our employee relations are positive.

ITEM 1A. RISK FACTORS

In addition to the other information in this Annual Report on Form 10-K/A, stockholders or prospective investors should carefully consider the following risk factors:

Risks Related To Our Business

We will require additional capital to fund our operations, which capital may not be available on commercially attractive terms or at all.

We will require sources of capital in addition to cash on hand to continue operations and to implement our business plan. We project that we have sufficient liquid assets to continue operating until the end of June 2010. We are currently evaluating different financing alternatives, including but not limited to selling shares of our common or preferred stock, or issuing notes that may be converted in shares of our common stock which could result in the

issuance of additional shares. If our operations do not become cash flow positive, we will be forced to seek credit line facilities from financial institutions, additional private equity investment, or debt arrangements. No assurances can be given that we will be successful in obtaining such additional financing on reasonable terms, or at all. If adequate funds are not available on acceptable terms, or at all, we may be unable to adequately fund our business plan, which could have a negative effect on our business, results of operations, and financial condition. In addition, if funds are available, the issuance of equity securities or securities convertible into equity could dilute the value of shares of our common stock and cause the market price to fall, and the issuance of debt securities could impose restrictive covenants that could impair our ability to engage in certain business transactions.

The current worldwide financial and credit markets are difficult to access.

The continuing crisis in the worldwide financial and credit markets make it extremely difficult to access sources of capital or borrowings. Credit line facilities from financial institutions, additional private equity investment, and debt arrangements may not be available to us for some time in the future. No assurances can be given that we will be successful in obtaining such additional financing on reasonable terms, or at all. If adequate funds are not available on acceptable terms, or at all, we may be unable to adequately fund our business plans, which could have a negative effect on our business, results of operations, and financial condition.

Our former wholly owned Swedish subsidiary, Neonode AB, has been liquidated under the Swedish bankruptcy laws

Neonode AB, our former wholly owned Swedish subsidiary, filed a petition to liquidate under the Swedish bankruptcy laws on December 9, 2008. Neonode AB was our operating company that developed and marketed our touchscreen mobile phone, the N2. We no longer manufacture or sell mobile phone products and have implemented a new strategy for our business. While we have acquired Neonode Technologies AB, we may not be successful in our transition from the manufacturing and selling of mobile phone products to the licensing of our touchscreen technologies to other companies.

We have never been profitable and we anticipate significant additional losses in the future.

Neonode Inc. was formed in 1997 and reconstituted in 2006 as a holding company, owning and operating Neonode AB, which had been formed in 2004. We had been primarily engaged in the business of developing and selling mobile phones. Following the liquidation of Neonode AB, we have implemented a new strategy for our business. We have a limited operating history on which to base an evaluation of our business and prospects. Our prospects must be considered in light of the risks and uncertainties encountered by companies in the early stages of development, particularly companies in new and rapidly evolving markets. We were not successful in selling mobile phones and have refocused our business on licensing our touchscreen technology. Although we secured one technology license agreement in July 2005, it was not the main focus of our business. We may not be successful in entering the technology licensing business. Our success will depend on many factors, including, but not limited to:

- the growth of touchscreen interface usage;
- the efforts and success of our OEM and other customers;
- the level of competition faced by us; and
- our ability to meet customer demand for engineering support, new technology and ongoing service.

In addition, we have experienced substantial net losses in each fiscal period since our inception. These net losses resulted from a lack of substantial revenues and the significant costs incurred in the development of our products and infrastructure. Our ability to continue as a going concern is dependent on our ability to raise additional funds and implement our business plan.

Our limited operating history and the emerging nature of our market, together with the other risk factors set forth in this report, make prediction of our future operating results difficult. There can also be no assurance that we will ever achieve significant revenues or profitability or, if significant revenues and profitability are achieved, that they could be sustained.

Our independent registered public accounting firm has included a going concern paragraph in their report on our financial statements.

While our independent registered public accounting firm expressed an unqualified opinion on our consolidated financial statements, our independent registered public accounting firm did include an explanatory paragraph indicating that there is substantial doubt about our ability to continue as a going concern due to our significant recurring losses in 2009, our negative cash flows from operations through December 31, 2009, and our accumulated deficit at December 31, 2009. Our ability to continue as an operating entity currently depends, in large measure, upon our ability to generate additional capital resources. . While we seek ways to continue to operate by securing additional financing resources, we do not at this time have any commitments or agreements that provide for additional capital resources. Our financial condition and the going concern emphasis paragraph may also make it more difficult for us to maintain, initiate, and secure new customer relationships.

If we fail to develop and introduce new products and services successfully and in a cost effective and timely manner, we will not be able to compete effectively and our ability to generate revenues will suffer.

We operate in a highly competitive, rapidly evolving environment, and our success depends on our ability to develop and introduce new products, technology, and services that our customers and end users choose to buy. If we are unsuccessful at developing and introducing new products, technology, and services that are appealing to our customers and end users with acceptable quality, prices and terms, we will not be able to compete effectively and our ability to generate revenues will suffer.

The development of new products, technology, and services is very difficult and requires high levels of innovation. The development process is also lengthy and costly. If we fail to anticipate our end users' needs or technological trends accurately or if we are unable to complete the development of products and services in a cost effective and timely fashion, we will be unable to introduce new products and services into the market or successfully compete with other providers.

As we introduce new or enhanced products or integrate new technology into new or existing products, we face risks including, among other things, disruption in customers' ordering patterns, excessive levels of older product inventories, inability to deliver sufficient supplies of new products to meet customers' demand, possible product and technology defects, and potentially unfamiliar sales and support environments. Premature announcements or leaks of new products, features, or technologies may exacerbate some of these risks. Our failure to manage the transition to newer products or the integration of newer technology into new or existing products could adversely affect our business, results of operations, and financial condition.

We are dependent on the ability of our customers to design, manufacture and sell their products that incorporate our touchscreen technologies.

Our products and technologies are licensed to other companies which must be successful in designing, manufacturing and selling the products that incorporate our technologies. If our customers are not able to design, manufacture or sell their products, or are delayed in producing their products, our revenues, profitability, and liquidity, as well as our brand image, may be adversely affected.

We must significantly enhance our sales and product development organizations.

We will need to improve the effectiveness and breadth of our sales operations in order to increase market awareness and sales of our technologies, especially as we expand into new market segments. Competition for qualified sales personnel is intense, and we may not be able to hire the kind and number of sales personnel we are targeting. Likewise, our efforts to improve and refine our products require skilled engineers and programmers. Competition for professionals capable of expanding our research and development organization is intense due to the limited number of people available with the necessary technical skills. If we are unable to identify, hire, or retain qualified sales, marketing, and technical personnel, our ability to achieve future revenue may be adversely affected.

We are dependent on the services of our key personnel.

We are dependent on our current management for the foreseeable future. The loss of the services of any member of management could have a materially adverse effect on our operations and prospects.

If third parties infringe our intellectual property or if we are unable to secure and protect our intellectual property, we may expend significant resources enforcing our rights or suffer competitive injury.

Our success depends in large part on our proprietary technology and other intellectual property rights. We rely on a combination of patents, copyrights, trademarks and trade secrets, confidentiality provisions, and licensing arrangements to establish and protect our proprietary rights. Our intellectual property, particularly our patents, may not provide us with a significant competitive advantage. If we fail to protect or to enforce our intellectual property rights successfully, our competitive position could suffer, which could harm our results of operations.

Our pending patent and trademark applications for registration may not be allowed, or others may challenge the validity or scope of our patents or trademarks, including patent or trademark applications or registrations. Even if our patents or trademark registrations are issued and maintained, these patents or trademarks may not be of adequate scope or benefit to us or may be held invalid and unenforceable against third parties.

We may be required to spend significant resources to monitor and police our intellectual property rights. Effective policing of the unauthorized use of our products or intellectual property is difficult and litigation may be necessary in the future to enforce our intellectual property rights. Intellectual property litigation is not only expensive, but time-consuming, regardless of the merits of any claim, and could divert attention of our management from operating the business. Despite our efforts, we may not be able to detect infringement and may lose competitive position in the market before they do so. In addition, competitors may design around our technology or develop competing technologies. Intellectual property rights may also be unavailable or limited in some foreign countries, which could make it easier for competitors to capture market share.

Despite our efforts to protect our proprietary rights, existing laws, contractual provisions and remedies afford only limited protection. Intellectual property lawsuits are subject to inherent uncertainties due to, among other things, the complexity of the technical issues involved, and we cannot assure you that we will be successful in asserting our intellectual property rights. Attempts may be made to copy or reverse engineer aspects of our products or to obtain and use information that we regard as proprietary. Accordingly, we cannot assure you that we will be able to protect our proprietary rights against unauthorized third party copying or use. The unauthorized use of our technology or of our proprietary information by competitors could have an adverse effect on our ability to sell our products.

We have an international presence in countries whose laws may not provide protection of our intellectual property rights to the same extent as the laws of the United States, which may make it more difficult for us to protect our intellectual property.

As part of our business strategy, we target customers and relationships with suppliers and original equipment manufacturers in countries with large populations and propensities for adopting new technologies. However, many of these countries do not address misappropriation of intellectual property nor deter others from developing similar, competing technologies or intellectual property. Effective protection of patents, copyrights, trademarks, trade secrets and other intellectual property may be unavailable or limited in some foreign countries. In particular, the laws of some foreign countries in which we do business may not protect our intellectual property rights to the same extent as the laws of the United States. As a result, we may not be able to effectively prevent competitors in these regions from infringing our intellectual property rights, which could reduce our competitive advantage and ability to compete in those regions and negatively impact our business.

If we are unable to obtain key technologies from third parties on a timely basis, free from errors or defects, we may have to delay or cancel the release of certain products or features in our products or incur increased costs.

We license third-party software for use in our products, including the operating systems. Our ability to release and sell our products, as well as our reputation, could be harmed if the third-party technologies are not delivered to customers in a timely manner, on acceptable business terms, or if they contain errors or defects that are not discovered and fixed prior to release of our products and we are unable to obtain alternative technologies on a timely and cost effective basis to use in our products. As a result, our product shipments could be delayed, our offering of features could be reduced, or we may need to divert our development resources from other business objectives, any of which could adversely affect our reputation, business and results of operations.

Changes in financial accounting standards or practices may cause unexpected fluctuations in and adversely affect our reported results of operations.

Any change in financial accounting standards or practices that cause a change in the methodology or procedures by which we track, calculate, record and report our results of operations or financial condition or both could cause fluctuations in, and adversely affect, our reported results of operations and cause our historical financial information not to be reliable as an indicator of future results.

Wars, terrorist attacks or other threats beyond our control could negatively impact consumer confidence, which could harm our operating results.

Wars, terrorist attacks or other threats beyond our control could have an adverse impact on the United States, Europe and the world economy in general, and consumer confidence and spending in particular, which could harm our business, results of operations and financial condition.

#### Risks Related to Owning Our Stock

If we continue to experience losses, we could experience difficulty meeting our business plan and our stock price could be negatively affected.

If we are unable to gain market acceptance of our touchscreen technologies, we will experience continuing operating losses and negative cash flow from our operations. Any failure to achieve or maintain profitability could negatively impact the market price of our common stock. We anticipate that we will continue to incur product development, sales and marketing and administrative expenses. As a result, we will need to generate significant quarterly revenues if we are to achieve and maintain profitability. A substantial failure to achieve profitability could make it difficult or impossible for us to grow our business. Our business strategy may not be successful, and we may not generate significant revenues or achieve profitability. Any failure to significantly increase revenues would also harm our ability to achieve and maintain profitability. If we do achieve profitability in the future, we may not be able to sustain or increase profitability on a quarterly or annual basis.

Our certificate of incorporation and bylaws and the Delaware General Corporation Law contain provisions that could delay or prevent a change in control.

Our board of directors has the authority to issue up to 2,000,000 shares of Preferred stock and to determine the price, rights, preferences and privileges of those shares without any further vote or action by the stockholders. The rights of the holders of common stock will be subject to, and may be materially adversely affected by, the rights of the holders of any Preferred stock that may be issued in the future. The issuance of Preferred stock could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock. Furthermore, certain other provisions of our certificate of incorporation and bylaws may have the effect of delaying or preventing changes in control or management, which could adversely affect the market price of our common stock. In addition, we are subject to the provisions of Section 203 of the Delaware General Corporation Law, an anti-takeover law.

Our stock price has been volatile, and your investment in our common stock could suffer a decline in value.

There has been significant volatility in the market price and trading volume of equity securities, which is unrelated to the financial performance of the companies issuing the securities. These broad market fluctuations may negatively affect the market price of our common stock. You may not be able to resell your shares at or above the price you pay for those shares due to fluctuations in the market price of our common stock caused by changes in our operating performance or prospects, and other factors.



Some specific factors that may have a significant effect on our common stock market price include:

- actual or anticipated fluctuations in our operating results or future prospects;
- our announcements or our competitors' announcements of new products;
- the public's reaction to our press releases, our other public announcements, and our filings with the SEC;
- strategic actions by us or our competitors, such as acquisitions or restructurings;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- changes in accounting standards, policies, guidance, interpretations or principles;
- changes in our growth rates or our competitors' growth rates;
- developments regarding our patents or proprietary rights or those of our competitors;
- our inability to raise additional capital as needed;
- concern as to the efficacy of our products;
- changes in financial markets or general economic conditions;
- sales of common stock by us or members of our management team; and
- changes in stock market analyst recommendations or earnings estimates regarding our common stock, other comparable companies, or our industry generally.

Future sales of our common stock could adversely affect its price and our future capital-raising activities could involve the issuance of equity securities, which would dilute your investment and could result in a decline in the trading price of our common stock.

We may sell securities in the public or private equity markets if and when conditions are favorable, even if we do not have an immediate need for additional capital at that time. Sales of substantial amounts of common stock, or the perception that such sales could occur, could adversely affect the prevailing market price of our common stock and our ability to raise capital. We may issue additional common stock in future financing transactions or as incentive compensation for our executive management and other key personnel, consultants and advisors. Issuing any equity securities would be dilutive to the equity interests represented by our then-outstanding shares of common stock. The market price for our common stock could decrease as the market takes into account the dilutive effect of any of these issuances. Furthermore, we may enter into financing transactions at prices that represent a substantial discount to the market price of our common stock. A negative reaction by investors and securities analysts to any discounted sale of our equity securities could result in a decline in the trading price of our common stock.

Our common stock is currently traded on the OTC Bulletin Board Market. Our stock price and liquidity may continue to be impacted.

Our common stock is traded on the OTC Bulletin Board market, which is generally considered a less efficient and less prestigious market than other markets, such as the Nasdaq Capital Market. The price and liquidity of our stock may continue to be adversely affected as a result of our common stock trading on the OTC Bulletin Board Market.

ITEM  
1B. UNRESOLVED STAFF COMMENTS

None.

ITEM  
2. PROPERTIES

On January 12, 2009, our subsidiary, Neonode Technologies AB, entered into a 12-month lease with Vasakronan Fastigheter AB for approximately 2,000 square feet of office space located at Linnegatan 89, Stockholm, Sweden for

approximately \$5,000 per month. The annual payment for this space equates to approximately \$60,000. This lease was extended through July 1, 2010 with a provision for additional automatic three-month extensions at our discretion.

In addition, we lease office space located in Lafayette, California that is provided by our Chief Financial Officer on a rent-free basis.

### ITEM 3. LEGAL PROCEEDINGS

On September 4, 2008, we received a summons to appear in the United States District Court for the Southern District of New York because one of our investors in previous private placements transactions, Alpha Capital Anstalt (Alpha), alleged that we failed to issue certain stock certificates pursuant to the terms and conditions of the September 2007 investment subscription agreements. Alpha was asking the court to award it \$734,650 in damages plus attorneys fees. Although we believed the claim had no merit, we signed a definitive settlement agreement on January 21, 2009, and issued Alpha 1,096,997 shares of our common stock as settlement in full. On February 13, 2009, a notice was sent to the Court by Alpha's legal counsel dismissing the action.

On December 9, 2008, Empire Asset Management (Empire), a broker dealer that acted as the Company's financial advisor and exclusive placement agent in previous private placement transactions, initiated a lawsuit against the Company in the Supreme Court of the State of New York alleging that the Corporation misrepresented the success of its business with the purpose of inducing Empire's customers to invest in the Company. Empire is seeking compensatory damages in an unspecified amount for the harm allegedly suffered. The Company intends to defend vigorously against the action.

On May 11, 2009, Mr. David Berman initiated a lawsuit against the Company in the Supreme Court of the State of New York alleging that the Corporation misrepresented the success of its business to induce Mr. Berman to invest in the Company. Mr. Berman, who was a client of Empire, invested \$549,860.00 in the Company's private placement offerings on March 4, 2008 and May 16, 2008, and purchased an additional 162,900 shares totaling \$251,081.69 in the after-market. The Company believes that the action has no merit and intends to defend vigorously against the action.

The Company's D&O insurance provider has extended coverage and will cover the costs of legal representation for both the Empire and Berman matters, subject to the payment by the Company of the retention amount of \$150,000.

On October 2, 2009, Xerox Corporation ("Xerox") initiated a law suit against the Company in the Superior Court of California alleging that the Company breached an equipment lease agreement with Xerox and demanding payment of \$108,592.81 plus interest, late payment charges, and legal costs. On December 14, 2009, Xerox obtained an entry of default against the Company without prior warning to the Company. The Company has filed a motion to set aside the entry of default and a hearing on this motion is set for June 2, 2010. The Company intends to defend vigorously against the action. The Company has accrued \$109,000 in the consolidated balance sheet at December 31, 2009 related to this lawsuit.

## PART II

## ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Effective January 2, 2009, our common stock was quoted on the Pink Sheets under the symbol NEON.PK and effective January 26, 2009, our common stock has been quoted on the Over the Counter Bulletin Board Market (OTCBB) under the symbol NEON.OB.

In 2008, our stock was traded on the Nasdaq Capital Market under the symbol NEON. The following table presents quarterly information on the price range of our common stock, indicating the high and low bid prices reported by the Nasdaq Capital Market. These prices do not include retail markups, markdowns or commissions. As of December 31, 2009, there were approximately 2,634 holders of record of our common stock.

|             | Fiscal Quarter Ended |         |              |             |
|-------------|----------------------|---------|--------------|-------------|
|             | March 31             | June 30 | September 30 | December 31 |
| Fiscal 2009 |                      |         |              |             |
| High        | \$0.06               | \$0.05  | \$0.05       | \$0.04      |
| Low         | \$0.02               | \$0.02  | 0.02         | \$0.02      |
| Fiscal 2008 |                      |         |              |             |
| High        | \$3.70               | \$3.09  | \$0.49       | \$0.19      |
| Low         | \$1.74               | \$0.35  | \$0.10       | \$0.03      |

There are no restrictions on our ability to pay dividends; however, it is currently the intention of our Board of Directors to retain all earnings, if any, for use in our business and we do not anticipate paying cash dividends in the foreseeable future. Any future determination as to the payment of dividends will depend, among other factors, upon our earnings, capital requirements, operating results and financial condition.

#### Sale of Unregistered Securities

During the period from October 9, 2009 through December 15, 2009, we completed a private placement of convertible notes totaling \$150,119 that can be converted, at the holder's option, into 7,505,951 shares of our common stock at a conversion price of \$0.02 per share. The convertible note holders have the right to have the conversion price adjusted to equal the lower stock price if we issue stock or convertible notes at a lower conversion price than \$0.02 during the period that the notes are outstanding. These convertible notes are due on December 31, 2010 and bear an annual interest rate of 7%, payable on June 30 and December 31 of each year that the convertible notes are outstanding. In addition, we issued 3,752,976 three-year warrants to the convertible note holders with an exercise price of \$0.04 per share. The warrants may be exercised and converted to common stock, at the warrant holders option, beginning on the six month anniversary date of issuance until the warrant expiration date. We are not obligate to register the common stock related to the convertible debt or the warrants.

During the three months ended December 31, 2009, we issued a total of 5,000,286 shares of common stock in exchange for 10,403 shares of Series A preferred stock and 2 shares of Series B preferred stock.

On December 31, 2009, we issued a warrant to purchase 1,305,740 of our common stock an exercise price of \$0.04 per share to an investor for services provided for the private placement of convertible notes and warrants in the 2009 financing transaction.

#### ITEM 6. SELECTED FINANCIAL DATA

Not applicable.

#### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. Words such as "believes," "anticipates," "expects," "intends" and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Readers are cautioned that the forward-looking statements reflect our analysis only as of the date hereof, and we do not assume any obligation to update these statements. Actual events or results may differ materially from the results discussed in or implied by the forward-looking statements. The following discussion should be read in conjunction with the company's consolidated financial statements for the years ended December 31, 2009 and 2008 and the related notes included therein.

## Overview

We specialize in user-friendly touchscreen solutions for hand-held devices, based on our innovative optical technology, which we refer to as zForce™. Our mission is to make the easiest (to use and integrate), best (functionality and design) and cheapest touchscreen solution for handheld devices.

Through our former wholly owned subsidiary, Neonode AB, we developed our touchscreen technology and an optical touchscreen mobile phone product, the Neonode N2. On December 1, 2008, we transferred the Neonode AB intellectual property including patents, copyrights and trademarks from Neonode AB to Neonode Inc. pursuant to an intercompany debt pledge agreement. On December 9, 2008, Neonode AB filed for liquidation under the Swedish bankruptcy laws. Effective with Neonode AB's bankruptcy filing on December 9, 2008, Neonode Inc. was no longer in the mobile phone business and was relieved of any financial obligations related to the accounts payable or other debts of Neonode AB.

We have not generated sufficient cash from the sale of our products or licensing of our technology to support our operations and have incurred significant losses. During the years ended December 31, 2008 and 2009, we raised approximately \$9.6 million and \$2.0 million, respectively, net cash proceeds through the sale of our securities and convertible debt. We raised an additional \$1.5 million through May 12, 2010 through the sale of our securities. Unless we are able to increase our revenues and/or decrease expenses substantially in addition to securing additional sources of financing, we will not have sufficient cash to support our operations through June 2010.

On December 30, 2008, we commenced certain refinancing and capital raising transactions to enable us to continue to develop our technology. A description of the actions we took to restructure and refinance the Company and a description of our new business are included above in Item 1 "Business."

We have incurred net operating losses and negative operating cash flows since inception. As of December 31, 2009, we had an accumulated deficit of \$80.6 million. We expect to incur additional losses and may have negative operating cash flows through the end of 2010. Although we have been able to fund our operations to date, there is no assurance that our capital raising efforts will be able to attract the additional capital or other funds needed to sustain our operations.

Our success is dependent on our obtaining sufficient capital or operating cash flows to fund our operations and to development of our technology and products, and on our bringing such technology and products to the worldwide market. To achieve these objectives, we may be required to raise additional capital through public or private financings or other arrangements. It cannot be assured that such financings will be available on terms attractive to us, if at all. Such financings may be dilutive to stockholders and may contain restrictive covenants.

In addition to the immediate risks relating to our ability to continue as a going concern and to obtain funding under the current market conditions, we are subject to certain risks common to technology-based companies in similar stages of development. See "Risk Factors" above. Principal risks include risks relating to the uncertainty of growth in market acceptance for our technology, a history of losses since inception, our ability to remain competitive in response to new technologies, the costs to defend, as well as risks of losing, patents and intellectual property rights, a reliance on our future customers' ability to develop and sell products that incorporate our technology, the concentration of our operations in a limited number of facilities, the uncertainty of demand for our technology in certain markets, our ability to manage growth effectively, our dependence on key members of our management and development team, our limited experience in conducting operations internationally, and our ability to obtain adequate capital to fund future operations.

## Critical Accounting Policies and Estimates

The preparation of our financial statements are in conformity with generally accepted accounting principles in the United States of America (GAAP) and include the accounts of Neonode Inc. and its former wholly owned subsidiary based in Sweden, Neonode AB, through December 9, 2008, the date Neonode AB filed for bankruptcy. The balance sheet as of December 31, 2008, includes the accounts of our new wholly owned subsidiary based in Sweden, Neonode Technologies AB. Operating results for Neonode Technologies AB from date of acquisition to December 31, 2008, have been insignificant. For 2009, the audited consolidated statements of operations and cash flows appearing elsewhere in this Annual Report on Form 10-K/A and the discussion of our financial condition and results of operations for the year ended December 31, 2009 appearing below include the results of operations of our new wholly owned subsidiary, Neonode Technologies AB, which Neonode Inc. purchased on December 29, 2008. The audited consolidated balance sheet as of December 31, 2009 includes the accounts of Neonode Inc. and Neonode Technologies AB.

All inter-company accounts and transactions have been eliminated in consolidation. Our accounting policies affecting our financial condition and results of operations are more fully described in Note 2 to our consolidated financial statements. Certain of our accounting policies require the application of judgment by management in selecting appropriate assumptions for calculating financial estimates, which inherently contain some degree of uncertainty. Management bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances. The historical experience and assumptions form the basis for making judgments about the reported carrying values of assets and liabilities and the reported amounts of revenue and expenses that may not be readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. We believe the following are some of the more critical accounting policies and related judgments and estimates used in the preparation of our consolidated financial statements.

## Revenue Recognition

### Neonode AB Mobile Phone Business and Licensing of Our Intellectual Property:

We recognize revenue from product sales when title transfers and risk of loss has passed to the customer, which is generally upon shipment of products to our customers. We estimate expected sales returns and record the amount as a reduction of revenues and cost of sales at the time of shipment. Our policy complies with the accounting guidance issued by the Securities and Exchange Commission (SEC). We recognized revenue from the sale of our mobile phones when all of the following conditions were met: (1) evidence existed of an arrangement with the customer, typically consisting of a purchase order or contract; (2) our products were delivered and risk of loss passed to the customer; (3) we completed all of the necessary terms of the contract; (4) the amount of revenue to which we were entitled was fixed or determinable; and (5) we believed it probable that we would be able to collect the amount due from the customer. To the extent that one or more of these conditions has not been satisfied, we deferred recognition of revenue. Judgments were required in evaluating the credit worthiness of our customers. Credit was not extended to customers and revenue was not recognized until we determined that collectibility was reasonably assured.

In 2008, our revenues generated by the sale of Neonode AB's mobile phones consisted primarily of sales to distributors. From time to time, we allowed certain distributors price protection subsequent to the initial product shipment. Price protection may have allowed the distributor a credit (either in cash or as a discount on future purchases) if there was a price decrease during a specified period of time or until the distributor resold the goods. Future price adjustments were difficult to estimate since we do not have a sufficient history of making price adjustments. Therefore, we deferred recognition of revenue derived from sales to these customers until they resold our products to their customers. Although revenue recognition and related cost of sales were deferred, we recorded an accounts receivable at the time of initial product shipment. As standard terms were generally FOB shipping point, payment terms were enforced from the shipment date, and legal title and risk of inventory loss passed to the distributor upon shipment.

For products sold to distributors with agreements allowing for price protection and product returns, we recognized revenue based on our best estimate of when the distributor sold the product to its end customer. Our estimate of such distributor sell-through was based on information received from our distributors. Revenue was not recognized upon shipment since, due to various forms of price concessions; the sales price was not substantially fixed or determinable at that time.

Revenue from products sold directly to end-users through our web sales channels were generally recognized when title and risk of loss passed to the buyer, which typically occurred upon shipment. Reserves for sales returns were estimated based primarily on historical experience and were provided at the time of shipment.



Generally, our customers were responsible for the payment of all shipping and handling charges directly with the freight carriers.

Neonode AB derived revenue from the licensing of our internally developed intellectual property (IP). We entered into IP licensing agreements that generally provided licensees the right to incorporate our IP components in their products with terms and conditions that varied by licensee. The IP licensing agreements generally included a nonexclusive license for the underlying IP. Fees under these agreements may have included license fees relating to our IP and royalties payable following the sale by our licensees of products incorporating the licensed technology. The license for our IP has standalone value and can be used by the licensee without maintenance and support. On December 1, 2008, we transferred the Neonode AB intellectual property including patents, copyrights and trademarks to Neonode inc. pursuant to an intercompany debt pledge agreement.

#### Hardware Products:

We may from time-to-time develop custom hardware products for our customers that incorporate our touchscreen technology. Our policy is to recognize revenue from hardware product sales when title transfers and risk of loss has passed to the customer, which is generally upon shipment of our hardware products to our customers. We defer and recognize service revenue over the contractual period or as services are rendered. We estimate expected sales returns and record the amount as a reduction of revenue and cost of hardware and other revenue at the time of shipment. Our policy complies with the accounting guidance provided by the SEC. Judgments are required in evaluating the credit worthiness of our customers. Credit is not extended to customers and revenue is not recognized until we have determined that collectibility is reasonably assured. Our sales transactions are denominated in U.S. dollars or Euros. The software component of our hardware products is considered incidental. Therefore, we do not recognize software revenue related to our hardware products separately from the hardware product sale. To date, we have not sold any hardware products.

When selling hardware, we expect our agreements with OEMs and ODMs to incorporate clauses reflecting the following understandings:

- all prices are fixed and determinable at the time of sale;
- title and risk of loss pass at the time of shipment (FOB shipping point);
- collectibility of the sales price is probable (the customer is creditworthy, the customer is obligated to pay, and such obligation is not contingent on the ultimate sale of the customer's integrated solution);
- the customer's obligation to us will not be changed in the event of theft or physical destruction or damage of the product;
- we do not have significant obligations for future performance to directly assist in the resale of the product by the OEMs; and
- there is no contractual right of return other than for defective products.

#### Software Products:

We may derive revenues from the following sources: (1) software, which includes our Neno™ software licenses and (2) engineering services, which include consulting. We account for the licensing of software in accordance with accounting guidance that requires judgment, including whether a software arrangement includes multiple elements, and if so, whether vendor-specific objective evidence (VSOE) of fair value exists for those elements. These documents include post delivery support, upgrades, and similar services. To date, we have not sold any software products.

For software license arrangements that do not require significant modification or customization of the underlying software, we recognize new software license revenue when: (1) we enter into a legally binding arrangement with a customer for the license of software; (2) we deliver the products; (3) customer payment is deemed fixed or determinable and free of contingencies or significant uncertainties; and (4) collection is reasonably assured. We initially defer all revenue related to the software license and maintenance fees until such time that we are able to establish VSOE for these elements of our software products. Revenue deferred under these arrangements is recognized to revenue over the expected contract term. We will also continue to defer revenues that represent undelivered post-delivery engineering support until the engineering support has been completed and the software product is accepted.

#### Engineering Services:

We may sell engineering consulting services to our customers on a flat rate or hourly rate basis. We recognize revenue as the engineering services stipulated under the contract are completed and accepted by our customers. On December 29, 2009, we signed an engineering services agreement with an OEM to provide engineering services over a three-month period in 2010 related to the development of a touchscreen application for a mobile phone product. The value of this agreement is approximately \$100,000.

#### Allowance for Doubtful Accounts

Our policy is to maintain allowances for estimated losses resulting from the inability of our customers to make required payments. Credit limits are established through a process of reviewing the financial history and stability of each customer. Where appropriate, we obtain credit rating reports and financial statements of our customers when determining or modifying their credit limits. We regularly evaluate the collectibility of our trade receivable balances based on a combination of factors. When a customer's account balance becomes past due, we initiate dialogue with the customer to determine the cause. If it is determined that the customer will be unable to meet its financial obligation, such as in the case of a bankruptcy filing, deterioration in the customer's operating results or financial position, or other material events impacting its business, we record a specific allowance to reduce the related receivable to the amount we expect to recover. Should all efforts fail to recover the related receivable, we will write-off the account. We also record an allowance for all customers based on certain other factors, including the length of time the receivables are past due and our historical collection experience with customers. We do not have any accounts receivable at December 31, 2009 and 2008, respectively.

#### Warranty Reserves

Our mobile phone products were generally warranted against defects for 12 months following the sale. We had a 12 month warranty from the manufacturer of the mobile phones. Reserves for potential warranty claims not covered by the manufacturer were provided at the time of revenue recognition and were based on several factors, including current sales levels and our estimate of repair costs. Shipping and handling charges were expensed as incurred. Upon filing for bankruptcy on December 9, 2008, the warranty obligations related to Neonode AB's previous sales of mobile phone products were transferred to the Swedish bankruptcy court along with all the assets and liabilities of Neonode AB.

We do not anticipate that our technology products will have any warranty obligations associated with licenses related to these technologies.

#### Research and Development

Research and Development (R&D) costs are expensed as incurred. R&D costs consists mainly of personnel related costs in addition to some external consultancy costs such as testing, certifying, and measurements.

Long-lived Assets

We assess any impairment by estimating the future cash flow from the associated asset in accordance with accounting guidance. If the estimated undiscounted cash flow related to these assets decreases in the future or the useful life is shorter than originally estimated, we may incur charges for impairment of these assets. The impairment is based on the estimated discounted cash flow associated with the asset.

### Stock Based Compensation Expense

We measure the cost of employee services received in exchange for an award of equity instruments, including share options, based on the fair value of the award on the grant date, and recognize it as compensation expense over the period the employee is required to provide services in exchange for the award, usually the vesting period.

We account for equity instruments issued to non-employees at their fair value and the unvested portion is re-measured each reporting period as long as the instrument requires variable accounting.

When determining stock-based compensation expense involving options and warrants, we determine the estimated fair value of options and warrants using the Black-Scholes option pricing model.

### Accounting for Debt Issued with Detachable Stock Purchase Warrants and Beneficial Conversion Features

We account for debt issued with stock purchase warrants by allocating the proceeds of the debt between the debt and the detachable warrants based on the relative fair values of the debt security without the warrants and the warrants themselves, if the warrants are equity instruments. The relative fair value of the warrants are recorded as a debt discount and amortized to expense over the life of the related debt using the effective interest method. At each balance sheet date, we make a determination if these warrants instruments should be classified as liabilities or equity, and reclassify them if the circumstances dictate.

In certain instances, the Company enters into convertible notes that provide for an effective or actual rate of conversion that is below market value, (a "BCF"). In these instances, we account for the value of the BCF as a debt discount, which is then amortized to expense over the life of the related debt using the effective interest method

### Liability for Warrants and Embedded Derivatives

We do not enter into derivative contracts for purposes of risk management or speculation. However, from time to time, we enter into contracts that are not considered derivative financial instruments in their entirety but that include embedded derivative features. Such embedded derivatives are assessed at inception of the contract and every reporting period and, depending on their characteristics, are accounted for as separate derivative financial instruments pursuant to the accounting guidance, if such embedded conversion features, if freestanding, would meet the classification of a liability. Accounting guidance requires that we analyze all material contracts and determine whether or not they contain embedded derivatives. Any such embedded conversion features that meet the above criteria are then bifurcated from their host contract and recorded on the consolidated balance sheet at fair value and the changes in the fair value of these derivatives are recorded each period in the consolidated statements of operations as an increase or decrease to Non-cash charges for conversion features and warrants.

Similarly, if warrants meet the classification of liabilities in accordance with accounting guidance, then the fair value of the warrants are recorded on the consolidated balance sheet at their fair values, and any changes in such fair values are recorded each period in the consolidated statements of operations as an increase or decrease to non-cash charges for conversion features and warrants.

### Income taxes

We recognize deferred tax liabilities and assets for the expected future tax consequences of items that have been included in the financial statements or tax returns. We estimate income taxes based on rates in effect in each of the jurisdictions in which we operate. Deferred income tax assets and liabilities are determined based upon differences between the financial statement and income tax bases of assets and liabilities using enacted tax rates in effect for the

year in which the differences are expected to reverse. The realization of deferred tax assets is based on historical tax positions and expectations about future taxable income. Valuation allowances are recorded against net deferred tax assets where, in our opinion, realization is uncertain based on the “not more likely than not” criteria of the accounting guidance.

Based on the uncertainty of future pre-tax income, we fully reserved our net deferred tax assets as of December 31, 2009 and 2008. In the event we were to determine that we would be able to realize our deferred tax assets in the future, an adjustment to the deferred tax asset would increase income in the period such a determination was made. The provision for income taxes represents the net change in deferred tax amounts, plus income taxes payable for the current period.

Effective January 1, 2007, we adopted the relevant accounting guidance related to uncertain tax positions, which provisions include a two-step approach to recognizing, de-recognizing and measuring uncertain tax positions. As a result, we recognized no increase in the liability for unrecognized tax benefits. As of December 31, 2009, we had no unrecognized tax benefits.

#### New Accounting Pronouncements

The following are the expected effects of recent accounting pronouncements. We are required to analyze these pronouncements and determine the effect, if any, the adoption of these pronouncements would have on our results of operations or financial position.

In June 2009, the FASB issued guidance on the hierarchy of generally accepted accounting principles, specifically as it relates to the codification of accounting standards (the "Codification"). The Codification, which was launched on July 1, 2009, became the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants Emerging Issues Task Force and related literature. The Codification eliminates the GAAP hierarchy contained in previous accounting guidance and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. This new guidance is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We have adopted the Codification with no impact to our consolidated financial statements.

In August 2009, the FASB issued Accounting Standard Update ("ASU") No. 2009-05, Measuring Liabilities at Fair Value, which provides additional guidance on how companies should measure liabilities at fair value under ASC 820. The ASU clarifies that the quoted price for an identical liability should be used. However, if such information is not available, an entity may use, the quoted price of an identical liability when traded as an asset, quoted prices for similar liabilities or similar liabilities traded as assets, or another valuation technique (such as the market or income approach). The ASU also indicates that the fair value of a liability is not adjusted to reflect the impact of contractual restrictions that prevent its transfer and indicates circumstances in which quoted market prices for an identical liability or quoted price for an identical liability traded as an asset may be considered level 1 fair value measurements. This ASU is effective October 1, 2009. During 2009, the Company adopted this standard, but it did not have a material impact on the consolidated financial statements.

## Results of Operations

### 2008 Financial Statements

On December 9, 2008, our former wholly owned Swedish subsidiary, Neonode AB, filed for liquidation under the bankruptcy laws of Sweden. Pursuant to the Swedish bankruptcy laws, we were no longer responsible for the debt and liabilities nor do we have any ownership interest in the assets of Neonode AB as of December 9, 2008, the effective date of the bankruptcy filing. The audited consolidated statements of operations and cash flows appearing elsewhere in this Annual Report on Form 10-K and the discussion of our financial condition and results of operations for the year ended December 31, 2008 appearing below include the results of operations of our former wholly owned subsidiary, Neonode AB, only from January 1, 2008 through December 9, 2008, the date Neonode AB filed for bankruptcy. Accounting guidance precludes consolidation of a majority-owned subsidiary where control does not rest with the majority owners, for instance, where the subsidiary is in bankruptcy. Accordingly, we deconsolidated Neonode AB from our consolidated financial statements on the date it filed for bankruptcy, December 9, 2008.

On December 29, 2008, we entered into a Share Exchange Agreement with Neonode Technologies AB, a Swedish engineering company, and the stockholders of Neonode Technologies AB: Iwo Jima SARL, Wirelesstoy AB, and Athemis Ltd. (the Neonode Technologies AB Stockholders), pursuant to which we agreed to acquire all of the issued and outstanding shares of Neonode Technologies AB in exchange for the issuance of 495,000 shares of Neonode Inc. Series A Preferred Stock to the Neonode Technologies AB Stockholders. The 495,000 shares of our Series A Preferred Stock were converted to 237,911,185 shares of our common stock in 2009. Pursuant to the terms of the Share Exchange Agreement, upon the closing of the transaction, Neonode Technologies AB became our wholly owned subsidiary. Neonode's consolidated balance sheets as of December 31, 2008 include the accounts of Neonode Inc. and its new wholly owned subsidiary, Neonode Technologies AB. Neonode Technologies AB did not have any operations prior to its acquisition by us on December 29, 2008; therefore, the acquisition of Neonode Technologies AB has no accounting impact on the consolidated statements of operations for the year ended December 31, 2008.

### 2009 Financial Statements

For 2009, the audited consolidated statements of operations and cash flows appearing elsewhere in this Annual Report on Form 10-K/A and the discussion of our financial condition and results of operations for the year ended December 31, 2009 appearing below include the results of operations of our new wholly owned subsidiary, Neonode Technologies AB, which Neonode Inc. purchased on December 29, 2008. The audited consolidated balance sheet as of December 31, 2009, includes the accounts of Neonode Inc. and Neonode Technologies AB.

The following table sets forth, as a percentage of net sales, certain statements of operations data for the year ended December 31, 2008. We did not have any sales in 2009, so no percentages of net sales are presented for the year ended December 31, 2009. These operating results are not necessarily indicative of our operating results for any future period.

|                            | 2008  |    |
|----------------------------|-------|----|
| Net sales                  | 100   | %  |
| Cost of sales              | 212   | %  |
| Gross margin               | (112) | %) |
| Operating expenses:        |       |    |
| Research and development   | 45    | %  |
| Sales and marketing        | 54    | %  |
| General and administrative | 82    | %  |
| Total operating expenses   | 181   | %  |
| Operating loss             | (293) | %) |

|  |     |    |
|--|-----|----|
| Other income (expense):  |     |    |
| Interest and other income  | --  |    |
| Interest and other expense   | (5  | %) |
| Foreign currency exchange rate loss  | (12 | %) |
| Write off of receivable from Neonode AB  | (39 | %) |
| Gain on debt forgiveness of Neonode AB   | 135 | %  |
| Gain on troubled debt restructuring  | 46  | %  |
| Non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants | 86  | %  |
| Total interest and other expense   | 212 | %  |
| Net loss   | (81 | %) |

## Net Sales

We did not have any net sales for the year ended December 31, 2009. Net sales for the year ended December 31, 2008 were \$7.3 million. Revenue for the year ended December 31, 2008 included \$6.9 million from the sale of our N2 mobile phones by our former wholly owned subsidiary, Neonode AB. A significant portion of our net sales in 2008 is primarily attributable to the sale of the inventory of approximately 28,000 N2 mobile phones held by our manufacturing partner in the fourth quarter of 2008. Our manufacturing partner applied the cash proceeds from the sale of the inventory of N2s to our outstanding accounts payable balance with them.

On December 9, 2008, our former wholly owned subsidiary, Neonode AB, filed for liquidation under the Swedish bankruptcy laws. Effective with Neonode AB's bankruptcy filing on December 9, 2008, Neonode Inc. was no longer in the mobile phone business and no longer has any known financial obligations related to the accounts payable or other debts of Neonode AB. The intellectual property of Neonode AB was transferred to Neonode Inc. prior to filing for bankruptcy and Neonode Inc. will continue to pursue technology sales and licensing opportunities through its newly-acquired subsidiary, Neonode Technologies AB.

We restructured and recapitalized our business on December 31, 2008 to focus our business on the development of our zForce touchscreen solutions that enable people to interact more easily and intuitively with a wide variety of mobile computing, communications, entertainment, and other electronic devices. Our sales are targeted at OEMs and ODMs which produce handheld devices for the digital lifestyle consumer products market, including portable digital music and video players, e-books, digital cameras, mobile phones, and other electronic devices which may utilize our customized touchscreen solutions.

We do not have any customers for our touchscreen technology and currently believe that we will depend on a limited number of OEM and ODM customers for substantially all our future revenue. Failure to anticipate or respond adequately to technological developments in our industry, changes in customer or supplier requirements, or changes in regulatory requirements or industry standards, or any significant delays in the development or introduction of products or services, could have a material adverse effect on our business, operating results and cash flows.

## Gross Margin

Gross margin as a percentage of net sales was (112)% in the year ended December 31, 2008. Our cost of sales includes the direct cost of production of the phone plus the cost of our internal production department and accrued estimated warranty costs. In the year ended December 31, 2008, our cost of sales includes an inventory write-down charge of \$10.2 million. We experienced limited success in selling our N2 mobile phone since introduction in 2007 and reevaluated our selling efforts and the potential markets for the N2 in 2008. Based upon this reevaluation, we decided that it was probable that in 2008 we would have to reduce the selling price of our N2 phones and/or offer our customers substantial incentives in order to sell the N2. As a result of our revaluation, we recorded a write-down reducing the value of our inventory to the estimated realizable value of our inventory prior to Neonode AB filing for bankruptcy on December 9, 2008.

## Product Research and Development

Product research and development (R&D) expenses for the year ended December 31, 2009 were \$1.0 million, a 70% decrease compared to \$3.3 million for the same period ended December 31, 2008.

The main factors that contributed to the decrease in R&D costs are a decrease in the headcount of our engineering department from 14 to eight, primarily at the end of 2008, along with a cessation in external development costs associated with the development of the N2 and a decrease related to corporate overhead, rent and travel-related costs.

On October 22, 2008, our former wholly owned Swedish subsidiary, Neonode AB, filed for company reorganization in compliance with the Swedish Reorganization Act (1996:764). In conjunction with the reorganization, we reduced our staffing levels across the company and cancelled all outside contractors and consultants, and stopped all R&D projects related to development and improvement of our mobile phone products. Under the Swedish Reorganization Act, the Swedish government assumed responsibility for payment of salaries and benefits to Neonode AB's employees on the day the Swedish court approved Neonode AB's petition for reorganization.

We are not currently planning to continue to pursue any expenditure on R&D projects related to developing or update our current or future mobile phone products. As part of our corporate reorganization, we will continue to pursue R&D expenditures on the development of our touchscreen and other technologies. We have a development roadmap based on our touchscreen and other technologies. As of December 31, 2009, we have 10 full-time employees and one part-time employee, of which eight full-time are part of our engineering department.

#### Sales and Marketing

Sales and marketing expenses for the year ended December 31, 2009 were \$0.3 million, compared to \$3.9 million for the same period in 2008, a decrease of 92%.

The decrease in the year ended December 31, 2009 over the same period in 2008 is primarily related to a wind down in product marketing activities related to our N2 mobile phone handset. On October 22, 2008, our Swedish subsidiary, Neonode AB, filed for company reorganization in compliance with the Swedish Reorganization Act (1996:764). In conjunction with the reorganization, we reduced our staffing levels across the company and cancelled all sales and promotional activities. Under the Swedish Reorganization Act, the Swedish government assumed responsibility for payment of salaries and benefits to Neonode AB's employees on the day the Swedish court approved Neonode AB's petition for reorganization.

Our sales activities after our corporate reorganization now focuses primarily on OEM and ODM customers who will integrate our touchscreen technology into their products, and the OEM and ODM customers will sell and market their products to their customers. As of December 31, 2009, we have retained two consultants in our sales and marketing department.

#### General and Administrative

General and administrative (G&A) expenses for the year ended December 31, 2009 were \$1.6 million, a 73% decrease from \$6.0 million for the same period in 2008.

The decrease in 2009 as compared to 2008 is related to a decrease in headcount in our G&A department from eight employees to two employees and one consultant. In addition there has been a significant decrease related to legal, accounting, facilities and travel costs. The year ended December 31, 2008 also includes \$225,000 in expense related to the termination of the Neonode USA agreement. On October 22, 2008, our Swedish subsidiary, Neonode AB, filed for company reorganization in compliance with the Swedish Reorganization Act (1996:764). In conjunction with the reorganization, we reduced our staffing levels across the company and cancelled all sales and promotional activities. Under the Swedish Reorganization Act, the Swedish government assumed responsibility for payment of salaries and benefits to Neonode AB's employees on the day the Swedish court approved Neonode AB's petition for reorganization.

As of December 31, 2009, we have two employees and one consultant in our G&A department fulfilling management and accounting responsibilities.

#### Amortization of Fair Value of Stock Issued to Related Parties for Purchase of Neonode Technologies AB

On December 29, 2008, we entered into a Share Exchange Agreement with Neonode Technologies AB and the stockholders of Neonode Technologies AB: Iwo Jima SARL, Wirelesstoy AB, and Athemis Ltd (the "Neonode Technologies AB Stockholders"), pursuant to which we agreed to acquire all of the issued and outstanding shares of Neonode Technologies AB in exchange for the issuance of 495,000 shares of Neonode Inc. Series A Preferred stock. Pursuant to the terms of the Share Exchange Agreement, upon the closing of the transaction, Neonode Technologies AB became a wholly owned subsidiary of the Company. The Neonode Technologies AB Stockholders

are or were employees of us and/or Neonode AB, and as such are related parties. Neonode Technologies AB did not have any operations in 2008.

The fair value of the conversion feature of the 495,000 shares of Series A Preferred shares issued to the related parties to acquire Neonode Technologies AB that was converted to a total of 237,911,185 shares of our common stock was \$9.5 million based on our stock price on March 31, 2009, the date our shareholders approved the increased conversion ratio. Because this transaction is essentially the issuance of shares to key employees for their continued service to enhance the Company, the \$9.5 million revised fair value of the common stock is being amortized to compensation expense at the rate of \$1.6 million per quarter for six quarters beginning January 1, 2009. For the year ended December 31, 2009, \$6.4 million has been recorded as compensation expense in our consolidated statements of operations.

#### Interest Expense and Other Expense

Interest expense for the year ended December 31, 2009 was \$60,000, as compared to \$308,000 for the year ended December 31, 2008. The \$338,000 decrease is due to a decrease in interest bearing debt outstanding at December 31, 2008 when we converted \$6.2 million of convertible debt to equity as part of a corporate reorganization.

#### Foreign Exchange Loss

Foreign exchange loss for the year ended December 31, 2009 was \$0, as compared to \$848,000 for the year ended December 31, 2008. In 2008 we recorded foreign exchange losses on the winding down of the operations of our formerly wholly owned subsidiary, Neonode AB.

#### Write-off of Accounts Receivable from Subsidiary

On December 9, 2008, our former wholly owned Swedish subsidiary, Neonode AB, filed a petition for liquidation in compliance with the Swedish Bankruptcy Act (1987:672). Mr. Hans Ödén of the Stockholm-based Ackordscentralen AB, a consultancy firm specializing in insolvency, was appointed by the district court of Stockholm to administer the process. We wrote off our \$2.8 million receivable from Neonode AB on December 9, 2008, the date Neonode AB filed for bankruptcy.

#### Gain on debt forgiveness of Neonode AB

For the year ended December 31, 2008, we recorded a gain on the forgiveness of debt of Neonode AB in bankruptcy totaling \$9.8 million pursuant to the applicable accounting guidance.

#### Gain (loss) on troubled debt restructuring

On December 29, 2008, we entered into Note Conversion Agreements with the holders of convertible notes and promissory notes of the Company in the aggregate amount of up to \$6,341,611, for the issuance of up to 250,014 shares of Series A Preferred Stock in exchange for the surrender of the Convertible Notes by the note holders. A total of 24 out of 27 note holders agreed to the surrender of notes and accrued interest on such notes in the aggregate amount of \$6,195,805 in consideration for the issuance of 244,265.56 shares of Series A Preferred Stock on December 31, 2008. The fair value of the convertible notes and promissory notes and related embedded conversion features amounted to \$3.1 million immediately prior to conversion, using the Black-Scholes option pricing model. The assumptions used when calculating the fair value of the common stock anti-dilution feature were a term of 0.23 years, volatility of 357.2%, and a risk-free interest rate of 1.1%. The fair value of the Series A Preferred stock on the date of conversion was \$10 per share, as the Company also raised \$1.2 million in cash from both inside and outside investors, with outside investors comprising approximately 51%. Accordingly, the Company believes that the \$10 per share for the Series A shares is at an arm's length price. This conversion resulted in troubled debt restructuring accounting in accordance with accounting guidance, and we recorded a non-cash gain on conversion of \$3.4 million.



On December 29, 2008, the Company commenced entering into Warrant Conversion Agreements with the holders of warrants for the purchase of shares, notes, and/or additional warrants of the Company, for the issuance of up to 108,850 shares of Series B Preferred Stock in exchange for the surrender of the warrants by the warrant holders. The Company has entered into Warrant Conversion Agreements with 92 out of 129 warrant holders for the issuance of 92,795.23 shares of Series B Preferred Stock on December 31, 2008. The fair value of the converted warrants which were recorded as liabilities amounted to \$159,000 immediately prior to conversion, using the Black-Scholes option pricing model. The assumptions used when calculating the fair value of the warrants prior to conversion were a term of 4.4 years, volatility of 152.3%, and a risk-free interest rate of 1.37%. The fair value of the Series B Preferred stock on the date of conversion was \$0.022 per share, which is based upon a fully diluted price per share using the Company's market capitalization on that date. This conversion resulted in troubled debt restructuring accounting in accordance with accounting guidance, and we recorded a non-cash gain on conversion of \$157,000.

On March 31, 2009, our shareholders approved a resolution to increase the conversion ratio to 480.63 shares of common stock for each share of Series A Preferred Stock and 132.07 for each share of Series B Preferred Stock. The fair value of the conversion of the 244,265.56 shares of Series A Preferred shares issued to the investors in the private placement transaction that will be converted to a total of 117,401,356 shares of our common stock was \$4.7 million based on our stock price on March 31, 2009, the date our shareholders approved the conversion ratio. On March 31, 2009, we recorded the \$2.3 million increase in the fair value as a loss on troubled debt restructuring for the year ended December 31, 2009.

The fair value of the conversion of the 97,795.23 shares of Series B Preferred shares issued to the investors in the private placement transaction that will be converted to a total of 12,255,466 shares of our common stock was \$488,000 based on our stock price on March 31, 2009, the date our shareholders approved the conversion ratio. On March 31, 2009, we recorded the \$488,000 increase in the fair value as loss on troubled debt restructuring for the year ended December 31, 2009.

#### Non-cash Items Related to Debt Discounts and Deferred Financing Fees and the Valuation of Conversion Features and Warrants

Non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants interest for the year ended December 31, 2009 amounted to a loss of \$2.8 million. This amount is comprised of \$222,000 of debt discount amortization related to the 2009 convertible notes, \$1.4 million related to the excess of the value of the 2009 debt conversion features over the note balances, and a net increase in the value of the derivatives through December 31, 2009 of \$1.2 million, primarily due to the increase in fair value caused by the increase in the number of warrants and decrease in warrant exercise price related to the 2008 financing warrant reset features that were triggered with the 2009 debt financing, offset by the reduction in fair value due to an overall decrease in our stock price during 2009.

Non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants for the year ended December 31, 2008 amounted to a gain of \$6.3 million. The change is the direct result of an overall decrease in the Company's common stock price that reduced the fair value of the conversion features and warrants during 2008.

#### Income Taxes

Our effective tax rate was 0% in the year ended December 31, 2009 and 2008, respectively. We recorded valuation allowances in 2009 and 2008 for deferred tax assets related to net operating losses due to the uncertainty of realization. As of December 31, 2008, due to the bankruptcy of Neonode AB, we no longer have any significant amounts of net operating loss carryforwards related to our operations prior to December 31, 2008 and recorded

\$1,372,000 of deferred tax assets relating to our tax operating losses for the year ended December 31, 2009. We recorded a valuation allowance in 2009 for the \$1,372,000 deferred tax assets due to the uncertainty of realization.

## Net Loss

As a result of the factors discussed above, we recorded a net loss of \$14.9 million for the year ended December 31, 2009 compared to a net loss of \$5.9 million in the comparable period in 2008.

## Liquidity and Capital Resources

Our liquidity is dependent on many factors, including sales volume, operating profit and the efficiency of asset use and turnover. Our future liquidity will be affected by, among other things:

- actual versus anticipated licensing of our technology;
- our actual versus anticipated operating expenses;
- the timing of our OEM customer product shipments;
- the timing of payment for our technology licensing agreements;
- our actual versus anticipated gross profit margin;
- our ability to raise additional capital, if necessary; and
- our ability to secure credit facilities, if necessary.

The consolidated financial statements included herein have been prepared on a going concern basis, which contemplates continuity of operations and the realization of assets and repayment of liabilities in the ordinary course of business. The reports of our independent registered public accounting firms in respect to the 2009 and 2008 fiscal years, included elsewhere in this amended annual report, include explanatory going concern paragraphs which raise substantial doubt about our ability to continue as a going concern. This indicates an absence of obvious or reasonably assured sources of future funding that we will require to fund future operations. Although we have been able to fund our operations to date, there is no assurance that cash flow from our operations or our capital raising efforts will be able to attract the additional capital or other funds needed to sustain our operations. The lack of a completed audit may make it more difficult for us to raise funds. If we are unable to obtain additional funding for operations, we may not be able to continue operations as proposed, requiring us to modify our business plan, curtail various aspects of our operations, or cease operations. In such event, investors may lose a portion or all of their investment.

On December 31, 2008, we completed certain refinancing and capital raising transactions, acquired Neonode Technologies AB, and began operations with a primary focus on licensing our touchscreen technology to third party OEM customers. We do not have any current active customers for our touchscreen technology. In most circumstances, our target customers will have to successfully integrate our technology into their products and then sell those products to their customers before we will receive any cash from technology license agreements.

Our cash is subject to interest rate risk. We invest primarily on a short-term basis. Our financial instrument holdings at December 31, 2009 were analyzed to determine their sensitivity to interest rate changes. The fair values of these instruments were determined by net present values. In our sensitivity analysis, the same change in interest rate was used for all maturities and all other factors were held constant. If interest rates increased by 10%, the expected effect on net loss related to our financial instruments would be immaterial. The functional currency of our foreign subsidiary is the applicable local currency, the Swedish Krona, and is subject to foreign currency exchange rate risk. Any increase or decrease in the exchange rate of the U.S. Dollar compared to the Swedish Krona will impact Neonode's future operating results.

At December 31, 2009, we had cash and cash equivalents of \$28,000, as compared to \$17,000 at December 31, 2008. In the year ended December 31, 2009, \$1.9 million of cash was used in operating activities, primarily as a result of our net loss increased (decreased) by the following non-cash items (in thousands):



|   |           |
|---|-----------|
| Depreciation and amortization   | \$ 8      |
| Stock-based compensation expense  | 6,790     |
| Loss on retirement of property and equipment                                      | 30        |
| Gain on conversion of accounts payable to equity                                  | (30)      |
| Loss on troubled debt restructuring   | 2,741     |
| Change in fair value of embedded derivatives and warrants recorded as a liability | 2,844     |
| Total net non-cash items included in cash used in our operations                  | \$ 12,383 |

Adjusted working capital deficit (current assets less current liabilities not including non-cash liabilities related to warrants and embedded derivatives) was \$1.9 million at December 31, 2009, compared to an adjusted working capital deficit of \$962,000 at December 31, 2008.

In the year ended December 31, 2009, we purchased \$27,000 of fixed assets, consisting primarily of computers and engineering equipment.

In December 2008, we completed a private placement of equity securities for cash totaling \$10.7 million. On December 31, 2008, \$1.0 million was included as a stock subscription receivable and the cash proceeds were received in January and February 2009.

During the period from August 25, 2009 through December 31, 2009, we completed a private placement of convertible notes totaling \$987,000 that can be converted, at the holder's option, into 49,349,151 shares of our common stock at a conversion price of \$0.02 per share. The convertible note holders have the right to have the conversion price adjusted to equal the lower stock price if we issue stock or convertible notes at a lower conversion price than \$0.02 during the period that the notes are outstanding. These convertible notes are due on December 31, 2010 and bear an annual interest rate of 7%, payable on June 30 and December 31 of each year that the convertible notes are outstanding. In addition we issued 24,674,576 three-year warrants to the convertible note holders with an exercise price of \$0.04 per share. The warrants may be exercised and converted to common stock, at the warrant holder's option, beginning on the six-month anniversary date of issuance until the warrant expiration date. We are not obligated to register the common stock related to the convertible debt or the warrants.

In the five months ended May 5, 2010, we received \$1.5 million cash proceeds and converted \$163,000 of accounts payable related to a private placement of convertible notes and stock purchase warrants that can be converted, at the holder's option, into 86,785,564 shares of our common stock at a conversion price of \$0.02 per share and 43,392,782 stock purchase warrants that have an exercise price of \$0.04 per share. The convertible note holders have the right to have the conversion price adjusted to equal the lower stock price if we issue stock or convertible notes at a lower conversion price than \$0.02 during the period that the notes are outstanding. These convertible notes are due on December 31, 2010 and bear an annual interest rate of 7%, payable on June 30 and December 31 of each year that the convertible notes are outstanding. The warrants may be exercised and converted to common stock, at the warrant holder's option, beginning on the six-month anniversary date of issuance until the warrant expiration date. We are not obligated to register the common stock related to the convertible debt or the warrants. On March 21, 2010, we issued 875,000 shares of our common stock and a warrant to purchase 875,000 of our common stock an exercise price of \$0.04 per share to Davisa Ltd for services provided for the private placement of convertible note and warrant in the March 2010 financing transaction.

The majority of our cash has been provided by borrowings from senior secured notes and bridge notes that have been, or are, convertible into shares of our common stock or from the sale of our common stock and common stock purchase warrants to private investors. We will require sources of capital in addition to cash on hand to continue operations and to implement our strategy. Our operations are not cash flow positive and we may be forced to seek

credit line facilities from financial institutions, additional private equity investment, or debt arrangements. No assurances can be given that we will be successful in obtaining such additional financing on reasonable terms, or at all. If adequate funds are not available on acceptable terms, or at all, we may be unable to adequately fund our business plans and it could have a negative effect on our business, results of operations and financial condition. In addition, if funds are available, the issuance of equity securities or securities convertible into equity could dilute the value of shares of our common stock and cause the market price to fall, and the issuance of debt securities could impose restrictive covenants that could impair our ability to engage in certain business transactions.

ITEM QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET

7A. RISK

Not applicable .

ITEM 8. FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders  
of Neonode Inc.

We have audited the accompanying consolidated balance sheet of Neonode Inc. (a Delaware corporation) and subsidiary (the "Company") as of December 31, 2009, and the related consolidated statements of operations, stockholders' deficit and comprehensive loss and cash flows for the year 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 audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 audit 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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 Neonode Inc. and subsidiary as of December 31, 2009, and the results of their operations and their cash flows for the year 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 discussed in the liquidity section of Note 1 to the consolidated financial statements, the Company has suffered recurring losses and negative cash flows from operations and has a working capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans regarding these matters are also described in the liquidity section of Note 1. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ KMJ Corbin & Company LLP

Costa Mesa, California  
May 12, 2010

Report of BDO Feinstein International AB, Independent Registered Public Accounting Firm

Board of Directors and Stockholders  
Neonode Inc.  
Stockholm, Sweden

We have audited the accompanying consolidated balance sheet of Neonode Inc. as of December 31, 2008, and the related consolidated statements of operations, stockholders' deficit and comprehensive loss, and cash flows for the year then. In connection with our audit of the financial statements, we have also audited the schedule for the year ended December 31, 2008, listed in the accompanying index. These financial statements and the schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and the schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Neonode Inc. at December 31, 2008, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the 2008 financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

The accompanying 2008 financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in the Liquidity section of Note 1 to the consolidated financial statements, the Company has suffered recurring losses and negative cash flows from operations and has a working capital deficiency that raise substantial doubt about its ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome from this uncertainty.

Stockholm, Sweden

April 14, 2009

BDO Feinstein International AB.

/s/ Johan Pharmanson  
Authorized Public Accountant

BDO Feinstein International AB

/s/ Tommy Bergendahl  
Authorized Public Accountant



NEONODE INC.  
CONSOLIDATED BALANCE SHEETS  
(In thousands, except share data)

|   | December 31,<br>2009 | December 31,<br>2008 |
|---|----------------------|----------------------|
| <b>ASSETS</b>   |                      |                      |
| Current assets:   |                      |                      |
| Cash and cash equivalents   | \$ 28                | \$ 17                |
| Prepaid expenses  | 58                   | 46                   |
| Debt issuance costs   | 26                   | --                   |
| Other current assets  | 52                   | -                    |
| Total current assets  | 164                  | 63                   |
| Property, plant and equipment, net  | 20                   | 116                  |
| Other assets  | 28                   | -                    |
| Total assets  | \$ 212               | \$ 179               |
| <b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>  |                      |                      |
| Current liabilities:  |                      |                      |
| Current portion of convertible debt and leases  | \$ 361               | \$ 17                |
| Accounts payable  | 699                  | 688                  |
| Accrued expenses  | 993                  | 320                  |
| Embedded derivatives of convertible debt and warrants   | 4,507                | -                    |
| Total current liabilities   | 6,560                | 1,025                |
| Convertible debt and leases, net of current portion net of discounts  | -                    | 207                  |
| Total liabilities   | 6,560                | 1,232                |
| Commitments and contingencies (Note 11)   |                      |                      |
| Stockholders' deficit:  |                      |                      |
| Series A Preferred stock, 899,081 shares authorized with par value of \$0.001 per share. 86,142 and 855,522 shares issued and outstanding at December 31, 2009 and 2008, respectively. (In the event of dissolution, each share of Series A Preferred stock has a liquidation preference equal to par value of \$0.001 over the shares of common stock) | 841                  | 3,531                |
| Series B Preferred stock, 108,850 shares authorized with par value of \$0.001 per share. 17,265 and 92,796 shares issued and outstanding at December 31, 2009 and 2008, respectively. (In the event of dissolution, each share of Series B Preferred stock has a liquidation preference equal to par value of \$0.001 over the shares of common stock)  | -                    | 2                    |
| Common stock, 700,000,000 shares authorized with par value of \$0.001 per share. 416,472,328 and 35,058,011 shares issued and outstanding at December 31, 2009 and 2008, respectively   | 416                  | 35                   |
| Additional paid in capital  | 73,048               | 61,016               |
| Accumulated other comprehensive loss  | (96 )                | --                   |

|   |           |           |
|---|-----------|-----------|
| Stock subscription receivable               | --        | (1,035 )  |
| Accumulated deficit                         | (80,557 ) | (64,602 ) |
| Total stockholders' deficit                 | (6,348 )  | (1,053 )  |
| Total liabilities and stockholders' deficit | \$ 212    | \$ 179    |

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

NEONODE INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In thousands, except per share amounts)

|  | Year ended<br>December 31, |            |
|--|----------------------------|------------|
|  | 2009                       | 2008       |
| Net revenue  | \$-                        | \$7,282    |
| Cost of sales  | -                          | 15,459     |
| Gross margin   | -                          | (8,177 )   |
| Operating expenses:  |                            |            |
| Product research and development   | 999                        | 3,288      |
| Sales and marketing  | 346                        | 3,943      |
| General and administrative   | 1,624                      | 5,957      |
| Amortization of fair value of stock issued to related parties for purchase of Neonode Technologies AB                      | 6,337                      | -          |
| Total operating expenses   | 9,306                      | 13,188     |
| Operating loss   | (9,306 )                   | (21,365 )  |
| Other (expense) income:  |                            |            |
| Interest and other income  | -                          | 16         |
| Interest and other expense   | (60 )                      | (368 )     |
| Foreign currency exchange rate loss  | -                          | (848 )     |
| Gain on conversion and forgiveness of accounts payable   | 30                         | -          |
| Write-off of receivable from Neonode AB  | -                          | (2,828 )   |
| Gain on forgiveness of Neonode AB's net liabilities  | -                          | 9,820      |
| (Loss) gain on troubled debt restructuring   | (2,741 )                   | 3,360      |
| Non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants | (2,844                     | 6,278      |
| Net other (expense) income   | (5,615 )                   | 15,430     |
| Net loss   | (14,921 )                  | (5,934 )   |
| Deemed dividend to preferred stockholders  | (1,035 )                   | -          |
| Net loss attributable to common stockholders   | \$(15,956 )                | \$(5,934 ) |
| Loss attributable to common stockholders per common share:   |                            |            |
| Basic and diluted loss per share   | \$(0.06 )                  | \$(0.21 )  |
| Basic and diluted – weighted average shares used in per share computations   | 247,546                    | 28,164     |

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

## NEONODE INC

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT AND COMPREHENSIVE LOSS

(Amounts in thousands)

|  | Common Stock | Additional Paid-in-Capital | Series A Preferred Stock | Series A Preferred Stock | Series B Preferred Stock | Series B Preferred Stock | Stock Subscriptions Receivable | Accumulated Other Comprehensive Loss | Accumulated Other Comprehensive Loss | Stockholders' Equity | Other Comprehensive Loss |
|--|--------------|----------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------------|--------------------------------------|--------------------------------------|----------------------|--------------------------|
|  | Shares       | Amount                     | Shares                   | Amount                   | Shares                   | Amount                   |                                |                                      |                                      | (deficit)            | Loss                     |
| Balances, December 31, 2007  | 23,781       | \$23                       | \$55,406                 | -                        | \$-                      | -                        | \$-                            | \$-                                  | \$354                                | \$(58,668)           | \$(2,885)                |
| Employee stock options exercised for cash  | 21           | -                          | 38                       | -                        | -                        | -                        | -                              | -                                    | -                                    | -                    | 38                       |
| Common stock issued related to employee liabilities  | 657          | -                          | 54                       | -                        | -                        | -                        | -                              | -                                    | -                                    | -                    | 54                       |
| Employee stock option compensation expense   | -            | -                          | 1,163                    | -                        | -                        | -                        | -                              | -                                    | -                                    | -                    | 1,163                    |
| Conversion of debt to common stock and warrants  | 10           | -                          | 15                       | -                        | -                        | -                        | -                              | -                                    | -                                    | -                    | 15                       |
| Shares of common stock issued pursuant to private placement and warrant repricing financing transactions net of \$1,137,000 cash and \$5,385,000 non-cash issuance costs | 10,589       | 11                         | 4,274                    | -                        | -                        | -                        | -                              | -                                    | -                                    | -                    | 4,285                    |
| Conversion of warrant liability to equity  | -            | -                          | 67                       | -                        | -                        | -                        | -                              | -                                    | -                                    | -                    | 67                       |
| Issuance of Series A Preferred stock in financing transaction, net of accrued issuance costs of \$46,000   | -            | -                          | -                        | 112                      | 1,076                    | -                        | -                              | -                                    | -                                    | -                    | 1,076                    |
|  | -            | -                          | -                        | 248                      | 2,443                    | -                        | -                              | -                                    | -                                    | -                    | 2,443                    |

|  |         |     |        |       |         |    |   |         |       |          |          |            |
|--|---------|-----|--------|-------|---------|----|---|---------|-------|----------|----------|------------|
| Issuance of Series A Preferred stock in debt conversion transaction, net of stock given in lieu of cash issuance costs of \$41,000 |         |     |        |       |         |    |   |         |       |          |          |            |
| Issuance of Series A Preferred stock in acquisition of Neonode Technologies AB   | -       | -   | -      | 495   | 12      | -  | - | -       | -     | -        | -        | 12         |
| Stock subscription receivable associated with financing transaction on December 31, 2008   | -       | -   | -      | -     | -       | -  | - | (1,035) | -     | -        | -        | (1,035 )   |
| Issuance of Series B Preferred stock in warrant conversion   | -       | -   | -      | -     | -       | 93 | 2 | -       | -     | -        | -        | 2          |
| Foreign currency translation adjustment  | -       | -   | -      | -     | -       | -  | - | -       | (354) | -        | -        | (354 ) 354 |
| Net loss   | -       | -   | -      | -     | -       | -  | - | -       | -     | (5,934 ) | (5,934 ) | \$(5,934 ) |
| Comprehensive loss   |         |     |        |       |         |    |   |         |       |          |          |            |
| Balances, December 31, 2008  | 35,058  | 35  | 61,016 | 855   | 3,531   | 93 | 2 | (1,035) | -     | (64,602) | (1,053 ) | \$(5,580 ) |
| Employee stock option and warrant compensation expense   | -       | -   | 453    | -     | -       | -  | - | -       | -     | -        | -        | 453        |
| Amortization of fair value of stock issued to related parties for purchase of Neonode Technologies AB                              | -       | -   | 6,337  | -     | -       | -  | - | -       | -     | -        | -        | 6,337      |
| Common stock issued to settle accounts payable   | 763     | 1   | 22     | -     | -       | -  | - | -       | -     | -        | -        | 23         |
| Common stock issued to settle lawsuit  | 1,189   | 1   | 34     | -     | -       | -  | - | -       | -     | -        | -        | 35         |
|  | 369,487 | 369 | 2,321  | (769) | (2,690) | -  | - | -       | -     | -        | -        | -          |

|  |         |       |          |    |       |      |     |       |          |            |            |            |            |
|--|---------|-------|----------|----|-------|------|-----|-------|----------|------------|------------|------------|------------|
| Exchange of Series A Preferred Stock for common stock  |         |       |          |    |       |      |     |       |          |            |            |            |            |
| Exchange of Series B Preferred Stock for common stock  | 9,975   | 10    | (8 )     | -  | -     | (76) | (2) | -     | -        | -          | -          | -          | -          |
| Loss on troubled debt restructuring related to the modification of conversion feature of preferred stock | -       | -     | 2,741    | -  | -     | -    | -   | -     | -        | -          | -          | -          | 2,741      |
| Fair value of warrants reclassified to derivative liabilities due to adoption of new accounting standard | -       | -     | (67 )    | -  | -     | -    | -   | -     | -        | -          | -          | -          | (67 )      |
| Deemed dividend to preferred stockholders  | -       | -     | 1,035    | -  | -     | -    | -   | -     | -        | -          | (1,035 )   | -          | -          |
| Proceeds received from subscription receivable   | -       | -     | -        | -  | -     | -    | -   | 1,035 | -        | -          | -          | -          | 1,035      |
| Reclassification of warrants to derivative liabilities due to insufficient authorized shares             | -       | -     | (837 )   | -  | -     | -    | -   | -     | -        | -          | -          | -          | (837 )     |
| Foreign currency translation adjustment  | -       | -     | -        | -  | -     | -    | -   | -     | (96 )    | -          | -          | (96 )      | (96 )      |
| Net loss   | -       | -     | -        | -  | -     | -    | -   | -     | -        | (14,921)   | (14,921)   | (14,921)   | (14,921)   |
| Comprehensive loss   |         |       |          |    |       |      |     |       |          |            |            |            |            |
| Balances, December 31, 2009  | 416,472 | \$416 | \$73,048 | 86 | \$841 | 17   | -   | -     | \$ (96 ) | \$(80,557) | \$(6,348 ) | \$(15,011) | \$(15,011) |

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

NEONODE INC  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)

|   | Year ended  | December 31, |
|---|-------------|--------------|
|   | 2009        | 2008         |
| Cash flows from operating activities:   |             |              |
| Net loss  | \$(14,921 ) | \$(5,934 )   |
| Adjustments to reconcile net loss to net cash used in operating activities:   |             |              |
| Stock based compensation expense  | 6,790       | 1,163        |
| Stock issued in settlement  | 35          | --           |
| Depreciation and amortization   | 8           | 339          |
| Loss on retirement of property and equipment  | 30          | 16           |
| Gain on conversion of accounts payable to equity  | (30 )       | --           |
| Write-down of inventory to net realizable value   | ---         | 10,155       |
| Write-off of receivable from Neonode AB   | ---         | 2,828        |
| Gain on forgiveness of Neonode AB's net liabilities   | ---         | (9,820 )     |
| Loss (gain) on troubled debt restructuring  | 2,741       | (3,360 )     |
| Debt discounts and deferred financing fees and the valuation of conversion features and warrants  | 2,844       | (6,278 )     |
| Changes in operating assets and liabilities:  |             |              |
| Cumulative effect of the foreign exchange translation rates on the assets and liabilities of Neonode AB for the period January 1, 2008 through December 9, 2008, the date of bankruptcy |             |              |
|   | ---         | 5,223        |
| Accounts receivable and other current assets  | (52 )       | 870          |
| Inventories   | ---         | (3,089 )     |
| Prepaid expenses  | (12 )       | 1,035        |
| Other assets  | (28 )       | --           |
| Accounts payable and accrued expenses   | 696         | (5,474 )     |
| Deferred revenue  | ---         | (2,979 )     |
| Net cash used in operating activities   | (1,899 )    | (15,305 )    |
| Cash flows from investing activities:   |             |              |
| Proceeds from sale of property and equipment  | --          | 32           |
| Purchase of property, plant and equipment   | (27 )       | (205 )       |
| Net cash used in investing activities   | (27 )       | (173 )       |
| Cash flows from financing activities:   |             |              |
| Proceeds from issuance of convertible debt  | 908         | --           |
| Proceeds from purchase of employee stock options  | ---         | 38           |
| Cash increase resulting from merger and acquisition transactions and sale of software business  | ---         | 12           |
| Proceeds from issuance of common stock, warrant repricing and preferred stock   | 1,035       | 9,733        |
| Equity issuance costs   | ---         | (1,137 )     |
| Restricted cash   | ---         | 5,702        |
| Net cash provided by financing activities   | 1,943       | 14,348       |

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|  |         |   |          |
|--|---------|---|----------|
| Effect of exchange rates on cash and cash equivalents  | (6      | ) | -        |
| Net increase (decrease) in cash and cash equivalents   | 11      |   | (1,130 ) |
| Cash and cash equivalents at beginning of period   | 17      |   | 1,147    |
| Cash and cash equivalents at end of period   | \$ 28   |   | \$ 17    |
| Supplemental disclosure of cash flow information:  |         |   |          |
| Interest paid  | \$32    |   | \$121    |
| Supplemental disclosure of non-cash transactions:  |         |   |          |
| Fair value of warrants issued in repricing   | \$--    |   | \$13,786 |
| Fair value of warrants and Series A Preferred stock issued to financial advisors and Bridge Note holders for financing and restructuring transaction costs   | \$--    |   | \$5,472  |
| Conversion of September convertible notes  | \$--    |   | \$35     |
| Fair value of August note surrendered towards the exercise of re-priced warrants   | \$--    |   | \$375    |
| Fair value of Series A and B Preferred stock issued to convert convertible notes and warrants to equity  | \$--    |   | \$2,445  |
| Fair value of stock issued to employees in settlement of employee related vacation and severance liabilities   | \$--    |   | \$54     |
| Fair value of warrant liability converted to equity  | \$--    |   | 67       |
| Fair value of 495,000 shares of Series A Preferred stock issued to related parties for 100% of Neonode Technologies AB Preferred Stock Series A Subscription Receivable  | \$4,555 |   | \$4,950  |
| Fair value of conversion of common stock of Series A and B preferred stock issued to note and warrant holders related to corporate restructuring in excess of amounts recorded in equity at December 31, 2008. | \$2,741 |   | \$--     |
| Fair value of warrants reclassified to embedded derivative liabilities due to adoption of new accounting standard  | \$67    |   | \$--     |
| Deemed dividend to investors who received Series A Preferred stock issued related to corporate restructuring at December 31, 2008 based on the fair value of the conversion to common stock at March 31, 2009  | \$1,035 |   | \$--     |
| Debt discount recorded as a result from embedded derivative liabilities  | \$987   |   | \$--     |
| Fair value of warrants issued to broker as debt issuance costs   | \$26    |   | \$--     |
| Fair value of 762,912 shares of common stock issued to convert accounts payable to equity  | \$23    |   | \$--     |
| Conversion of accrued expenses to convertible debt   | \$79    |   | \$--     |
| Removal of capital lease and related fixed assets  | \$85    |   | \$--     |
| Exchange of preferred stock for common stock   | \$2,692 |   | \$--     |
| Reclassification of previously issued warrants to derivative liabilities due to insufficient authorized shares on a fully diluted basis  | \$837   |   | \$--     |

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

NEONODE INC.

Notes to the Consolidated Financial Statements

1. Nature of the business and operations

Background and Organization

Neonode Inc. was incorporated in the State of Delaware in 2006 as the parent of Neonode AB, a company founded in February 2004 and incorporated in Sweden. On December 29, 2008, we entered into a Share Exchange Agreement with AB Cypresen nr 9683 (renamed Neonode Technologies AB), a Swedish engineering company, and Neonode Technologies AB became our wholly owned subsidiary. Together, Neonode Inc. and Neonode Technologies AB are known as “we,” “us,” “our,” or the “Company.”

On December 9, 2008, our former wholly owned subsidiary, Neonode AB, filed for liquidation under the Swedish bankruptcy laws. Effective with Neonode AB’s bankruptcy filing on December 9, 2008, Neonode Inc. is no longer in the mobile phone business and there are no known financial obligations related to the accounts payable or other debts of Neonode AB for which Neonode Inc. has responsibility. The consolidated statement of operations and consolidated statement of cash flows include the accounts of Neonode AB for the period January 1, 2008 through December 9, 2008, the date Neonode AB filed for bankruptcy.

On December 29, 2008, we entered into a Share Exchange Agreement with Neonode Technologies AB and the stockholders of Neonode Technologies AB: Iwo Jima SARL, Wirelesstoys AB, and Athemis Ltd (the “Neonode Technologies AB Stockholders”), pursuant to which we agreed to acquire all of the issued and outstanding shares of Neonode Technologies AB in exchange for the issuance of 495,000 shares of Neonode Inc. Series A Preferred stock. Pursuant to the terms of the Share Exchange Agreement, upon the closing of the transaction, Neonode Technologies AB became a wholly owned subsidiary of the Company. The Neonode Technologies AB Stockholders are or were employees of us and/or Neonode AB, and as such are related parties. Neonode Technologies AB did not have any operations in 2008. Our consolidated balance sheet as of December 31, 2008 includes the accounts of Neonode Technologies AB which is comprised of cash totaling approximately \$12,000. The acquisition of Neonode Technologies AB by us did not qualify as a business combination but rather as a merger of entities under common control; accordingly the acquired assets of Neonode Technologies AB are recorded at their historical cost basis of \$12,000.

Neonode Technologies AB was formed on December 29, 2008 following the bankruptcy filing on December 9, 2008 of Neonode AB, and is comprised principally of engineers formerly employed by Neonode AB. Based on Swedish tax considerations, we determined that it would be more efficient to form a new company which would be acquired by Neonode Inc. rather than to re-hire each of the former employees of Neonode AB on an individual basis. Furthermore, we determined that based on the importance to the Company of retaining the technology and business expertise of the beneficial owners of Neonode Technologies AB and of ensuring our ability to continue to develop our technology, in exchange for complete ownership of Neonode Technologies AB, we were prepared to issue to the Neonode Technologies AB Stockholders shares representing approximately 49.5% of the Company. However, since we did not have a sufficient number of unissued shares of common stock at that time to issue shares of common stock representing 49.5% of the Company as well as enter into the other Refinancing Agreements, we decided that in exchange for all of the shares of Neonode Technologies AB we would issue shares of Series A Preferred stock at a ratio such that assuming an increase in the Company’s authorized share capital and an increase in the conversion rate (see Note 9), the Neonode Technologies AB Stockholders would own in the aggregate an amount of shares equal to approximately 49.5% of the Company after completion of our refinancing and capital raising activities. Nevertheless, pursuant to the Share Exchange Agreement, we did not guarantee that either the

Company's authorized share capital would be increased or that the conversion rate would be increased (see Note 9).

The fair value of the Series A Preferred stock issued to the Neonode Technologies AB Stockholders in excess of the \$12,000 cash balance is accounted for as compensation. Pursuant to the Share Exchange Agreement, the beneficial owners of the Neonode Technologies AB Stockholders agreed to remain employees of Neonode Technologies AB for a period of 18 months. In addition, each of the beneficial owners of the Neonode Technologies AB Stockholders signed a repurchase agreement with the Company granting the Company a lapsing repurchase right to purchase the Series A Preferred stock held by such Neonode Technologies AB Stockholder in the event the beneficial owner's employment with Neonode Tech is terminated other than for cause prior to the expiration of 18 months from December 29, 2008. Each month, 1/18 of the Series A Preferred shares held by the Neonode Tech Stockholders is released from the lapsing repurchase right. Thus, the fair value of the common stock (as converted from Series A Preferred Stock during 2009 – see Note 9) issued under the Share Exchange Agreement is being amortized to compensation expense over the 18-month vesting period beginning January 1, 2009.

### Operations

We provide optical touchscreen solutions for handheld consumer and industrial electronic devices. We license our touchscreen technology to Original Equipment Manufacturers (“OEMs”) and Original Design Manufacturers (“ODMs”) who imbed our touchscreen technology into electronic devices that they develop and sell such as mobile phones, e-book readers, mobile internet devices, global positioning systems (GPS), digital picture frames and micro PCs. The cornerstone of our solution is our innovative optical infrared touchscreen technology, zForce™. We believe that keyboards and keypads with moving parts will become obsolete for handheld devices and that our touchscreen solutions will be at the forefront of a new wave of finger-based and pen input technologies that will enable the user to interact and operate everything from small mobile devices to large industrial applications using a combination of touches, swipes, and hand gestures.

### Liquidity

The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the ordinary course of business. We have incurred net operating losses and negative operating cash flows since inception. As of December 31, 2009, we had an accumulated deficit of approximately \$80.6 million, a stockholders' deficit of approximately \$6.3 million and a working capital deficit (current assets less current liabilities, not including non-cash liabilities related to warrants and embedded derivatives) of approximately \$1.9 million. In addition, for the year ended December 31, 2009, we had cash used in operating activities of approximately \$1.9 million. Our operations are subject to certain risks and uncertainties frequently encountered by companies in the early stages of operations. Such risks and uncertainties include, but are not limited to, technical and quality problems in new products, ability to raise additional funds, credit risks and costs for developing new products. Our ability to generate revenues in the future will depend substantially on our ability to enter into customer contracts with customers and to raise additional funds through debt or equity. During 2009, we raised approximately \$1.9 million through debt and equity offerings (see Notes 7 and 9). Through May 5, 2010, we completed private placements of convertible notes and stock purchase warrants totaling approximately \$1.5 million (see Note 17).

There is no assurance that we will be successful in obtaining sufficient funding on acceptable terms, if at all. If we are unable to secure additional funding and/or our stockholders, if required, do not approve such financing, we would have to curtail certain expenditures which we consider necessary for optimizing the probability of success of developing new products and executing our business plan. If we are unable to obtain additional funding for operations, we may not be able to continue operations as proposed, requiring us to modify our business plan, curtail various aspects of our operations or cease operations. The consolidated financial statements do not include any adjustments related to the recovery of assets and classification of liabilities that might be necessary should we be unable to continue as a going concern.



## Neonode AB Bankruptcy

On December 9, 2008, Neonode AB, our former wholly owned subsidiary located in Sweden, filed for liquidation under the bankruptcy laws in Sweden. Under Swedish bankruptcy law, effective with the bankruptcy filing, we no longer have an ownership interest in Neonode AB, and, as such, we are no longer responsible for the liabilities of Neonode AB and we no longer have title or an ownership interest in the assets of Neonode AB. The Swedish bankruptcy court appointed a Swedish legal firm as receiver with the expressed duty to liquidate all the assets of Neonode AB and enter into final settlements with the creditors of Neonode AB.

We accounted for our investment in Neonode AB in accordance with accounting guidance, which precludes consolidation of a majority-owned subsidiary where control does not rest with the majority owners - for instance, where the subsidiary is in bankruptcy. Accordingly, we deconsolidated Neonode AB from our consolidated financial statements on the date it filed for bankruptcy, December 9, 2008.

Our consolidated statements of operations and cash flows include the accounts of Neonode AB for the period January 1, 2008 through December 9, 2008, the date Neonode AB filed for bankruptcy. Since we no longer have an ownership interest in Neonode AB, we recorded a write-off of our receivable from Neonode AB totaling \$2.8 million on the date Neonode AB filed for bankruptcy. We also recorded a gain on debt forgiveness of Neonode AB in bankruptcy totaling \$9.8 million.

Our consolidated balance sheets do not include the accounts of Neonode AB at December 31, 2008 and 2009.

## 2. Summary of significant accounting policies

### Principles of Consolidation

The preparation of our consolidated financial statements are in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The consolidated balance sheet as of December 31, 2008 includes the accounts of our new wholly owned subsidiary based in Sweden; Neonode Technologies AB. Operating results for Neonode Technologies AB for 2008 were insignificant. The consolidated statement of operations and cash flows for the year ended December 31, 2008 include the accounts of Neonode Inc. and Neonode AB for the period January 1, 2008 through December 9, 2008, the date that Neonode AB filed for bankruptcy. For 2009, the audited consolidated statements of operations and cash flows include the results of operations of Neonode Technologies AB. The consolidated balance sheet as of December 31, 2009 includes the accounts of Neonode Inc. and Neonode Technologies AB. All inter-company accounts and transactions have been eliminated in consolidation.

### Estimates

The preparation of consolidated financial statements in conformity with GAAP requires making estimates and assumptions that affect, at the date of the consolidated financial statements, the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from these estimates. Significant estimates include, but are not limited to, the recoverability of long-lived assets, the fair value of embedded derivatives and securities such as shares, options and warrants issued for stock-based compensation and in certain financing transactions.

### Cash and Cash Equivalents

We have not had any liquid investments other than normal cash deposits with bank institutions to date. The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents.



### Accounts Receivable and Allowance for Doubtful Accounts

Our net accounts receivable are stated at net realizable value. Our policy is to maintain allowances for estimated losses resulting from the inability of our customers to make required payments. Credit limits are established through a process of reviewing the financial history and stability of each customer. Where appropriate, we obtain credit rating reports and financial statements of the customer when determining or modifying its credit limits. We regularly evaluate the collectibility of our trade receivable balances based on a combination of factors. When a customer's account balance becomes past due, we initiate dialogue with the customer to determine the cause. If it is determined that the customer will be unable to meet its financial obligation, such as in the case of a bankruptcy filing, deterioration in the customer's operating results or financial position or other material events impacting its business, we record a specific allowance to reduce the related receivable to the amount we expect to recover. Should all efforts fail to recover the related receivable, we will write-off the account. We also record an allowance for all customers based on certain other factors including the length of time the receivables are past due and historical collection experience with customers. At December 31, 2009 and 2008, we had no accounts receivable.

### Property, Plant and Equipment

Property, plant and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method based upon estimated useful lives of the assets ranging from one to five years as follows:

#### Estimated useful lives

|                        |         |
|------------------------|---------|
| Tooling                | 1 year  |
| Computer equipment     | 3 years |
| Furniture and fixtures | 5 years |

Equipment purchased under capital leases is amortized on a straight-line basis over the estimated useful life of the asset.

Upon retirement or sale of property and equipment, cost and accumulated depreciation and amortization are removed from the accounts and any gains or losses are reflected in the consolidated statement of operations. Maintenance and repairs are charged to expense as incurred.

### Long-lived Assets

We assess any impairment by estimating the future cash flow from the associated asset in accordance with relevant accounting guidance. If the estimated undiscounted future cash flow related to these assets decreases or the useful life is shorter than originally estimated, we may incur charges for impairment of these assets. The impairment is based on the estimated discounted cash flow associated with the asset. At December 31, 2009, we believe there is no impairment of our long-lived assets. There can be no assurance, however, that market conditions will not change or sufficient commercial demand for our products and services will materialize, which could result in impairment of long-lived assets in the future.

### Foreign Currency Translation

The functional currency of our foreign subsidiary is the applicable local currency, the Swedish Krona. The translation from Swedish Krona to U.S. Dollars is performed for balance sheet accounts using current exchange rates in effect at

the balance sheet date and for income statement accounts using a weighted average exchange rate during the period. Gains or losses resulting from translation are included as a separate component of accumulated other comprehensive loss. Gains or losses resulting from foreign currency transactions are included in other (expense) income . In addition, as Neonode AB entered into bankruptcy and we no longer control that entity, the foreign currency translation adjustment account relating to Neonode AB was written off into our statement of operations during the year ended 2008. Foreign currency transaction losses included in other (expense) income were \$0 and \$848,000 during the years ended December 31, 2009 and 2008, respectively.

### Liability for Warrants and Embedded Derivatives

We do not enter into derivative contracts for purposes of risk management or speculation. However, from time to time, we enter into contracts that are not considered derivative financial instruments in their entirety but that include embedded derivative features, such as conversion features. Such embedded derivatives are assessed at inception of the contract and every reporting period, depending on their characteristics, are accounted for as separate derivative financial instruments pursuant to accounting guidance, if such embedded conversion features, if freestanding, would meet the classification of a liability. Accounting guidance requires that we analyze all material contracts and determine whether or not they contain embedded derivatives. Any such embedded conversion features that meet the above criteria are then bifurcated from their host contract and recorded on the consolidated balance sheet at fair value and the changes in the fair value of these derivatives are recorded each period in the consolidated statement of operations as an increase or decrease to non-cash charges for conversion features and warrants.

Similarly, if warrants meet the criteria in accordance with accounting guidance to be classified as liabilities, then the fair value of the warrants are recorded on the consolidated balance sheet at their fair values, and any changes in such fair values are recorded each period in the consolidated statement of operations as an increase or decrease to non-cash charges for conversion features and warrants.

### Concentration of Credit and Business Risks

In the short term, we anticipate that we will depend on a limited number of customers for substantially all of our future revenue. Failure to anticipate or respond adequately to technological developments in our industry, changes in customer or supplier requirements or changes in regulatory requirements or industry standards, or any significant delays in the development or introduction of products or services, could have a material adverse effect on our business, operating results and cash flows.

### Risk and Uncertainties

Our long-term success is dependent on our obtaining sufficient capital to fund our operations and to develop our products, and on our bringing such products to the worldwide market and obtaining sufficient sales volume to be profitable. To achieve these objectives, we will be required to raise additional capital through public or private financings or other arrangements. It cannot be assured that such financings will be available on terms attractive to us, if at all. Such financings may be dilutive to our stockholders and may contain restrictive covenants.

We are subject to certain risks common to technology-based companies in similar stages of development. Principal risks include risks relating to the uncertainty of market acceptance for our products, a history of losses since inception, our ability to remain competitive in response to new technologies, the costs to defend, as well as risks of losing, patents and intellectual property rights, a reliance on a limited number of suppliers, the concentration of our operations in a limited number of facilities, the uncertainty of demand for our products in certain markets, our ability to manage growth effectively, our dependence on key members of our management and development team, our limited experience in conducting operations internationally, and our ability to obtain adequate capital to fund future operations.

We are exposed to a number of economic and industry factors that could result in portions of our technology becoming obsolete or not gaining market acceptance. These factors include, but are not limited to, technological changes in our markets, our ability to meet changing customer requirements, competitive pressures in products and prices, and the ability of our customers to manufacture and sell their products that incorporate our technology.



A significant portion of our business is conducted in currencies other than the U.S. dollar (the currency in which its financial statements are reported), primarily the Swedish Krona and, to a lesser extent, the Euro. We incur a significant portion of our expenses in Swedish Krona, including a significant portion of our product development expense and a substantial portion of our general and administrative expenses. As a result, appreciation of the value of the Swedish Krona relative to the other currencies, particularly the U.S. dollar, could adversely affect operating results. We do not currently undertake hedging transactions to cover our currency exposure, but we may choose to hedge a portion of our currency exposure in the future as it deems appropriate.

Our future success depends on market acceptance of our technology as well as our ability to introduce new versions of our technology to meet the evolving needs of our customers.

## Revenue Recognition

### Neonode AB Mobile Phone Business and Licensing of Our Intellectual Property:

We recognized revenue from product sales when title transferred and risk of loss had passed to the customer, which was generally upon shipment of products to our customers. We estimated expected sales returns and recorded the amount as a reduction of revenues and cost of sales at the time of shipment. Our policy complied with the accounting guidance, which required revenue recognition from the sale of our mobile phones when all of the following conditions were met: (1) evidence existed of an arrangement with the customer, typically consisting of a purchase order or contract; (2) our products were delivered and risk of loss passed to the customer; (3) we completed all of the necessary terms of the contract; (4) the amount of revenue to which we were entitled was fixed or determinable; and (5) we believed it was probable that we would be able to collect the amount due from the customer. To the extent that one or more of these conditions had not been satisfied, we deferred recognition of revenue. Judgments were required in evaluating the credit worthiness of our customers. Credit was not extended to customers and revenue was not recognized until we determined that collectibility was reasonably assured.

In 2008, our revenues generated by the sale of Neonode AB's mobile phones consisted primarily of sales to distributors. From time to time, we allowed certain distributors price protection subsequent to the initial product shipment. Price protection allowed the distributor a credit (either in cash or as a discount on future purchases) if there was a price decrease during a specified period of time or until the distributor resold the goods. Future price adjustments were difficult to estimate since we did not have a sufficient history of making price adjustments. Therefore, we deferred recognition of revenue derived from sales to these customers until they resold our products to their customers. Although revenue recognition and related cost of sales were deferred, we recorded an accounts receivable at the time of initial product shipment. As standard terms were generally FOB shipping point, payment terms were enforced from the shipment date, and legal title and risk of inventory loss passed to the distributor upon shipment.

For products sold to distributors with agreements allowing for price protection and product returns, we recognized revenue based on our best estimate of when the distributor sold the product to its end customer. Our estimate of such distributor sell-through was based on information received from our distributors. Revenue was not recognized upon shipment since, due to various forms of price concessions; the sales price was not substantially fixed or determinable at that time.

Revenue from products sold directly to end-users through our web sales channels were generally recognized when title and risk of loss has passed to the buyer, which typically occurs upon shipment. Reserves for sales returns were estimated based primarily on historical experience and were provided at the time of shipment.

Generally, our customers were responsible for the payment of all shipping and handling charges directly with the freight carriers.

Neonode AB derived revenue from the licensing of internally developed intellectual property (IP). We entered into IP licensing agreements that generally provided licensees the right to incorporate our IP components in their products with terms and conditions that varied by licensee. The IP licensing agreements generally included a nonexclusive license for the underlying IP. Fees under these agreements may have included license fees relating to our IP and royalties payable following the sale by our licensees of products incorporating the licensed technology. The license for our IP has standalone value and can be used by the licensee without maintenance and support. On December 1, 2008, we transferred the Neonode AB intellectual property including patents, copyrights and trademarks to Neonode Inc. pursuant to an intercompany debt pledge agreement.

#### Hardware Products:

We may from time-to-time develop custom hardware products for our customers that incorporate our touchscreen technology. Our policy is to recognize revenue from hardware product sales when title transfers and risk of loss has passed to the customer, which is generally upon shipment of our hardware products to our customers. We defer and recognize service revenue over the contractual period or as services are rendered. We estimate expected sales returns and record the amount as a reduction of revenue and cost of hardware and other revenue at the time of shipment. Our policy complies with the accounting guidance. Judgments are required in evaluating the creditworthiness of our customers. Credit is not extended to customers and revenue is not recognized until we have determined that collectibility is reasonably assured. Our sales transactions are denominated in U.S. dollars or Euros. The software component of our hardware products is considered incidental. Therefore, we do not recognize software revenue related to our hardware products separately from the hardware product sale. To date, we have not sold any hardware products.

When selling hardware, we expect our agreements with OEMs and ODMs to incorporate clauses reflecting the following understandings:

- all prices are fixed and determinable at the time of sale;
- title and risk of loss pass at the time of shipment (FOB shipping point);
- collectibility of the sales price is probable (the customer is creditworthy, the customer is obligated to pay and such obligation is not contingent on the ultimate sale of the customer's integrated solution);
- the customer's obligation to us will not be changed in the event of theft or physical destruction or damage of the product;
- we do not have significant obligations for future performance to directly assist in the resale of the product by the OEMs; and
- there is no contractual right of return other than for defective products.

#### Software Products:

We may derive revenues from the following sources: (1) software, which includes our Neno™ software licenses and (2) engineering services, which include consulting. We account for the licensing of software in accordance with accounting guidance and such guidance requires judgment, including whether a software arrangement includes multiple elements, and if so, whether vendor-specific objective evidence (VSOE) of fair value exists for those elements. These documents include post delivery support, upgrades, and similar services.

For software license arrangements that do not require significant modification or customization of the underlying software, we recognize new software license revenue when: (1) we enter into a legally binding arrangement with a customer for the license of software; (2) we deliver the products; (3) customer payment is deemed fixed or determinable and free of contingencies or significant uncertainties; and (4) collection is reasonably assured. We initially defer all revenue related to the software license and maintenance fees until such time that we are able to establish VSOE for these elements of our software products. Revenue deferred under these arrangements is recognized to revenue over the expected contract term. We will also continue to defer revenues that represent undelivered post-delivery engineering support until the engineering support has been completed and the software product is accepted. To date, we have not sold any software products.

#### Engineering Services:

We may sell engineering consulting services to our customers on a flat rate or hourly rate basis. We recognize revenue as the engineering services stipulated under the contract are completed and accepted by our customers. On December 29, 2009, we signed an engineering services agreement with an OEM to provide engineering services over a three-month period in 2010 related to the development of a touchscreen application for a mobile phone product. The value of this agreement is approximately \$100,000, which will be recognized as revenue in 2010.

#### Warranty Reserves

Our mobile phone products were generally warranted against defects for 12 months following the sale. We have a 12-month warranty from the manufacturer of the mobile phones. Reserves for potential warranty claims not covered by the manufacturer were provided at the time of revenue recognition and were based on several factors, including current sales levels and our estimate of repair costs. Shipping and handling charges were expensed as incurred. Upon filing for bankruptcy on December 9, 2008, the warranty obligations related to Neonode AB's previous sales of mobile phone products were transferred to the Swedish bankruptcy court along with all the assets and liabilities of Neonode AB.

We do not anticipate that our technology products will have any warranty obligations associated with licenses related to these technologies.

#### Advertising

Advertising costs are expensed as incurred. External advertising costs amounted to \$0 and \$452,000 for the years ended December 31, 2009 and 2008, respectively.

#### Research and Development

Research and development ("R&D") costs are expensed as incurred. R&D costs consist mainly of personnel related costs in addition to some external consultancy costs such as testing, certifying and measurements.

#### Stock Based Compensation Expense

We measure the cost of employee services received in exchange for an award of equity instruments, including share options, based on the fair value of the award on the grant date, and recognize it as compensation expense over the period the employee is required to provide services in exchange for the award, usually the vesting period, net of estimated forfeitures.

We account for equity instruments issued to non-employees at their fair value and the unvested portion is re-measured each reporting period as long as the instrument requires variable accounting.

When determining stock-based compensation expense involving options and warrants, we determine the estimated fair value of options and warrants using the Black-Scholes option pricing model.

#### Accounting for Debt Issued with Detachable Stock Purchase Warrants and Beneficial Conversion Features

We account for debt issued with stock purchase warrants by allocating the proceeds of the debt between the debt and the detachable warrants based on the relative fair values of the debt security without the warrants and the warrants themselves, if the warrants are equity instruments. The relative fair value of the warrants are recorded as a debt

discount and amortized to expense over the life of the related debt using the effective interest method. At each balance sheet date, we make a determination if these warrant instruments should be classified as liabilities or equity, and reclassify them if the circumstances dictate.

In certain instances, the Company enters into convertible notes that provide for an effective or actual rate of conversion that is below market value, and the embedded conversion feature does not qualify for derivative treatment (a "BCF"). In these instances, we account for the value of the BCF as a debt discount, which is then amortized to expense over the life of the related debt using the effective interest method.

## Income Taxes

We recognize deferred tax liabilities and assets for the expected future tax consequences of items that have been included in the financial statements or tax returns. We estimate income taxes based on rates in effect in each of the jurisdictions in which we operate. Deferred income tax assets and liabilities are determined based upon differences between the financial statement and income tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The realization of deferred tax assets is based on historical tax positions and expectations about future taxable income. Valuation allowances are recorded against net deferred tax assets where, in our opinion, realization is uncertain based on the “not more likely than not” criteria of the accounting guidance.

Based on the uncertainty of future pre-tax income, we fully reserved our net deferred tax assets as of December 31, 2009 and 2008. In the event we were to determine that we would be able to realize our deferred tax assets in the future, an adjustment to the deferred tax asset would increase income in the period such a determination was made. The provision for income taxes represents the net change in deferred tax amounts, plus income taxes payable for the current period.

Effective January 1, 2007, we adopted the relevant accounting guidance related to uncertain tax positions, which provisions include a two-step approach to recognizing, de-recognizing and measuring uncertain tax positions. As a result, we recognized no increase in the liability for unrecognized tax benefits. As of December 31, 2009, we had no unrecognized tax benefits.

## Net Loss Per Share

Net loss per share amounts have been computed based on the weighted average number of shares of common stock outstanding during the period. Net loss per share, assuming dilution amounts from common stock equivalents, is computed based on the weighted average number of shares of common stock and potential common stock equivalents outstanding during the period. The weighted average number of shares of common stock and potential common stock equivalents used in computing the net loss per share for years ended December 31, 2009 and 2008 exclude the potential common stock equivalents, as the effect would be anti-dilutive.

## Comprehensive Loss

Our comprehensive loss includes foreign currency translation gains and losses reflected in stockholders' deficit.

## Cash Flow Information

Cash flows in foreign currencies have been converted to U.S. dollars at an approximate weighted average exchange rate for the respective reporting periods. The weighted average exchange rate for the consolidated statements of operations was 7.65 and 6.58 Swedish Krona to one U.S. Dollar for the years ended December 31, 2009 and 2008, respectively. The weighted average exchange rate for the consolidated balance sheets was 7.21 and 7.84 Swedish Krona to one U.S. Dollar as of December 31, 2009 and 2008, respectively.

## Fair Value of Financial Instruments

We disclose the estimated fair values for all financial instruments for which it is practicable to estimate fair value. Financial instruments including cash and cash equivalents, payables and current portions of long-term debt are deemed to approximate fair value due to their short maturities. The carrying amounts of long-term debt cannot be reasonably determined since no quoted market prices exist for these instruments and quoted prices for similar

instruments cannot be located.

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## New Accounting Pronouncements

In June 2009, the FASB issued guidance on the hierarchy of generally accepted accounting principles, specifically as it relates to the codification of accounting standards (the “Codification”). The Codification, which was launched on July 1, 2009, became the single source of authoritative nongovernmental U.S. GAAP, superseding existing FASB, American Institute of Certified Public Accountants Emerging Issues Task Force and related literature. The Codification eliminates the GAAP hierarchy contained in previous accounting guidance and establishes one level of authoritative GAAP. All other literature is considered non-authoritative. This new guidance is effective for financial statements issued for interim and annual periods ending after September 15, 2009. We have adopted the Codification with no impact to our consolidated financial statements.

In August 2009, the FASB issued Accounting Standard Update (“ASU”) No. 2009-05, Measuring Liabilities at Fair Value, which provides additional guidance on how companies should measure liabilities at fair value under ASC 820. The ASU clarifies that the quoted price for an identical liability should be used. However, if such information is not available, an entity may use, the quoted price of an identical liability when traded as an asset, quoted prices for similar liabilities or similar liabilities traded as assets, or another valuation technique (such as the market or income approach). The ASU also indicates that the fair value of a liability is not adjusted to reflect the impact of contractual restrictions that prevent its transfer and indicates circumstances in which quoted market prices for an identical liability or quoted price for an identical liability traded as an asset may be considered level 1 fair value measurements. This ASU is effective October 1, 2009. During 2009, the Company adopted this standard, but it did not have a material impact on the consolidated financial statements.

## 3. Prepaid Expenses

Prepaid expenses consist of the following (in thousands):

|                        | December 31, |      |
|------------------------|--------------|------|
|                        | 2009         | 2008 |
| Prepaid insurance      | \$30         | \$-- |
| Prepaid rent           | 6            | --   |
| Other                  | 22           | 46   |
| Total prepaid expenses | \$58         | \$46 |

## 4. Other Current Assets

Other current assets consist of the following (in thousands):

|                            | December 31, |      |
|----------------------------|--------------|------|
|                            | 2009         | 2008 |
| Receivable from suppliers  | \$33         | \$-- |
| Other                      | 19           | --   |
| Total other current assets | \$52         | \$-- |

## 5. Property, Plant and Equipment

Property, plant and equipment consist of the following (in thousands):

|   | December 31, |       |
|---|--------------|-------|
|   | 2009         | 2008  |
| Computer equipment                      | \$27         | \$146 |
| less accumulated depreciation           | (7 )         | (30 ) |
| Property, plant and equipment, net      | \$20         | \$116 |
| <br>                                    |              |       |
| Depreciation expense for the year ended | \$8          | \$287 |

On January 31, 2009, we vacated our leased office in San Ramon, California and disposed of the excess office furniture and equipment. We recorded a net \$30,000 loss on the retirement of the assets, which is recorded as a component of interest and other expense in the accompanying consolidated statement of operations for the year ended December 31, 2009.

## 6. Accrued Expenses

Accrued expenses consist of the following (in thousands):

|   | December 31, |       |
|---|--------------|-------|
|   | 2009         | 2008  |
| Earned salary, vacation and benefits  | \$28         | \$--  |
| Accrued interest  | --           | 8     |
| Accrued legal and audit fees  | 409          | 312   |
| Accrued consulting fees, including \$405,000 due to related parties (see Note 16) | 556          | --    |
| Total accrued expenses  | \$993        | \$320 |

## 7. Convertible Debt and Leases

Our convertible debt and leases consist of the following (in thousands):

|  | December 31, |       |
|--|--------------|-------|
|  | 2009         | 2008  |
| Senior Convertible Secured Notes September 2009                                    | \$987        | \$--  |
| Senior Convertible Secured Notes September 2007                                    | 139          | 139   |
| Capital lease  | --           | 85    |
|  | 1,126        | 224   |
| <br>   |              |       |
| Unamortized debt discount  | (765 )       | --    |
| Convertible long-term debt and leases, net of debt discount                        | 361          | 224   |
| Less: short term portion   | (361 )       | (17 ) |
| Convertible long-term debt and leases, net of debt discount and short term portion | \$--         | \$207 |



Future maturities of convertible notes payable (in thousands):

| Year ended December 31,  | Future Maturity<br>of Notes<br>Payable |
|--------------------------|--|
| 2010                     | \$ 1,126                               |
| Total principal payments | \$ 1,126                               |

#### Capital Lease

We leased Xerox office equipment and returned the leased equipment to Xerox in 2009, thus eliminating the lease obligation. Xerox filed a lawsuit to collect the remainder of the lease payments (see Note 11). We have filed a motion to dismiss the lawsuit and have accrued approximately \$109,000 related to the lawsuit.

#### September 2009 Senior Convertible Secured Notes Financing transaction

During the period from August 25, 2009 through December 15, 2009, we completed a private placement of convertible notes totaling \$987,000 that can be converted, at the holder's option, into 49,349,151 shares of our common stock at a conversion price of \$0.02 per share (the "September 2009 Convertible Notes"). Included in the convertible notes was approximately \$79,000 of related-party accruals that were converted to these notes. The convertible note holders have the right to have the conversion price adjusted to equal the lower stock price if we issue common stock or convertible notes at a lower conversion price than \$0.02 during the period that the notes are outstanding. The September 2009 Convertible Notes are due on December 31, 2010 and bear an annual interest rate of 7%, payable on June 30 and December 31 of each year that the convertible notes are outstanding. In addition, we issued 24,674,576 three-year warrants to the convertible note holders with an exercise price of \$0.04 per share. The warrants may be exercised and converted to common stock, at the warrant holder's option, beginning on the six-month anniversary date of issuance until the warrant expiration date. We are not obligated to register the common stock related to the convertible debt or the warrants.

The embedded conversion feature of the convertible debt of the September 2009 Convertible Notes meets the definition of a derivative financial instrument and is classified as a liability in accordance with accounting guidance. The note holders have the right to convert the debt into shares of our common stock, and the notes include price protection whereby these notes are protected for as long as the notes remain outstanding against future private placements made at lower share prices, and therefore, the total number of shares of our common stock that the convertible notes can be convertible into is not fixed. The embedded conversion features are revalued on each balance sheet date and marked to market with the adjusting entry to non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants on the consolidated statements of operations.

The fair value of the embedded conversion feature of the September 2009 Convertible Notes totaled \$2.2 million on the dates of issuance of the convertible debt. The \$2.2 million fair value of the conversion feature is included in the account entitled embedded derivatives of convertible debt and warrants on our consolidated balance sheet. We recorded a debt discount of \$987,000 and the excess fair value was recorded as an expense in the account entitled non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants on our consolidated statement of operations (totaling \$1.2 million) for the year ended December 31, 2009. The embedded conversion feature was valued on the dates we received the proceeds using the Black-Scholes option pricing model. The assumptions used for the Black-Scholes option pricing model at the dates of issuance ranged from a term of 1 to 1.33 years, volatility of 226.79% to 247.52%, and a risk-free interest rate of 1.13%.



The embedded conversion feature is revalued on each balance sheet date and marked to market using the Black-Scholes option pricing model. The value of the conversion feature is \$959,000 at December 31, 2009 and is included on our consolidated balance sheet as of December 31, 2009 in the account entitled embedded derivatives of convertible debt and warrants. The \$1.2 million reduction in the fair value from the date of issuance is included as income in the account entitled non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants on our consolidated statement of operations for the year ended December 31, 2009. The assumptions used for the Black-Scholes option pricing model at December 31, 2009 were a term of 1 year, volatility of 250.6%, and a risk-free interest rate of 1.13%.

The \$987,000 debt discount is being amortized to expense over the 15-month term of the debt on a straight-line basis, which approximates the effective interest method. Included in the account entitled non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants on the consolidated statements of operations for the year ended December 31, 2009 is \$222,000 related to three months of amortization of the debt discount.

On December 31, 2009, we issued a warrant to purchase 1,305,740 of our common stock an exercise price of \$0.04 per share to an investor for services provided for the private placement of convertible notes and warrants in the 2009 financing transaction. The fair value of the 1,305,740 shares of common stock is \$26,000 on the date of issuance and was recorded as debt issuance costs and included in current assets in the accompanying consolidated balance sheet as of December 31, 2009. The warrants were valued using the Black-Scholes option pricing model. The assumptions used for the Black-Scholes option pricing model are a term of 2.7 years, volatility of 267.66%, and a risk-free interest rate of 1.13%.

#### 2008 Troubled Debt Restructuring

##### Conversion of Senior Convertible Notes to Series A Preferred Stock:

We determined that, based on the capitalization of the Company, the value of the notes held by the note holders entitled the note holders to shares representing approximately twenty-five percent of the Company. However, since we did not have a sufficient number of unissued shares of common stock to convert all of the outstanding notes into shares of common stock as well as enter into the other Refinancing Agreements, we decided to exchange the existing notes for shares of Series A Preferred Stock at a ratio such that assuming an increase in the Company's authorized share capital and an increase in the conversion rate, the note holders would own in the aggregate an amount of shares equal to approximately 25% of the Company after completion of our refinancing and capital raising activities. Nevertheless, pursuant to the Note Conversion Agreements, we did not guarantee that either the Company's authorized share capital would be increased or that the conversion rate would be increased (see Note 9). On December 31, 2008, 24 out of 27 convertible and promissory note holders agreed to the surrender of notes and accrued interest on such notes in the aggregate amount of \$6,195,805 in consideration for the issuance of 244,265.56 shares of Series A Preferred stock. The carrying value of the convertible notes, promissory notes, and debt discount plus the fair value of the related embedded conversion features amounted to \$5.9 million immediately prior to conversion, using the Black-Scholes option pricing model. The assumptions used when calculating the fair value of the common stock anti-dilution feature were a term of 0.23 years, volatility of 357.2%, and a risk-free interest rate of 0.11%. The fair value of the Series A Preferred stock on the date of conversion was \$10 per share, as we also raised \$1.2 million in cash at \$10 per share from both inside and outside investors, with outside investors comprising approximately 51% of the total (see Note 9). This conversion resulted in troubled debt restructuring accounting in accordance with accounting guidance, and we recorded a non-cash gain on conversion of \$3.3 million (see below). The remaining \$139,000 convertible notes outstanding after the conversion transaction have a due date of August 26, 2010 and bear an annual interest rate of the greater of 8% or LIBOR plus 3%, payable quarterly in cash or shares of our common stock at our option.



## Conversion of Warrants to Series B Preferred Stock:

On December 29, 2008, we commenced entering into Warrant Conversion Agreements with the holders of warrants for the purchase of shares, notes and/or additional warrants of the Company for the issuance of up to 108,850 shares of Series B Preferred Stock in exchange for the surrender of the warrants by the warrant holders. If all of the existing warrants were to have been converted into shares of common stock of the Company, the Company would have had to issue 14,365,434 shares of common stock. Since we did not have a sufficient number of unissued shares of common stock to convert all of the outstanding warrants into shares of common stock as well as enter into the other Refinancing Agreements, we decided to exchange the existing warrants for shares of Series B Preferred Stock at a ratio such that assuming an increase in the Company's authorized share capital and an increase in the conversion rate, the warrant holders would own in the aggregate 14,365,434 shares of common stock after completion of our refinancing and capital raising activities. Nevertheless, pursuant to the Warrant Conversion Agreements, we did not guarantee that either the Company's authorized share capital would be increased or that the conversion rate would be increased (see Note 9). On December 31, 2008, 92 out of 129 holders of warrants for the purchase of shares, notes, and/or additional warrants agreed to the surrender of 12,255,560 warrants in exchange for the issuance of 92,795 shares of Series B Preferred Stock. The fair value of the converted warrants which were previously recorded as liabilities amounted to \$112,000 immediately prior to the exchange, using the Black-Scholes option pricing model. The assumptions used when calculating the fair value of the warrants prior to the exchange were a term of 4.4 years, volatility of 152.3%, and a risk-free interest rate of 1.37%. The fair value of the Series B Preferred stock on the date of exchange was \$0.0245 per share, which is based upon a fully diluted price per share using our market capitalization on that date. This transaction resulted in troubled debt restructuring accounting in accordance with accounting guidance, and we recorded a non-cash gain on conversion of \$109,000. The remaining outstanding warrants no longer meet the classification of liabilities according to accounting guidance since the toxic securities (the anti-dilution feature) from September 26, 2007 financing are no longer applicable, and, as such, the remainder of the warrants previously recorded as a liability on the consolidated balance sheet has been reclassified to equity at December 31, 2008 at the fair value of \$67,000.

These transactions were accounted for as a troubled debt restructuring modification of terms pursuant to relevant accounting guidance. On December 31, 2008, the gain resulting from the conversions of the Notes, embedded conversion features and a warrant, calculated in accordance with accounting guidance, was determined as follows:

|   |         |
|---|---------|
| Conversion of carrying value of Senior Secured Notes, net of discount                 | \$2,661 |
| Conversion of carrying value of embedded conversion features                          | 3,051   |
| Conversion of carrying value of warrants  | 93      |
| Total conversion of carrying value of debt, embedded conversion features and warrants | 5,805   |
| Decreases to gain:  |         |
| Fair value of Series A and B Preferred stock issues in exchange                       | 2,445   |
| Gain on Troubled Debt Restructuring   | \$3,360 |

On both a basic and diluted income per share basis, the \$3.4 million gain was \$0.12 per share for the year ended December 31, 2008.

## Prior Outstanding Debt and Warrants Converted to Preferred Stock on December, 31, 2008

- 1) Senior Convertible Secured August Bridge Notes



On August 8, 2007, we made an offering of convertible notes pursuant to a Note Purchase Agreement (August Bridge Notes or Bridge Notes), dated as of July 31, 2007, amended most recently on March 24, 2008. The August Bridge Notes were originally convertible into the units described below. We received \$3,250,000 from the Bridge Note offering and issued an option to an investor/financial advisor to invest \$750,000, at the same terms and conditions as the Bridge Notes. The August Bridge Notes originally matured on December 31, 2007; however, the maturity date of these notes was extended to December 31, 2008 and the option to invest expired on December 31, 2008. The August Bridge Notes were due December 31, 2008, bore 8% per annum interest and were convertible into purchase units that are made up of a combination of shares of our common stock, convertible debt and warrants. The note holders had a right to convert their notes plus accrued interest into purchase units anytime before December 31, 2008. Each purchase unit of \$3,000 is comprised of one \$1,500 three-year promissory note bearing the higher of 8% or LIBOR plus 3% interest per annum, convertible into shares of our common stock at a conversion price of \$3.50 per share, 600 shares of our common stock and 5 year warrants to purchase 696.5 shares of our common stock at a price of \$1.27 per share. For accounting purposes, the embedded conversion feature was determined to meet the definition of a derivative and was recorded as liability. This was because the holder of the notes could convert debt and accrued interest, when interest is at the greater of 8% or LIBOR plus 3%, and therefore, the total number of shares into which the instrument could be convertible was not fixed. Accordingly, the embedded conversion feature was bifurcated from the debt host instrument and treated as a liability, with the offset to debt discount. The related warrants were also recorded as a liability for the same reason.

On December 31, 2008, all of the Bridge Notes plus accrued interest were converted into 123,641 shares of our Series A Preferred stock. Please see above section, 2008 Troubled Debt Restructuring, for accounting treatment.

## 2) August Bridge Notes Extension Warrants

On September 26, 2007, the August Bridge Note holders that had not converted their debt were given three year warrants to purchase up to 219,074 shares (1st Extension Warrants) of our common stock at a price of \$3.92 per share in exchange for an agreement to extend the term of their notes from the original date of December 31, 2007 until June 30, 2008. The fair value of the warrants issued to the holders of the remaining Bridge Notes was calculated at September 26, 2007 as \$706,000, using the Black-Scholes option pricing model. The assumptions used for calculating the fair value of the 1st Extension Warrants were a term of 3 years, volatility of 116%, and a risk-free interest rate of 4.16%. The 1st Extension Warrants were classified as a liability pursuant to the relevant accounting guidance. The fair value of the warrants was recorded as a debt issuance cost and is allocated to interest expense based on the effective interest rate method over the nine month term of the notes with the offsetting entry to a liability. As a result of the extension of the loan maturity period, the agreement to delay conversion of the bridge notes and the issuance of the 1st Extension Warrants, the modifications were significant enough to trigger debt extinguishment accounting resulting in a debt extinguishment charge for the year ended December 31, 2007 amounting to \$442,000. The liability for the 1st Extension Warrants issued to the August Bridge Note holders is revalued at the end of each reporting period and the change in the liability is recorded in the account entitled non-cash financing items.

On December 31, 2008, all of the 1st Extension Warrants related to the Bridge Notes were exchanged into 1,659 shares of our Series B Preferred stock.

On December 31, 2008, we compared the fair value of the Series B Preferred stock issued upon conversion of the outstanding 219,074 1st Extension Warrants related to the Bridge Notes. The carrying value of the warrants was calculated using the Black-Scholes option pricing model. The resulting gain is included in the Non-cash items related to gain on troubled debt restructuring in our Consolidated Statements of Operations for the year ended December 31, 2008.

On May 21, 2008, the August Bridge Note holders that had not converted their debt were given additional three year warrants (2nd Extension Warrants) to purchase up to 510,294 shares of our common stock at a price of \$1.45 per share in exchange for an agreement to extend the term of their notes from June 30, 2008 until December 31, 2008. The 2nd Extension Warrants were classified as a liability pursuant to relevant accounting guidance. The liability for the 2nd Extension Warrants issued to the August Bridge Note holders is revalued at the end of each reporting period using the Black-Scholes option pricing model and the change in the liability is recorded as "Non-cash financing items." The assumptions used when calculating the fair value of the 2nd Extension Warrants were a term of 3 years, volatility of 125.57% and a risk-free interest rate of 2.68%.

On December 31, 2008, all of the 2nd Extension Warrants related to the Bridge Notes were exchanged for 3,864 shares of our Series B Preferred stock.

- On December 31, 2008, we calculated the fair value of the Series B Preferred stock issued upon conversion of the outstanding 510,294 2nd Extension Warrants related to the Bridge Notes. The carrying value of the warrants was calculated using the Black-Scholes option pricing model. The resulting gain is included in the Non-cash items related to gain on troubled debt restructuring in our consolidated statements of operations for the year ended December 31, 2008.

### 3) Option to Invest in Bridge Notes

In conjunction with the issuance of the August Bridge Notes, we issued and investor an option to invest up to \$750,000 under the same terms and conditions as the August Bridge Notes. The initial fair value of the option to purchase \$750,000 of the August Bridge Notes amounted to \$716,000 based on the Black-Scholes option pricing model. The assumptions used when calculating the fair value of the original option to invest were a term of 0.39 years, volatility of 99%, and interest rate of 4.16%. The initial fair value of the option to invest was recorded as a deferred financing fee to be allocated to interest expense using the effective interest rate method over the nine month term of the notes with the offset recorded as other current liability. The liability for the option to purchase additional August Bridge Notes is revalued at the end of each reporting period and the change in the liability is recorded in the account entitled non-cash items relating to debt discounts and deferred financing fees and the valuation of conversion features and warrants.

The fair value of the option to purchase \$750,000 of the August Bridge Notes originally issued on August 8, 2007 and due to expire on December 31, 2007 was extended until March 15, 2008 on December 31, 2007 and revalued based on the Black-Scholes option pricing model. The assumptions used when calculating the fair value of the extended option to invest were a term of 0.21 years, volatility of 99% and interest rate of 3.36%. The fair value of the extension totaled \$475,000 and was recorded as a deferred financing fee to be allocated to interest expense using the effective interest rate method over the 12 month remaining term of the August Bridge Notes with the offset recorded as other current liability.

The fair value of the option to purchase \$750,000 of the August Bridge Notes originally issued on August 8, 2007 and extended until March 15, 2008 was extended until June 30, 2008 on March 15, 2008 and revalued based on the Black-Scholes option pricing model. The assumptions used when calculating the fair value of the extended option to invest were a term of 0.25 years, volatility of 79% and interest rate of 1.38%. The fair value of the extension totaled \$823,000 and was recorded as a deferred financing fee to be allocated to interest expense using the effective interest rate method over the nine months remaining term of the August Bridge Notes with the offset recorded as other current liability.

On April 17, 2008, the option holder exercised \$375,000 of the original \$750,000 option amount and was issued a note on the same terms and conditions as the August Bridge Notes. The option to invest the \$375,000 unexercised portion was extended until December 31, 2008 in conjunction with the May 2008 financing. The fair value of the unexercised option to purchase \$375,000 of the August Bridge Notes was revalued based on the Black-Scholes option pricing model. The assumptions used when calculating the fair value of the extended option to invest were a term of 0.5 years, volatility of 107% and interest rate of 1.23%. The fair value of the extension totaled \$324,000 and was recorded as a deferred financing fee to be allocated to interest expense using the effective interest rate method over the six months remaining term of the August Bridge Notes with the offset recorded as other current liability. The exercise of \$375,000 of the original \$750,000 option reduced the liability for the option by \$314,000.

On May 21, 2008, as part of the May 21, 2008 warrant repricing financing transaction described below, the \$375,000 of Bridge Note debt was cancelled and was converted into 295,275 shares common stock and 590,550 warrants at an exercise price of \$1.45 per share.

On December 31, 2008, all of the 590,550 5-year warrants were exchanged for 4,471 shares of our Series B Preferred stock. The option to invest the remaining unexercised \$375,000 of the original \$750,000 option to invest terminated on December 31, 2008 without the option holder exercising the option.

- On December 31, 2008, we calculated the fair value of the Series B Preferred stock issued upon conversion of the outstanding 590,550 Warrants. The carrying value of the warrants was calculated using the Black-Scholes option

pricing model. The resulting gain is included in the non-cash items related to gain on troubled debt restructuring in our consolidated statements of operations for the year ended December 31, 2008.

#### 4) Senior Convertible Secured Notes September 26, 2007 Financing

On September 26, 2007, we sold \$5.7 million of securities in a private placement, comprised of \$2.9 million of three-year promissory notes bearing the greater of 8% or LIBOR plus 3% interest per annum, convertible into shares of our common stock at a conversion price of \$3.50 per share, 952,499 shares of our common stock, and 5 year warrants to purchase 1,326,837 shares of our common stock at a price of \$3.92 per share.

In addition, on September 26, 2007, certain holders of the August Bridge Notes converted an aggregate of \$454,900 of debt and accrued interest into units offered in the September 26, 2007 financing. The debt holders of the August Bridge Notes that were converted received (i) \$227,450 three-year promissory notes bearing the higher of 8% or LIBOR plus 3% interest per annum, convertible into shares of our common stock at a conversion price of \$3.50 per share, (ii) 75,817 shares of our common stock, and (iii) 5-year warrants to purchase 105,612 shares of our common stock at a price of \$3.92 per share. The fair value of the 5-year warrants totaled \$340,000 and was calculated using the Black-Scholes option pricing model.

The total issuance of securities and debt on September 26, 2007 to investors and Bridge Note holders who converted was (i) \$3.1 million of three-year promissory notes bearing the higher of 8% or LIBOR plus 3% interest per annum, convertible into shares of our common stock at a conversion price of \$3.50 per share, (ii) 1,028,316 shares of our common stock, and (iii) 5-year warrants to purchase 1,432,449 shares of our common stock at a price of \$3.92 per share.

The embedded conversion feature of the convertible debt issued on September 26, 2007 met the definition of a derivative financial instrument and is classified as a liability in accordance with accounting guidance. The note holder has the right to convert the debt and accrued interest and the interest rate is calculated at the greater of 8% or LIBOR plus 3%, and therefore, the total number of shares of our common stock into which the convertible note can be convertible is not fixed. Accordingly, the embedded conversion features are revalued on each balance sheet date and marked to market with the adjusting entry to non-cash financial items. The fair value of the conversion feature related to the September 26, 2007 convertible notes totaled \$1.4 million at September 26, 2007 and was recorded as a debt discount. On the issuance date, we allocated the proceeds first to the warrants based on their fair value with the remaining balance allocated between debt, \$771,000, and equity, \$669,000, based on their relative fair values.

For the year ended December 31, 2008, \$1.1 million of the debt discount is included in gain on troubled debt restructuring and \$12,000 is included in interest expense in the consolidated statements of operations.

On December 31, 2008, \$3.1 million of the Senior Secured Convertible Notes plus accrued interest were converted into 120,624 shares of our Series A Preferred stock. After conversion, \$139,000 of the Senior Secured convertible Notes due August 31, 2010 remains outstanding. Please see above section, 2008 Troubled Debt Restructuring, for accounting treatment.

- The liability related to the embedded conversion feature was \$0 at December 31, 2008 because the right for us to repurchase the notes expired on September 25, 2008 and, as such, the embedded conversion feature was no longer applicable.

The warrants issued in conjunction with the September 26, 2007 financing met the definition of a liability pursuant to relevant accounting guidance. The fair value of the warrants issued in conjunction with issuance of shares of our common stock and convertible debt totaled \$4.3 million on its issuance date and was recorded as a liability. The fair value of the warrants on the date of issuance was calculated using the Black-Scholes option pricing model using a term of 5 years, volatility of 116%, and a risk-free interest rate of 4.2%.

All of the warrants, except for warrants to purchase 5,804 shares of our common stock, related to the Senior Convertible Secured Notes from September 2007 were exchanged for 8,994 shares of our Series B Preferred stock at December 31, 2008.

At December 31, 2008, the remaining outstanding 5,804 warrants no longer met the classification of liabilities in accordance with accounting guidance since the anti-dilution feature related to September 26, 2007 financing expired when the value of outstanding notes payable dropped below \$2,000,000. The fair value of the warrants was measured at year end and the change in the fair value is included in the consolidated statements of operations in the non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants. The fair value of \$174,000 is included in equity as of December 31, 2008.

As part of the September 26, 2007 Private Placement, we issued 142.875 unit purchase warrants to Empire Asset Management Company (Empire) for financial advisory services provided in connection with the placement. Each unit purchase warrant has a strike price of \$3,250 and is comprised of a \$1,500 three-year promissory note, bearing the higher of 8% or LIBOR plus 3% interest per annum, convertible into shares of our common stock at a conversion price of \$3.50 per share, 500 shares of our common stock and a five-year warrant to purchase 696.5 shares of our common stock at a purchase price of \$3.92 per share. At the date of issuance, the fair value of the unit purchase warrants issued to Empire totaled \$614,000 and was included in the issuance costs related to the September financing. The assumptions used for the Black-Scholes option pricing model were a term of five years, volatility of 99%, and a risk-free interest rate of 4.2%. The liability for the option to purchase additional units is revalued at the end of each reporting period and the change in the liability is recorded as "Non-cash financing items."

On December 31, 2008, all of the Unit Purchase Warrants related to the Senior Convertible Secured Notes were exchanged for 5,990 shares at no exercise price of our Series B Preferred stock. Please see above section, 2008 Troubled Debt Restructuring, for accounting treatment.

- On December 31, 2008, the liability related to the Unit Purchase Warrants amounted to \$0, resulting in a \$509,000 decrease for the year ended December 31, 2008 compared to the fair value of these unit purchase warrants of \$509,000 at December 31, 2007. The \$509,000 gain is included in the non-cash items related to gain on troubled debt restructuring in our consolidated statements of operations for the year ended December 31, 2008.

#### 5) May 21, 2008 Warrant Repricing

On May 21, 2008, we offered our existing warrant holders an opportunity to exercise Neonode common stock purchase warrants on a discounted basis and to receive two new five-year common stock purchase warrants with an exercise price of \$1.45 for each outstanding warrant exercised. In all, 8,009,586 new warrants were issued, including 590,550 to the option holder who converted the \$375,000 of debt. The warrants were classified as a liability pursuant to accounting guidance. The warrants were recorded in the account entitles liability for warrants to purchase common stock and are valued at fair value at the end of each reporting period using the Black-Scholes option pricing model. The fair value of the warrants totaled \$13.8 million. The assumptions used for the calculation of the fair value were a term of 5 years, volatility of 110.28%, and interest rate of 3.09%.

On December 31, 2008, 6,618,889 of the warrants were exchanged for 50,117 shares of our Series B Preferred stock. Please see above section, 2008 Troubled Debt Restructuring, or accounting treatment. 1,476,068 of the warrants issued related to the Warrant Repricing remain outstanding after the December 31, 2008 restructuring and warrant conversion.

- On December 31, 2008, the remaining 1,476,068 outstanding warrants no longer met the classification of liabilities in accordance with accounting guidance and, as such, these warrants previously recorded as a liability on the consolidated balance sheet were reclassified to equity using the \$44,000 fair value on December 31, 2008. The assumptions used when calculating the fair value of the warrants at December 31, 2008 were a term of 4.3 years, volatility of 143.1%, and a risk-free interest rate of 1.46%.

6) Loan Agreement with Almi Företagspartner

On April 6, 2005, our formerly wholly owned subsidiary, Neonode AB, entered into a loan agreement with Almi Företagspartner ("Almi") in the amount of SEK 2,000,000, with 72,000 warrants to purchase Neonode Inc. shares. The loan had an expected credit period of 48 months with an annualized interest rate of 2%. We were not required to make any repayments of principal for the first nine months. Quarterly repayments of principal thereafter amounted to SEK 154,000. We had the right to redeem the loan at any time prior to expiration subject to a prepayment penalty of 1%, on an annualized basis, of the outstanding principal amount over the remaining term of the loan. A floating charge (chattel mortgage) of SEK 2,000,000 was pledged as security. On December 9, 2008, Neonode AB filed for liquidation under the Swedish bankruptcy laws and the note with Almi is no longer an obligation of ours after that date. The Almi note was written off when Neonode AB filed for bankruptcy on December 9, 2008 and is included in the gain on debt forgiveness of Neonode AB on the Consolidated Statements of Operations for the year ended December 31, 2008.

The warrants had a term of five years with a strike price of \$10.00. The warrants were callable by us for \$0.10 should the price of our common stock trade over \$12.50 on a public exchange for 20 consecutive days. The warrants were analyzed under the accounting guidance, and were determined to be equity instruments. In accordance with accounting guidance, because the warrants are equity instruments, we have allocated the proceeds of the second Almi loan between the debt and detachable warrants based on the relative fair values of the debt security and the warrants themselves. To calculate the debt discount related to the warrants, the fair market value of the warrants was calculated using the Black-Scholes options pricing model. The assumptions used for the Almi loan debt discount were a term of five years, volatility of 30% and a risk-free interest rate of 4.50%. The aggregate debt discount amounted to \$42,000 and is amortized over the expected term of the loan agreement.

On December 31, 2008, Almi exchanged all 72,000 warrants for 545 shares of our Series B Preferred stock.

7) Common Stock

On March 4, 2008, we issued 1,800,000 shares of common stock to investors of a private placement at a price of \$2.50 per share. The issuance of these shares triggered the anti-dilution feature related to common stock issued in the September 26, 2007 financing transaction. As a result we were required to issue an additional 207,492 shares of our common stock to investors in the September 26, 2007 financing. On December 31, 2008, as part of the refinancing and capital raising transactions, we issued 4,421,072 shares of our common stock to investors in the September 26, 2007 financing to satisfy the anti-dilution features contained in the financing agreement. Because we reduced the outstanding debt to less than \$2.0 million, the anti-dilution features contained in the financing agreement are no longer outstanding as of December 31, 2008.

On December 31, 2008, the liability related to the common stock anti-dilution feature amounted to \$0, resulting in a \$1.4 million decrease since the initial valuation.

8) Warrants

As part of the May 21, 2008 financing transaction, we issued 400,480 warrants at a price of \$1.27 per share and an additional 800,959 warrants at a price of \$1.45 per share to Empire for financial advisory services provided in connection with the transaction. At the date of issuance, the fair value of the warrants issued to Empire totaled \$2.0 million and was included in the issuance costs related to the May 21, 2008 financing transaction. The assumptions used for the Black-Scholes option pricing model were a term of 5 years, volatility of 110.28%, and a risk-free interest rate of 3.09%.

On December 31, 2008, 559,228 of the warrants were exchanged for 4,234 shares of our Series B preferred stock. On December 31, 2008, 161,074 of the \$1.27 warrants and 481,457 of the \$1.45 Warrants remain outstanding after restructuring.

- On December 31, 2008, the remaining 642,531 outstanding warrants no longer met the classification of liabilities in accordance with accounting guidance and, as such, the warrants previously recorded as a liability on the consolidated balance sheet were reclassified to equity using the fair value of the warrants on December 31, 2008. The assumptions used when calculating the fair value of the warrants at December 31, 2008 were a term of 4.3 years, volatility of 143.1%, and a risk-free interest rate of 1.46%.

## 8. Fair Value Measurement of Assets and Liabilities

The three levels of the fair-value hierarchy are described as follows:

Level 1: Quoted prices (unadjusted) in active markets for identical assets and liabilities. We had no level 1 assets or liabilities.

Level 2: Inputs other than Level 1 that are observable, either directly or indirectly. We had no level 2 assets or liabilities.

Level 3: Unobservable inputs. We valued warrants and embedded conversion features that were without observable market values and the valuation required a high level of judgment to determine fair value (level 3 inputs).

The following table shows the classification of our liabilities at December 31, 2009 that are subject to fair value measurements and the roll-forward of these liabilities from December 31, 2008 (in thousands):

|   | December<br>31,<br>2009 | Net<br>Increase in<br>Fair Value | New<br>Derivatives<br>Added | December<br>31,<br>2008 |
|---|-------------------------|----------------------------------|-----------------------------|-------------------------|
| Fair value of embedded conversion features and warrants | \$4,507                 | \$1,214                          | \$3,293                     | \$-                     |

## 9. Stockholders' Deficit

### Common Stock

On January 21, 2009 we signed a definitive settlement agreement with one of our investors in previous private placement transactions, Alpha Capital Anstalt ("Alpha"), whereby we issued Alpha 1,188,667 shares of our common stock valued at \$35,000 in exchange for a dismissal of all pending legal actions.

We converted approximately \$53,000 of our accounts payable to 762,912 shares of our common stock on January 26, 2009. The fair value of the shares of common stock issued to settle the accounts payable was \$23,000 based on our stock price on January 26, 2009 and the difference of \$30,000 is included in the account entitled gain on conversion and forgiveness of accounts payable on our consolidated statements of operations.

On January 28, 2008, a holder of convertible notes issued on September 26, 2007 elected to convert an aggregate amount of debt and accrued interest amounting to \$35,000. The conversion resulted in the issuance of 10,000 shares of common stock at \$3.50. The debt discounts, conversion features and deferred financing fees that related to the loans that were converted amounted to an aggregate of \$20,000. The net amount of \$15,000 was recorded in equity.

On March 4, 2008, we sold \$4.5 million in securities in a private placement to accredited investors. We sold 1,800,000 shares (Investor Shares) of our common stock, for \$2.50 per share. After placement agent fees and offering expenses, we received net cash proceeds of approximately \$4,000,000.

In addition, we issued an aggregate of 207,492 shares of common stock to investors who participated in the September 26, 2007 private placement pursuant to anti-dilution provisions contained in the September 26, 2007 Private Placement Subscription Agreement. Empire acted as financial advisor in the private placement and received compensation in connection with the private placement of approximately \$450,000 in cash and 120,000 shares of our common stock valued at \$152,400 on the date of issuance.

On May 21, 2008, we completed a \$5.1 million, net cash proceeds to us of \$4.1 million, private placement, primarily to prior security holders, directors, affiliates of management and institutional investors. We offered our existing warrant holders an opportunity to exercise Neonode common stock purchase warrants on a discounted basis. In all, 4,004,793 outstanding warrants were exercised at a strike price of \$1.27 per warrant (including \$375,000 of surrender of debt). We issued 4,004,793 shares of our common stock and two new common stock purchase warrants, with an exercise price of \$1.45, for each outstanding warrant exercised. A total of 8,009,586 new common stock purchase warrants were issued to investors who surrendered or purchased shares under the warrant exchange offer. We also extended the maturity date of \$2.85 million of convertible debt that was due on June 30, 2008 until December 31, 2008 by issuing the note holders 510,293 common stock purchase warrants, with an exercise price of \$1.45. Empire acted as financial advisor for the transaction and was paid a cash fee of approximately \$510,000 and received a warrant to purchase 400,480 shares of our common stock at \$1.27 per share and a warrant to purchase 800,959 shares of our common stock at \$1.45 per share.

On September 4, 2008, we issued 107,638 shares of our common stock to one of our Swedish employees in settlement of a severance payment dispute totaling \$20,400.

On November 17, 2008, we issued 549,808 shares of our common stock to our US based employees upon their termination from employment for payment of their accrued vacation liability totaling \$35,700.

On December 31, 2008, we issued 4,421,072 shares of our common stock to investors who participated in the September 26, 2007 private placement pursuant to anti-dilution provisions contained in the September 26, 2007 Private Placement Subscription Agreement.

## Preferred Stock

The terms of the Series A and Series B Preferred stock are as follows:

- Dividends and Distributions.

Series A Preferred: The holders of shares of Series A Preferred stock are entitled to participate with the holders of our common stock with respect to any dividends declared on the common stock in proportion to the number of shares of common stock issuable upon conversion of the shares of Series A Preferred stock held by them.

Series B Preferred: The holders of shares of Series B Preferred stock are entitled to participate with the holders of our common stock with respect to any dividends declared on the common stock in proportion to the number of shares of common stock issuable upon conversion of the shares of Series B Preferred stock held by them.

- Liquidation Preference.

Series A Preferred: In the event of any liquidation, dissolution, or winding up of our operations, either voluntary or involuntary, subject to the rights of any other series of Preferred stock to be established by the Board of Directors (the "Senior Preferred Stock"), the holders of Series A Preferred stock shall be entitled to receive, after any distribution to the holders of Senior Preferred Stock and prior to and in preference to any distribution to the holders of common stock, \$0.001 for each share of Series A Preferred stock then outstanding.

Series B Preferred: In the event of any liquidation, dissolution, or winding up of our operations, either voluntary or involuntary, subject to the rights of the Series A Preferred stock and Senior Preferred Stock, the holders of Series B Preferred stock shall be entitled to receive, after any distribution to the holders of Senior Preferred Stock and prior to and in preference to any distribution to the holders of common stock, \$0.001 for each share of Series B Preferred stock then outstanding.

- Voting.

The holders of shares of Series A Preferred stock and Series B Preferred stock shall have one vote for each share of Series A Preferred stock and Series B Preferred stock held by them.

- Conversion.

Initially, each share of Series A Preferred stock and each share of Series B Preferred stock was convertible into one share of our common stock. Any modification to the conversion rate requires shareholder approval. Although the restructuring contemplated a conversion ratio that was finally approved on March 31, 2009 (see Note 7), we did not guarantee that either our authorized share capital would be increased or that the conversion rate would be increased. On March 31, 2009, our shareholders approved a resolution to increase the authorized share capital, and to increase the conversion ratio to 480.63 shares of common stock for each share of Series A Preferred stock and to 132.07 shares of our common stock for each shares of Series B Preferred stock, thus completing the restructuring begun in December 2008. See below for the accounting ramifications of this conversion rate change.



On April 24, 2009, we initiated the process of allowing the shareholders of our preferred stock to convert the Series A and B Preferred stock to shares of our common stock. In order to convert the preferred stock to common stock each preferred stock shareholder is required to submit the preferred stock certificate to our transfer agent and request conversion to common stock. The conversion to common stock is not mandatory and shareholders who own preferred stock may choose not to convert their preferred stock to shares of our common stock. The following table summarizes the Preferred stock not yet converted as of December 31, 2009:

|                               | Shares of Preferred Stock Not Exchanged as of December 31, 2009 | Conversion Ratio | Shares of Common Stock after Conversion of all Outstanding Shares of Preferred Stock Not yet Exchanged at December 31, 2009 |
|-------------------------------|---|------------------|---|
| Series A Preferred stock      | 86,142.26   | 480.63           | 41,402,554  |
| Series B Preferred stock      | 17,264.58   | 132.07           | 2,280,133   |
| Total Remaining Not Exchanged | 103,406.84  | -                | 43,682,687  |

#### Series A Preferred Stock

On December 31, 2008, we issued the following Series A Preferred stock:

- 112,290.40 shares to investors in a private placement who invested \$1,121,904.
- 244,265.56 shares to convertible debt holders who converted \$6,195,805 of principal and accrued interest (see Note 7);
- 495,000 shares to acquire Neonode Technologies AB (see Note 1); and
- 4,067.02 shares for brokerage services in regards to the refinancing and capital raising transactions.

These transactions are discussed in more detail below.

On December 31, 2008, we issued 112,190.40 shares of Series A Preferred stock that at the date of issuance had a conversion rate of one share of common stock for each share of Series A Preferred stock to investors in a private placement transaction that raised \$1.1 million. \$1,035,000 of the funds raised were received in 2009. On March 31, 2009, the value of the 53,922,072 shares of common stock that these Series A Preferred shares are now convertible into was approximately \$2.1 million. The increase in the value of the Series A Preferred stock as a result of this modification was \$1,035,000, which we have recorded as a deemed preferred stock dividend (since the underlying transaction was a cash raise). As of December 31, 2009, 103,000 shares of Series A Preferred stock have been converted to 49,504,890 shares of common stock.

The fair value of the conversion feature of the 244,265.56 shares of Series A Preferred stock issued to the convertible debt holders (see Note 7) that will now be convertible to a total of 117,401,356 shares of our common stock was \$4.7 million based on our stock price on March 31, 2009, the date our shareholders approved the increased conversion

ratio. On December 31, 2008, the \$2.4 million fair value of the Series A Preferred stock issued prior to the change in conversion rate was included in the calculation of gain on troubled debt restructuring; therefore, on March 31, 2009, we recorded the \$2.3 million increase in the fair value as an increase in additional paid-in capital and as a loss on troubled debt restructuring on our consolidated statements of operations for the year ended December 31, 2009 as the final part of the restructuring that began in 2008 (since the underlying transaction was a debt extinguishment). As of December 31, 2009, convertible debt holders exchanged 171,380.62 shares of Series A Preferred stock that had been issued to them and were issued 82,370,667 shares of our common stock.

The fair value of the conversion feature of the 495,000 shares of Series A Preferred shares issued to the related parties to acquire Neonode Technologies AB (see Note 1) that was converted to a total of 237,611,185 shares of our common stock was \$9.5 million based on our stock price on March 31, 2009, the date our shareholders approved the increased conversion ratio. Because this transaction is essentially the issuance of shares to key employees for their continued service to enhance the Company, the \$9.5 million revised fair value of the common stock is being amortized to compensation expense at the rate of \$1.6 million per quarter for six quarters beginning January 1, 2009. For the year ended December 31, 2009, \$6.3 million has been recorded as compensation expense in our consolidated statements of operations.

## Series B Preferred Stock:

The fair value of the conversion feature of the 92,795.94 shares of Series B Preferred shares issued to the warrant holders (see Note 7) that is now convertible into 12,255,560 shares of our common stock was \$490,000, based on our stock price on March 31, 2009, the date our shareholders approved the increased conversion ratio. On December 31, 2008, the \$2,000 fair value of the Series B Preferred stock issued prior to the change in conversion rate was included in the calculation of gain on troubled debt restructuring; therefore, on March 31, 2009, we recorded the \$488,000 increase in the fair value as an increase in additional paid-in capital and as a loss on troubled debt restructuring on our consolidated statements of operations for the year ended December 31, 2009 as the final part of the restructuring that began in 2008 (since the underlying transaction was a debt extinguishment). As of December 31, 2009, the holders of the Series B Preferred stock exchanged 75,530.64 of the 92,795.94 shares of Series B Preferred stock that had been issued to them and were issued 9,975,382 shares of our common stock.

## 10. Stock-Based Compensation

We have several approved stock option plans for which stock options and restricted stock awards are available to grant to employees, consultants and directors. All employee and director stock options granted under our stock option plans have an exercise price equal to the market value of the underlying common stock on the grant date. There are no vesting provisions tied to performance conditions for any options, as vesting for all outstanding option grants was based only on continued service as an employee, consultant or director. All of our outstanding stock options and restricted stock awards are classified as equity instruments.

## Stock Options

As of December 31, 2009, we had four equity incentive plans:

- The 1996 Stock Option Plan (the 1996 Plan), which expired in January 2006;
- The 1998 Non-Officer Stock Option Plan (the 1998 Plan), which expired in June 2008;
- The 2007 Neonode Stock Option Plan (the Neonode Plan), out of which we will not grant any additional equity awards; and
- The 2006 Equity Incentive Plan (the 2006 Plan).

We also had one non-employee director stock option plan as of December 31, 2009:

- The 2001 Non-Employee Director Stock Option Plan (the Director Plan).

The following table details the outstanding options to purchase shares of our common stock pursuant to each plan at December 31, 2009:

| Plan          | Options Outstanding | Available for Issue | Outstanding Options Vested |
|---------------|---------------------|---------------------|----------------------------|
| 1996 Plan     | 25,000              | ---                 | 25,000                     |
| 1998 Plan     | 28,000              | ---                 | 28,000                     |
| Neonode Plan  | 176,595             | ---                 | 176,595                    |
| 2006 Plan     | 225,000             | 157,554             | 149,999                    |
| Director Plan | 42,500              | ---                 | 42,500                     |
| <b>Total</b>  | <b>497,095</b>      | <b>157,554</b>      | <b>422,094</b>             |



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The following table summarizes information with respect to all options to purchase shares of common stock outstanding under the 1996 Plan, the 1998 Plan, the 2006 Plan, the Neonode Plan and the Director Plan at December 31, 2009:

| Options Outstanding     |                                | Options Exercisable                                 |                                 |                                |                                 |
|-------------------------|--------------------------------|---|---------------------------------|--------------------------------|---------------------------------|
| Range of Exercise Price | Number Outstanding at 12/31/09 | Weighted Average Remaining Contractual Life (years) | Weighted Average Exercise Price | Number Exercisable at 12/31/09 | Weighted Average Exercise Price |
| \$ 0.00 - \$ 1.50       | \$176,595                      | \$2.05  | \$ 1.42                         | 176,595                        | \$ 1.42                         |
| \$ 1.51 - \$ 2.50       | 19,500                         | 3.95  | \$ 2.33                         | 19,500                         | \$ 2.33                         |
| \$ 2.51 - \$ 4.00       | 82,000                         | 4.94  | \$ 3.46                         | 82,000                         | \$ 3.46                         |
| \$ 4.01 - \$ 6.00       | 187,000                        | 4.54  | \$ 4.91                         | 111,999                        | \$ 4.91                         |
| \$ 6.01 - \$ 27.50      | 32,000                         | 1.80  | \$ 17.60                        | 32,000                         | \$ 17.60                        |
|                         | 497,095                        | 3.52  | \$ 4.15                         | 422,094                        | \$ 4.01                         |

A summary of the combined activity under all of the stock option plans is set forth below:

|   | Weighted Average Number of Shares | Exercise Price Per Share | Weighted Average Exercise Price |
|---|-----------------------------------|--------------------------|---------------------------------|
| Outstanding at January 1, 2008                                | 2,434,732                         | \$ 1.42 - \$ 27.50       | \$ 2.58                         |
| Granted   | 570,000                           | \$ 0.60 - \$ 3.45        | \$ 3.17                         |
| Cancelled or expired  | (1,660,754 )                      | \$ 1.84 - \$ 12.95       | \$ 2.58                         |
| Exercised   | ( 21,000 )                        | \$ 1.84 - \$ 1.84        | \$ 1.84                         |
| Outstanding at December 31, 2008                              | 1,322,978                         | \$ 0.60 - \$ 27.50       | \$ 2.85                         |
| Granted   | --                                | \$ --                    | \$ --                           |
| Cancelled or expired  | (825,883 )                        | \$ 0.60 - \$ 12.95       | \$ 2.06                         |
| Exercised   | --                                | \$ --                    | \$ --                           |
| Outstanding, vested and expected to vest at December 31, 2009 | 497,095                           | \$ 1.42 - \$ 27.50       | \$ 4.15                         |

The aggregate intrinsic value of the 497,095 stock options that are outstanding, vested and expected to vest at December 31, 2009 is \$10,000.

The 1996 Plan terminated effective January 17, 2006 and the 1998 Plan terminated effective June 15, 2008. Although we can no longer issue stock options out of the plans, the outstanding options at the date of termination will remain

outstanding and vest in accordance with their terms. Options granted under the Director Plan vest over a one to four-year period, expire five to seven years after the date of grant and have exercise prices reflecting market value of the shares of our common stock on the date of grant. Stock options granted under the 1996, 1998 and 2006 Plans are exercisable over a maximum term of ten years from the date of grant, vest in various installments over a one to four-year period and have exercise prices reflecting the market value of the shares of common stock on the date of grant.

The Neonode Plan has been designed for participants (i) who are subject to Swedish income taxation (each, a Swedish Participant) and (ii) who are not subject to Swedish income taxation (each, a Non-Swedish Participant). The options issued under the plan to the Non-Swedish Participant are five year options with 25% vesting immediately and the remaining vesting over a three year period. The options issued to Swedish participants are vested immediately upon issuance.

We did not grant any options to purchase shares of our common stock to employees or members of our Board of Directors during the year ended December 31, 2009. We granted options to purchase 570,000 shares of our common stock to employees or members of our Board of Directors during the year ended December 31, 2008. The fair value of stock-based compensation related to the employee and director stock options is calculated using the Black-Scholes option pricing model as of the grant date of the underlying stock options.

We granted 15,660,000 stock purchase warrants to employees or members of our Board during the year ended December 31, 2009 (see below). The stock purchase warrants have an exercise price equal to \$0.02 per share, which was the market price on the date of grant, August 25, 2009. These stock purchase warrants have a seven-year term and are vested on the date of grant. The stock underlying the stock purchase warrants granted to employees or members of our Board has not been registered for resale. The warrants granted to employees have a fair value on the date of grant of \$305,000. The fair value of stock-based compensation related to the employee warrants is calculated using the Black-Scholes option pricing model as of the grant date of the underlying warrant.

The stock compensation expense reflects the fair value of the vested portion of options for the Swedish and Non-Swedish participants at the date of issuance, the amortization of the unvested portion of the stock options, less the option premiums received from the Swedish participants. Employee and director stock-based compensation expense related to stock options and warrants in the accompanying consolidated statements of operations is as follows (in thousands):

|                          | Year ended<br>December<br>31, 2008 | Year ended<br>December<br>31, 2009 | Remaining<br>unamortized<br>expense at<br>December 31,<br>2009 |
|--------------------------|------------------------------------|------------------------------------|--|
| Stock based compensation | \$ 1,163                           | \$ 453                             | \$ 228   |

The remaining unamortized expense of \$228,000 related to stock options will be recognized on a straight-line basis monthly as compensation expense over the remaining vesting period which approximates 4.6 years.

The fair value of each option and warrant grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

|   |        |   |
|---|--------|---|
| Options granted in the year ended December 31                         | 2008   |   |
| Expected life (in years)  | 2.67   |   |
| Risk-free interest rate   | 2.86   | % |
| Volatility  | 150.56 | % |
| Dividend yield  | 0.00   | % |
| Warrants granted to employees/directors in the year ended December 31 | 2009   |   |
| Expected life (in years)  | 7.0    |   |
| Risk-free interest rate   | 2.28   | % |
| Volatility  | 166.13 | % |
| Dividend yield  | 0.00   | % |



The weighted average grant-date fair value of options granted during the fiscal year ended December 31, 2008 was \$3.17. The weighted average grant-date fair value of warrants granted during the fiscal year ended December 31, 2009 was \$0.02. The total intrinsic value of options exercised during the fiscal year ended December 31, 2008 was \$1,000. No options were exercised during the year ended December 31, 2009.

The fair value of stock-based awards to employees is calculated using the Black-Scholes option pricing model, even though this model was developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which differ significantly from our stock options. The Black-Scholes model also requires subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated values. The expected term and forfeiture rate of options granted is derived from historical data on employee exercises and post-vesting employment termination behavior, as well as expected behavior on outstanding options. The risk-free rate is based on the U.S. Treasury rates in effect during the corresponding period of grant. The expected volatility is based on the historical volatility of our stock price. These factors could change in the future, which would affect fair values of stock options granted in such future periods, and could cause volatility in the total amount of the stock-based compensation expense reported in future periods.

#### Stock Warrants

| Description                      | Outstanding Warrants as of December 31, 2009 |                |             | Expiration Date |
|----------------------------------|--|----------------|-------------|-----------------|
|                                  | Issue Date                                   | Exercise Price | Shares      |                 |
| September 2007 Investor Warrants | 9/26/2007                                    | \$ 1.45        | 5,804       | 9/26/2012       |
| May 2008 Broker Warrants         | 5/20/2008                                    | \$ 0.02        | 45,133,832  | 5/20/2013       |
| May 2008 Investor Warrants       | 5/22/2008                                    | \$ 0.02        | 107,014,930 | 5/20/2013       |
| August 2009 Employee Warrants    | 8/25/2009                                    | \$ 0.02        | 15,660,000  | 8/25/2016       |
| September 2009 Investor Warrants | 9/15/2009                                    | \$ 0.04        | 20,921,600  | 9/15/2012       |
| October 2009 Investor Warrants   | 10/15/2009                                   | \$ 0.04        | 3,052,976   | 10/15/2012      |
| December 2009 Investor Warrants  | 12/15/2009                                   | \$ 0.04        | 700,000     | 12/15/2012      |
| Broker Warrants for 2009 Debt    | 12/31/2009                                   | \$ 0.04        | 1,305,740   | 12/31/2012      |
| Total warrants outstanding       |  |                | 193,794,882 |                 |

The outstanding warrants related to 2008 financing transactions contain price protection features whereby these instruments are protected separately for the life of the warrants. Under the price protection clause, if we issue warrants or convertible instruments, with certain exceptions, at a lower exercise price or conversion price than the remaining outstanding warrants, the exercise price of such warrants would be reduced to the lower price and the warrants exercisable would increase so that the total required cash investment of the warrant holder remains unchanged. In September 2009, we issued convertible notes to investors in the September 2009 convertible debt financing transaction convertible at \$0.02 per share (see Note 7) and this issuance triggered the price protection provision related to the original 2,118,599 previously outstanding price protected warrants; as such, we reduced the exercise price of the 2,118,599 warrants to \$0.02 per share and increased the warrant shares to 152,148,762.

On January 1, 2009, we adopted the new accounting guidance that requires warrants with certain types of anti-dilution ratchet features be accounted for as liabilities, where as of December 31, 2008 they had been accounted for as equity. Prior to this new accounting guidance, these ratchet provisions were only evaluated under prior accounting guidance, and because these ratchet provisions are generally within a company's control, they did not trigger liability or

derivative accounting. We determined that the original 2,118,599 outstanding warrants that include ratchet features fall under the new accounting guidance and the fair value of the warrants must be recorded as a liability and marked-to-market each reporting period with the changes in the fair value recorded as income/expense in the consolidated statement of operations.

- On January 1, 2009, the fair value of the outstanding warrants was \$67,000 and was recorded as a liability in the account entitled embedded derivatives of convertible debt and warrants with the corresponding reduction to additional paid-in capital on the consolidated balance sheet. The assumptions used for the Black-Scholes option pricing model at January 1, 2009 were a term of 4.3 years, volatility of 143.12%, and a risk-free interest rate of 1.46%.
- As a result of the issuance of convertible notes in early October 2009, we no longer had enough unissued authorized shares to settle all outstanding equity instruments, including convertible preferred stock, convertible debt, options and warrants. Therefore, in accordance with the applicable accounting guidance, all non-employee warrants were required to be recorded as liabilities from that point and marked-to-market at each period until we have sufficient unissued authorized shares to settle all outstanding equity instruments. As a result, we reclassified the fair value of all non-employee warrants not already recorded as liabilities totaling \$837,000 as of October 1, 2009 from additional paid-in capital to embedded derivatives of convertible debt and warrants.
- During the fourth quarter of 2009, we issued additional convertible debt with warrants and also warrants to a broker. As we no longer had enough unissued authorized shares to settle all outstanding equity instruments, we classified the warrants issued to the debt holder and broker as liabilities. The fair value of those warrants was \$214,000, which was recorded as an expense in the account entitled non-cash items related to debt discounts and deferred financing fees and valuation of conversion features and warrants on our consolidated statement of operations for the year ended December 31, 2009.
  - On December 31, 2009, we issued a warrant to purchase 1,305,740 of our common stock an exercise price of \$0.04 per share to an investor for services provided for the private placement of convertible notes and warrants in the 2009 financing transaction. The fair value of the 1,305,740 shares of common stock is \$26,000 on the date of issuance and was recorded as debt issuance costs and included in current assets in the accompanying consolidated balance sheet as of December 31, 2009. The warrants were valued using the Black-Scholes option pricing model. The assumptions used for the Black-Scholes option pricing model are a term of 2.7 years, volatility of 267.66%, and a risk-free interest rate of 1.13%.
- During the year ended December 31, 2009, we recorded a net increase related to the fair value of the outstanding warrants of \$2.4 million as expense in the account entitled non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants on the consolidated statements of operations. The fair value of the outstanding warrants is \$3.5 million on December 31, 2009. The assumptions used for the Black-Scholes option pricing model at December 31, 2009 were a term of 3.4 years, volatility of 229.23%, and a risk-free interest rate of 1.13%.

See above and Note 7 for additional discussions about stock warrant activity during 2009 and 2008.

## 11. Commitments and Contingencies

The following is a summary of our agreements that we have determined are within the scope of accounting guidance.

### Warranty Obligations

Our mobile phone products were generally warranted against defects for 12 months following the sale. We had a 12-month warranty from the manufacturer of the mobile phones. Reserves for potential warranty claims not covered by the manufacturer were provided at the time of revenue recognition and were based on several factors, including current sales levels and our estimate of repair costs. Shipping and handling charges were expensed as incurred. We accrued the estimated costs to be incurred in performing warranty services at the time of revenue recognition and

shipment of the products to our customers. Our estimate of costs to service our warranty obligations was based on our expectation of future conditions. To the extent we experienced increased warranty claim activity or increased costs associated with servicing those claims, the warranty accrual would have increased, resulting in decreased gross margin. On December 9, 2008, Neonode AB filed for liquidation under the Swedish bankruptcy laws and we have no further obligations related to product warranties effective with the bankruptcy filing. We do not provide a warranty on our touchscreen technology and therefore, no warranty reserve has been accrued for the year ended December 31, 2009.

The following table sets forth an analysis of our warranty reserve (in thousands):

|   | Year ended<br>December<br>31,<br>2008 |
|---|---------------------------------------|
| Warranty reserve at beginning of year                     | \$95                                  |
| Less: Cost to service warranty obligations                | --                                    |
| Obligation of Neonode AB                                  | (95 )                                 |
| Plus: Increases to reserves                               | -                                     |
| Total warranty reserve included in other accrued expenses | \$--                                  |

#### Indemnities and Guarantees

We have agreed to indemnify each of our executive officers and directors for certain events or occurrences arising as a result of the officer or director serving in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. However, we have directors' and officers' liability insurance policy that should enable us to recover a portion of future amounts paid. As a result of our insurance policy coverage, we believe the estimated fair value of these indemnification agreements is minimal and have no liabilities recorded for these agreements as of December 31, 2009 and 2008, respectively.

We enter into indemnification provisions under our agreements with other companies in the ordinary course of business, typically with business partners, contractors, customers and landlords. Under these provisions we generally indemnify and hold harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of our activities or, in some cases, as a result of the indemnified party's activities under the agreement. These indemnification provisions often include indemnifications relating to representations made by us with regard to intellectual property rights. These indemnification provisions generally survive termination of the underlying agreement. The maximum potential amount of future payments we could be required to make under these indemnification provisions is unlimited. We have not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, we believe the estimated fair value of these agreements is minimal. Accordingly, we have no liabilities recorded for these agreements as of December 31, 2009 and 2008, respectively.

We are the secondary guarantor under the sublease of our previous headquarters that expired in March 2010. We have not recorded a liability at December 31, 2009.

#### Legal

On December 9, 2008, Empire Asset Management ("Empire"), a broker dealer that acted as our financial advisor and exclusive placement agent in previous private placement transactions, initiated a lawsuit against us in the Supreme Court of the State of New York alleging that the Corporation misrepresented the success of its business to induce Empire's customers to invest in us. Empire is seeking compensatory damages in an unspecified amount for the harm allegedly suffered. We believe that the action has no merit and intend to defend vigorously against the action. Our Directors and Officer ("D&O") insurance provider has extended coverage and will provide us with legal representation.

On May 11, 2009, Mr. David Berman initiated a lawsuit against us in the Supreme Court of the State of New York alleging that the Corporation misrepresented the success of its business to induce Mr. Berman to invest in us. Mr. Berman, who was a client of Empire, invested \$549,860 in our private placement offerings on March 4, 2008 and May 16, 2008, and purchased an additional 162,900 shares totaling \$251,082 in the aftermarket. We believe that the action has no merit and intend to defend vigorously against the action. Our D&O insurance provider has extended coverage and will cover the costs of legal representation, subject to payment of the retention amount.

Our D&O insurance policy provides for a retention amount of \$150,000, and we accrued a provision for legal expense and accounts payable totaling \$150,000 at December 31, 2009 and 2008, respectively, related to the potential payment of the retention under our D&O insurance policy that includes our maximum cash liability for both the Empire and Berman lawsuits.

On October 2, 2009, Xerox Corporation (“Xerox”) initiated a lawsuit against the Company in the Superior Court of California alleging that the Company breached an equipment lease agreement with Xerox and demanding payment of \$108,592.81 plus interest, late payment charges, and legal costs. On December 14, 2009, Xerox obtained an entry of default against the Company without prior warning to the Company. We accrued the total amount of the lawsuit of \$109,000 at December 31, 2009. The Company has filed a motion to set aside the entry of default and a hearing on this motion is set for June 2, 2010. The Company intends to defend vigorously against the action.

#### Operating Leases

On January 12, 2009, our subsidiary, Neonode Technologies AB, entered into a 12-month lease with Vasakronan Fastigheter AB for approximately 2,000 square feet of office space located at Linnegatan 89, Stockholm, Sweden for approximately \$5,000 per month. On January 12, 2010, we extended the lease until July 1, 2010 with provisions to cancel the lease with a ninety-day notice period.

The future minimum lease payments under this operating lease are as follows as of December 31, 2009 (in thousands):

| Year Ending December 31, | Future<br>minimum<br>payments<br>on<br>operating<br>leases |
|--------------------------|--|
| 2010                     | \$ 30  |

Total rent expense under the leases for office space located in Sweden and the US under leases that have been cancelled was \$68,000 and \$378,000 for the years ended December 31, 2009 and 2008, respectively.

#### 12. Income Taxes

Loss before income taxes was distributed geographically as follows (in thousands):

|          | Year<br>Ended<br>Dec. 31,<br>2009 | Year<br>Ended<br>Dec. 31,<br>2008 |
|----------|-----------------------------------|-----------------------------------|
| Domestic | \$(13,300 )                       | \$1,976                           |

|         |             |            |
|---------|-------------|------------|
| Foreign | (1,621 )    | (7,910 )   |
| Total   | \$(14,921 ) | \$(5,934 ) |

We had no provision (benefit) for income taxes for the year ended December 31, 2009 and 2008. The effective income tax rate differs from the statutory federal income tax rate for the following reasons:

|   | Year Ended<br>Dec. 31,<br>2009 | Year Ended<br>Dec. 31,<br>2008 |
|---|--------------------------------|--------------------------------|
| Amount at standard tax rates  | (34%)                          | (34%)                          |
| Non-deductible loss on revaluation of embedded conversion features and extinguishment of convertible debt | 6.5%                           | --                             |
| Loss on debt restructuring  | 6.2%                           |                                |
| Other permanent differences due to Neonode AB bankruptcy  | --                             | 34%                            |
| Stock compensation  | 14.4%                          | --                             |
| Foreign losses not benefitted   | 3.7%                           | --                             |
| Valuation allowance   | 3.2%                           | --                             |
| Effective tax rate  | --                             | --                             |

Significant components of the deferred tax balances are as follows (in thousands):

|                               | December 31,<br>2009 | December 31,<br>2008 |
|-------------------------------|----------------------|----------------------|
| Deferred tax assets:          |                      |                      |
| Stock compensation            | \$495                | \$280                |
| Accrued expenses              | \$64                 | \$25                 |
| Net operating losses          | \$813                | \$--                 |
| Total deferred tax assets     | \$1,372              | \$305                |
| Valuation allowance           | (1,372 )             | (305 )               |
| Total net deferred tax assets | \$--                 | \$--                 |

Valuation allowances are recorded to offset certain deferred tax assets due to management's uncertainty of realizing the benefits of these items. Management applies a full valuation allowance for the accumulated losses of Neonode Inc, and its subsidiary Neonode Technologies AB, since it is not determinable using the "more likely than not" criteria that there will be any future benefit of our deferred tax assets. This is mainly due to our history of operating losses. The main components of our deferred tax benefits at December 31, 2008 are related to accrued employee benefits and stock compensation. On December 9, 2008, Neonode AB filed for liquidation under the Swedish bankruptcy laws and effective with the filing we are no longer responsible for the liabilities and no longer have any ownership interest in the assets of Neonode AB, including any tax net operating loss carryforwards. Our US Federal state and foreign tax operating loss carryforward from 2009 is \$808,000, \$808,000 and \$1,621,000, respectively. The Federal loss carryovers expire in 2029, the state net operating losses expire in 2019, and the foreign losses expire in 2020. The main components of our deferred tax benefits at December 31, 2009 are related to our net operating loss and accrued employee benefits and stock compensation. The Company underwent significant ownership changes in 2007 and 2008, which impact the Company's ability to utilize net operating losses and credit for Federal and state purposes under the provisions of Section 382 of the US Internal Revenue Code. As a result, beginning 2008 we no longer are recording tax operating loss carryforwards from prior periods as deferred tax assets.



Effective January 1, 2007, we adopted the provisions of accounting guidance which includes a two-step approach to recognizing, de-recognizing and measuring uncertain tax positions accounted for in accordance with accounting guidance. As a result we recognized no increase in the liability for unrecognized tax benefits. Therefore, upon implementation of accounting guidance we recognized no material adjustment to the January 1, 2007 balance of retained earnings. A reconciliation of the unrecognized tax benefits for the year ended December 31, 2009 is as follows:

|  |    |     |
|--|----|-----|
| Balance at January 1, 2009                                   | \$ | --- |
| Additions for tax positions of prior years                   |    | --- |
| Reductions for tax position of prior years                   |    | --- |
| Additions based on tax positions related to the current year |    | --- |
| Decreases – Settlements                                      |    | --- |
| Reductions – Settlements                                     |    | --- |
| Balance at December 31, 2009                                 | \$ | --- |

We adopted a policy to classify accrued interest and penalties as part of the accrued tax liability in the provision for income taxes. For the year ended December 31, 2009, we did not recognize any interest or penalties related to unrecognized tax benefits.

Our continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. As of December 31, 2009, we had no accrued interest and penalties related to uncertain tax matters.

By the end of 2009, we had no uncertain tax positions that would be reduced as a result of a lapse of the applicable statute of limitations. We do not anticipate the adjustments would result in a material change to our financial position.

We file income tax returns in the U.S. federal jurisdiction, California and Sweden. The 1996 through 2009 tax years are open and may be subject to potential examination in one or more jurisdictions. We are not currently under federal, state or foreign income tax examination.

### 13. Employee Benefit Plans

We participated in a number of individual defined contribution pension plans for our employees in Sweden. Contributions relating to these defined contribution plans for the year ended December 31, 2008 was \$363,000. As part of the restructuring on December 31, 2008, we no longer participate in any pension plans for our employees in Sweden.

### 14. Net Loss Per Share

Basic net loss per common share for the years ended December 31, 2009 and 2008 was computed by dividing the net loss for the relevant period by the weighted average number of shares of common stock outstanding. Diluted earnings per common share is computed by dividing net loss by the weighted average number of shares of common stock and common stock equivalents outstanding.

Potential common stock equivalents of approximately 500,000 and 1.3 million outstanding stock options (see Note 10), 193.8 million and 2.1 million outstanding stock warrants (see Note 10), 43.7 million and 950,000 shares issuable upon conversion of preferred stock (see Note 9) and 49.3 million and 40,000 shares issuable upon conversion of notes (see Note 7) are excluded from the diluted earnings per share calculation for the years ended December 31, 2009 and 2008, respectively, due to their anti-dilutive effect.

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(in thousands, except per share amounts)

Year ended December 31,  
2009 2008

**BASIC AND DILUTED**

|  |              |             |
|--|--------------|-------------|
| Weighted average number of common shares outstanding   | 247,546      | 28,164      |
| Number of shares for computation of net loss per share | 247,546      | 28,164      |
| Net loss attributable to common stockholders           | \$ (15,956 ) | \$ (5,934 ) |
| Net loss per share basic and diluted                   | \$ (0.06 )   | \$ (0.21 )  |

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## 15. Segment Information

We have one reportable segment. Prior to December 9, 2008, the date Neonode AB filed for bankruptcy, we operated in one industry segment: the development of intellectual property related to optical infrared touchscreen and the sale of associated products and licenses that encompass this technology. In December 2008, prior to our subsidiary, Neonode AB, filing for bankruptcy we transferred the patents, copyrights and all technology intellectual property to Neonode Inc. pursuant to an intercompany debt pledge agreement and continue to develop and license our touchscreen technology. We have carried out substantially all of our operations through our subsidiary Neonode AB located in Sweden, although we did carry out some development activities together with our manufacturing partner in Malaysia. The majority of the sales of our mobile phones were concentrated in Europe.

## 16. Related Party Transactions

Mr. Per Bystedt, our Chairman of the Board and Chief Executive Officer, is personally involved in our refinancing and capital raising activities. Mr. Bystedt is the beneficial holder of approximately 82.4 million shares of our common stock, or approximately 12%, of the Company's outstanding shares of common stock as of December 31, 2009 on a fully diluted basis, and is the beneficial owner of Iwo Jima SARL. Iwo Jima SARL invested \$100,000 in our December 2008 financing transaction and received 10,000 shares of our Series A Preferred stock that was exchanged for 4,806,300 shares of our common stock. Iwo Jima SARL also surrendered warrants in exchange for 7,210.96 shares Series B Preferred stock. The Series B Preferred stock was exchanged for 952,351 shares of our common stock. Iwo Jima SARL was one of the three Neonode Technologies AB Stockholders who participated in the share exchange transaction with us pursuant to the Share Exchange Agreement on December 29, 2008 (see Note 1). Iwo Jima SARL received 151,788.17 shares of our Series A Preferred stock that was exchanged for 72,906,894 shares of our common stock. On November 6, 2009, Iwo Jima SARL transferred 4,000,000 shares of our common stock to certain of our employees. On September 15, 2009, Iwo Jima SARL purchased \$64,000 in convertible notes that may be converted, at the option of Iwo Jima SARL, into 3,215,450 shares of our common stock and also received a warrant that when exercised can be converted into 1,607,725 shares of our common stock at a conversion price of \$0.04 per share. On September 15, 2009, Mr. Bystedt directly purchased \$51,000 in convertible notes that may be converted, at the option of Mr. Bystedt, into 2,569,150 shares of our common stock and also received a warrant that, when exercised, can be converted into 1,284,575 shares of our common stock at a conversion price of \$0.04 per share. Mr. Bystedt holds 40,000 employee stock options to purchase our common stock at \$3.45 per share. Mr. Bystedt, through his company, Iwo Jima SARL, entered into a consulting agreement with us whereby he has earned a total of \$211,000 for his services for the year ended December 31, 2009. As of December 31, 2009, \$159,000 is included in our accrued expenses in the accompanying consolidated balance sheet.

Mr. Thomas Eriksson, Chief Executive Officer of our wholly owned subsidiary, Neonode Technologies AB, and a member of our Board, is the beneficial holder of approximately 73.0 million shares of our common stock, or approximately 11% of our outstanding shares of common stock as of December 31, 2009 on a fully diluted basis, and is the beneficial owner of Wirelesstoys AB, which company is one of the three Neonode Technologies AB Stockholders which participated in the share exchange transaction with us pursuant to the Share Exchange Agreement (see Note 1). Wirelesstoys AB received 151,788.17 shares of our Series A Preferred stock that was exchanged for 72,906,894 shares of our common stock. Mr. Eriksson, through his company, Wirelesstoys AB, entered into a consulting agreement with us whereby he has earned a total of \$216,000 for his services for the year ended December 31, 2009. We paid \$119,000 of the amount owed to Wirelesstoys AB during the year ended December 31, 2009, and \$97,000 is included in our accrued expenses at December 31, 2009.

Mr. Magnus Goertz, one of our founders, is the beneficial holder of approximately 62.8 million shares of our common stock, or approximately 9% of our outstanding shares of common stock as of December 31, 2009 on a fully diluted basis, and is the beneficial owner of Athemis Ltd., which company is one of the three Neonode Technologies AB

Stockholders which participated in the share exchange transaction with the Company pursuant to the Share Exchange Agreement (see Note 1). Athemis Ltd received 151,788.17 shares of our Series A Preferred stock that was exchanged for 72,953,948 shares of our common stock. On November 6, 2009, Athemis Ltd transferred 12,000,000 shares of our common stock to certain of our employees. Mr. Goertz, through his company, Athemis Ltd, entered into a consulting agreement with us whereby he has earned a total of \$218,000 for his services for the year ended December 31, 2009. We paid \$71,000 of the amount owed to Athemis Ltd. during the year ended December 31, 2009, and \$147,000 is included in our accrued expenses at December 31, 2009.

Mr. David W. Brunton, our Chief Financial Officer, purchased 14,564.22 shares of Series A Preferred stock from the Neonode Technologies AB Stockholders (Iwo Jima SARL, Wirelesstoys AB, and Athemis Ltd.) that was exchanged for 7,000,001 shares of our common stock. On August 25, 2009, Mr. Brunton was granted a warrant to purchase 4,000,000 shares of our common stock at an exercise price of \$0.02 per share, valued at \$78,000 (see Note 10). As of December 31, 2009, Mr. Brunton is the beneficial owner of approximately 11.5 million shares of our common stock or approximately 2% of our outstanding shares of common stock on a fully diluted basis. Mr. Brunton holds 225,000 employee stock options to purchase our common stock with exercise prices ranging from \$2.33 to \$22.25 per share.

We additionally lease office space located in Lafayette, California that is provided by Mr. Brunton on a rent-free basis.

Mr. John Reardon, a member of our Board, was granted on August 25, 2009 a warrant to purchase 5,000,000 shares of our common stock at an exercise price of \$0.02 per share, valued at \$97,000 (see Note 10). As of December 31, 2009, Mr. Reardon is the beneficial owner of approximately 5.3 million shares of our common stock or approximately 1% of our outstanding shares of common stock on a fully diluted basis. Mr. Reardon holds 232,095 employee stock options to purchase our common stock with exercise prices ranging from \$1.42 to \$27.50 per share.

Mr. Mats Dahlin, a member of the Board of Directors of our wholly owned subsidiary, Neonode Technologies AB, is the beneficial owner of Davisa Ltd. On October 9, 2009 and December 15, 2009, Davisa Ltd purchased a total of \$77,650 in convertible notes that may be converted, at the option of Davisa Ltd, into 3,882,516 shares of our common stock and also received warrants that, when exercised, can be converted into 1,941,258 shares of our common stock at a conversion price of \$0.04 per share. On August 25, 2009, Davisa Ltd was granted a warrant to purchase 4,660,000 shares of our common stock at an exercise price of \$0.02 per share for Mr. Dahlin's services as a board member and advisor to the Company, valued at \$91,000 (see Note 10). Mr. Dahlin, through his company, Davisa Ltd, entered into a consulting agreement with us whereby he has earned a total of \$28,000 for his services for the year ended December 31, 2009. We converted the \$28,000 to a convertible note and a warrant as discussed above. As of December 31, 2009, Mr. Dahlin is the beneficial owner of approximately 10.5 million shares of our common stock or approximately 1.5% of our outstanding shares of common stock on a fully diluted basis.

## 17. Subsequent Events

In the three months ended March 31, 2010, we received \$1 million in cash proceeds and converted \$163,000 of accounts payable related to a private placement of convertible notes and stock purchase warrants that can be converted, at the holder's option, into 60,160,564 shares of our common stock at a conversion price of \$0.02 per share and 30,080,282 stock purchase warrants that have an exercise price of \$0.04 per share. The convertible note holders have the right to have the conversion price adjusted to equal the lower stock price if we issue stock or convertible notes at a lower conversion price than \$0.02 during the period that the notes are outstanding. These convertible notes are due on December 31, 2010 and bear an annual interest rate of 7%, payable on June 30 and December 31 of each year that the convertible notes are outstanding. The warrants may be exercised and converted to common stock, at the warrant holder's option, beginning on the six-month anniversary date of issuance until the warrant expiration date. Mr. Bystedt purchased \$16,000 of convertible notes as part of the financing transaction that may be converted into 819,500 shares of our common stock and also received a warrant that, when exercised, can be converted into 419,750 shares of our common stock at a conversion price of \$0.04 per share. In addition, Iwo Jima SARL converted \$163,000 of amounts owed to it for Mr. Bystedt's consulting services (see Note 16) into convertible notes that may be converted into 8,167,614 shares of our common stock and also received a warrant that, when exercised, can be converted into 4,083,807 shares of our common stock at a conversion price of \$0.04 per share. A company controlled by Mats Dahlin, Davisa Ltd purchased a total of \$138,000 convertible notes as part of the financing transaction that may be converted, at the option of Davisa Ltd, into 6,903,700 shares of our common stock and also received warrants that, when exercised, can be converted into 3,451,850 shares of our common stock at a conversion price of \$0.04 per

share. We are not obligated to register the common stock related to the convertible debt or the warrants.

The embedded conversion feature of the convertible debt issued in the 2010 convertible debt financing transaction meets the definition of a derivative financial instrument and will be classified as a liability in accordance with accounting guidance. The note holders have the right to convert the debt into shares of our common stock, and the notes include price protection whereby these notes are protected for as long as the notes remain outstanding against future private placements made at lower share prices, and therefore, the total number of shares of our common stock that the convertible notes can be convertible into is not fixed. The embedded conversion features will be revalued on each balance sheet date and marked to market with the adjusting entry to non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants on the condensed consolidated statements of operations.

The value of the embedded conversion feature using the Black-Scholes option pricing model is \$1.4 million on the date of issuance and \$200,000 will be expensed to non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants on the date of issuance and \$1.2 million will be recorded as a debt discount. The assumptions used for the Black-Scholes option pricing model for the conversion feature on the date of issuance were a term of 0.77 to 0.92 years, volatility of 308.82% to 318.82%, and a risk-free interest rate of 1.13%. Because there are not enough unissued authorized shares to settle all currently outstanding equity instruments, the warrants issued with the debt will also be recorded as a derivative liability and expensed to non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants, totaling \$814,000. The assumptions used for the Black-Scholes option pricing model for the warrants on the date of issuance were a term of 3 years, volatility of 242.73%, and a risk-free interest rate of 1.13%.

On March 21, 2010, we issued 875,000 shares of our common stock and a warrant to purchase 875,000 of our common stock an exercise price of \$0.04 per share to an investor for services provided for the private placement of convertible note and warrant in the 2010 financing transaction. The aggregate fair value of the shares and warrant is \$50,000, which will be recorded as debt issuance costs and amortized to interest expense over the remaining term of the convertible notes. The warrants were valued using the Black-Scholes option pricing model. The assumptions used for the Black-Scholes option pricing model were a term of 2.9 years, volatility of 258.33%, and a risk-free interest rate of 1.13%.

Subsequent to December 31, 2009, Series A Preferred stockholders exchanged 18,021.93 shares of Series A Preferred stock for 8,661,880 shares of our common stock, and Series B Preferred stockholders exchanged 7,389.85 shares of Series B Preferred stock for 975,977 shares of our common stock.

In April 2010, we received \$533,000 in proceeds related to a private placement of convertible notes and stock purchase warrants that can be converted, at the holder's option, into 26,625,000 shares of our common stock at a conversion price of \$0.02 per share and 13,312,500 stock purchase warrants that have an exercise price of \$0.04 per share. The convertible note holders have the right to have the conversion price adjusted to equal the lower stock price if we issue stock or convertible notes at a lower conversion price than \$0.02 during the period that the notes are outstanding. These convertible notes are due on December 31, 2010 and bear an annual interest rate of 7%, payable on June 30 and December 31 of each year that the convertible notes are outstanding. The warrants may be exercised and converted to common stock, at the warrant holder's option, beginning on the six-month anniversary date of issuance until the warrant expiration date. We are not obligated to register the common stock related to the convertible debt or the warrants.

The embedded conversion feature of the convertible debt issued in the April 2010 convertible debt financing transaction meets the definition of a derivative financial instrument and will be classified as a liability in accordance with accounting guidance. The note holders have the right to convert the debt into shares of our common stock, and the notes include price protection whereby these notes are protected for as long as the notes remain outstanding against future private placements made at lower share prices, and therefore, the total number of shares of our common

stock that the convertible notes can be convertible into is not fixed. The embedded conversion features will be revalued on each balance sheet date and marked to market with the adjusting entry to non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants on the consolidated statements of operations.

The value of the embedded conversion feature using the Black-Scholes option pricing model is \$533,000 on the date of issuance will be recorded as a debt discount. The assumptions used for the Black-Scholes option pricing model for the conversion feature on the date of issuance were a term of 0.66 years, volatility of 308.82%, and a risk-free interest rate of 1.13%. Because there are not enough unissued authorized shares to settle all currently outstanding equity instruments, the warrants issues with the debt will also be recorded as a derivative and expensed to non-cash items related to debt discounts and deferred financing fees and valuation of conversion features and warrants, totaling \$267,000. The assumptions used for the Black-Scholes option pricing model for the warrants on the date of issuance were a term of 3 years, volatility of 242.73%, and a risk-free interest rate of 1.13%.

We have evaluated subsequent events through the filing date of this Form 10-K/A, and have determined that no further subsequent events have occurred that would require recognition in the consolidated financial statements or disclosure in the notes thereto, other than already disclosed in Note 17.

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

On November 5, 2009 BDO Sweden AB (BDO) resigned as our independent registered public accounting firm. On November 6, 2009, our Audit Committee of the Board of Directors approved the replacement of BDO with KMJ/Corbin & Company (“KMJ”) as our independent registered public accounting firm for the 2009 fiscal year.

#### ITEM 9A. CONTROLS AND PROCEDURES

##### Disclosure Controls and Procedures

Under the supervision of and with the participation of our management, including the Company’s Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the December 31, 2009. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective for the reasons described below.

During the audit of our consolidated financial statements for the year ended December 31, 2009, management determined that we had certain material weaknesses relating to our accounting for certain financing transactions, including convertible debt and derivative financial instruments. In addition we failed to complete the required audit and review of our annual and quarterly financial statements in a timely manner. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of a Company’s annual or interim financial statements will not be prevented or detected on a timely basis. In addition, we entered into several complex financing transactions that resulted in accounting adjustments during our year-end audit. Because these material weaknesses as to internal control over financial reporting also bear upon our disclosure controls and procedures, our Chief Executive Officer and Chief Financial Officer were unable to conclude our disclosure controls and procedures were effective.

Despite the conclusion that disclosure controls and procedures were not effective as of the end of period covered by this report, the Chief Executive Officer and Chief Financial Officer believe that the financial statements and other information contained in this annual report present fairly, in all material respects, our business, financial condition and results of operations.

##### Internal Control over Financial Reporting

##### Report of Management on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control system has been designed to provide reasonable, not absolute, assurance to our management and Board of Directors that the objectives of our control system with respect to the integrity, reliability and fair presentation of published financial statements are met. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we assessed the effectiveness of our internal control over financial reporting as of December 31, 2009. In making this assessment, we used the criteria established in the framework on Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations (“COSO”) of the Treadway Commission. Based on our assessment, which was conducted according to the COSO criteria, we have concluded that our internal control over financial reporting was not effective in achieving its objectives as of December 31, 2009 due to a material weakness that existed in our internal controls relating to our accounting for certain financing transactions, including convertible debt and derivative financial instruments.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. Based on management's assessment of our internal control over financial reporting as of December 31, 2009, the following material weaknesses existed as of that date:

The Company's controls over accounting for certain financing transactions did not operate effectively as of December 31, 2009. In addition, we entered into several complex financing transactions that resulted in accounting adjustments during our year-end audit. In addition, we failed to complete the required audit and review of our annual and quarterly financial statements for 2009 in a timely manner.

This annual report is not required to include a report of the Company's independent registered public accounting firm due to temporary rules of the Commission that would permit us to provide only management's assessment in this annual report.

As we move towards complete integration and consolidation of business and financial operations of Neonode Technologies AB and Neonode, we expect to take steps to both remedy the material weaknesses described above and facilitate our management's assessment of internal control over financial reporting in accordance with the Sarbanes-Oxley Act and Commission rules. Our planned steps include:

- adding personnel to our financial department, consultants, or other resources (including those with public company reporting experience) to enhance our policies and procedures, including those related to revenue recognition;
- exploring the suitability of further upgrades to our accounting system to complement the new management reporting system software described above; and
- Management will perform an assessment of the effectiveness of our internal control over financial reporting and implement appropriate internal controls on weaknesses determined, if any, documenting, and then testing, the effectiveness of those controls.

#### ITEM 9B. OTHER INFORMATION

None

#### PART III

#### ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The following individuals serve as the Directors and executive officers of our company. There are no familial relationships between our directors or our executive officers and any other director or executive officer.

| NAME            | AGE | POSITION  |
|-----------------|-----|---|
| Per Bystedt     | 45  | Chairman of the Board of Directors and Chief Executive Officer            |
| John Reardon    | 49  | Director  |
| Thomas Eriksson | 40  | CEO of Neonode Technologies AB and Director                               |
| David Brunton   | 59  | Vice President, Finance, Chief Financial Officer, Treasurer and Secretary |

## Board of Directors

The Board is divided into three classes. Each class consists, as nearly as possible, of one-third of the total number of directors, and each class has a three-year term. Vacancies on the Board may be filled only by persons elected by a majority of the remaining directors. A director elected by the Board to fill a vacancy in a class shall serve for the remainder of the full term of that class, and until the director's successor is elected and qualified. This includes vacancies created by an increase in the number of directors.

The Board presently has three members. The following is a brief biography of each director

Per Bystedt - Mr. Bystedt has served as the Chairman of the Board of Directors and the Chief Executive Officer of the Company since May 2008 and served as the interim Chief Executive Officer of Old Neonode from October 2005 through July 2006. Since 1997, Mr. Bystedt has been the Chief Executive Officer of Spray AB, an internet investment company. From 1991 through 1997, Mr. Bystedt was a Senior Vice President of various television production and network companies including Trash Television, ZTV AB, TV3 Broadcasting Group Ltd and MTG AB. From 2000 through the present, Mr. Bystedt has served as a member of the board of directors of Axel Johnson AB. From 2000 to 2008, he was a member of the board of directors of Eniro AB and, from 2005 to 2008, was a member of the board of directors of Servera AB. From 2005 to 2008, Mr. Bystedt has been the chairman of the board of directors of AIK Fotboll AB from 2005 to the present. From 1997 through 2005 he served as a member of the board of directors of Ahlens AB, and from 1998 through 2000 he was the chairman of the board of directors of Razorfish, Inc. Mr. Bystedt holds an MBA degree from the Stockholm School of Economics.

John Reardon - Mr. Reardon has served as a director of SBE, Inc. since February 2004 and of Old Neonode since February 2007. Mr. Reardon is the chairman of the Audit Committee and member of the Compensation and Nominating and Governance Committees of the Company. Mr. Reardon has served as President and member of the board of directors of The RTC Group, a technical publishing company since 1990. In 1994, Mr. Reardon founded a Dutch corporation, AEE, to expand the activities of The RTC Group into Europe. Mr. Reardon also serves on the board of directors of One Stop Systems, Inc., a computing systems and manufacturing company. Mr. Reardon holds a BA degree from National University.

Thomas Eriksson - Mr. Eriksson has served as the Chief Executive Officer of Neonode Technologies AB, a wholly owned subsidiary of the Company, since January 1, 2009. From February 2006 through December 31, 2008, Mr. Eriksson served as the Chief Technical Officer of the Company. Mr. Eriksson was one of the founders of Neonode, Inc. in 2001.

David W Brunton - Mr. Brunton joined SBE, the predecessor to Neonode Inc, in November 2001 as Vice President, Finance, Chief Financial Officer, Secretary and Treasurer. From 2000 to 2001 he was the Chief Financial Officer for NetStream, Inc., a telephony broadband network service provider. Mr. Brunton is a certified public accountant and holds a BA degree from California State University - Chico.

## Board Leadership Structure

The Company has chosen to combine the principal executive officer and Board chairman positions. The Company believes that this Board leadership structure is the most appropriate for the Company for the following reasons. First, the Company is in its early stages and at this early time it is more efficient to have the leadership of the Board in the same hands as the principal executive officer of the Company. The challenges faced by the Company at this stage – obtaining financing, performing research and development activities, and implementing our business plan – are most efficiently dealt with by having one person intimately familiar with both the operational aspects as well as the strategic aspects of the Company’s business. Second, Mr. Bystedt is uniquely suited to fulfill both positions of responsibility because he possesses both the strategic vision as well as the hands-on management experience that the Company needs to execute on its business plan.

## Independence of the Board of Directors

A majority of the members of the board of a company listed on a national exchange must qualify as “independent,” as affirmatively determined by the board of directors. The Board consults with the Company’s counsel to ensure that the Board’s determinations are consistent with all relevant securities laws and regulations regarding the definition of “independent.”

The Company is not currently required to comply with these independence requirements. After review of all relevant transactions or relationships between each director, or any of his or her family members, and the Company, its senior management and its independent registered public accounting firm, the Board has determined that since only John Reardon is an independent director, the Board is not comprised of a majority of independent directors.

## Meetings of the Board of Directors

The Board met four times during the Company’s 2009 fiscal year. Each then-serving director attended 75% or more of the aggregate of the meetings of the Board and of the committees on which he served, held during the period for which he was a director or committee member, respectively. In addition, the Company’s independent directors met in regularly scheduled executive sessions at which only independent directors are present.

All of the board members attended last year’s annual meeting, either in person or telephonically.

## Board Committees

The Board has three committees: an Audit Committee, a Compensation Committee, and a Nominating and Governance Committee. John Reardon, Per Bystedt and Thomas Eriksson constitute the members of each committee. During the Company’s 2009 fiscal year, the Audit Committee met four times, the Compensation Committee met two times, and the Nominating and Governance Committee met two times. All then-serving directors attended at least 75% of the meetings of each committee.

Below is a description of each committee of the Board. Each of the committees has authority to engage legal counsel or other experts or consultants, as it deems appropriate to carry out its responsibilities. The Board has determined that only John Reardon meets the applicable rules and regulations regarding “independence” and is free of any relationship that would interfere with his individual exercise of independent judgment with regard to the Company.

### Audit Committee.

John Reardon is Chairman of the Audit Committee. The members of the Audit Committee are John Reardon, Per Bystedt and Thomas Eriksson. The Audit Committee of the Board, which was established in accordance with Section 3(a)(58)(A) of the Exchange Act, oversees the Company's corporate accounting and financial reporting process. For this purpose, the Audit Committee performs several functions, including the following:

- evaluates the performance of and assesses the qualifications of the independent registered public accounting firm;
  - determines and approves the engagement of the independent registered public accounting firm;
- determines whether to retain or terminate the existing independent registered public accounting firm or to appoint and engage a new independent registered public accounting firm;
- reviews and approves the retention of the independent registered public accounting firm to perform any proposed permissible non-audit services;
- monitors the rotation of partners of the independent registered public accounting firm on the Company's audit engagement team as required by law;
- confers with management and the independent registered public accounting firm regarding the effectiveness of internal controls over financial reporting;
- establishes procedures, as required under applicable law, for the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls or auditing matters and the confidential and anonymous submission by employees of concerns regarding questionable accounting or auditing matters;
  - reviews the financial statements to be included in the Company's Annual Report on Form 10-K; and
- discusses with management and the independent registered public accounting firm the results of the annual audit and the results of the Company's quarterly financial statements.

The Board has adopted a written Audit Committee Charter that is available on the Company's website at [http://www.neonode.com/Documents/investor/audit\\_committee\\_charter.pdf](http://www.neonode.com/Documents/investor/audit_committee_charter.pdf).

The Board annually reviews the SEC standards and definition of independence for Audit Committee members and has determined that a majority of the members of the Company's Audit Committee are not independent. The Company does not have an "audit committee financial expert" as defined in the rules of the Securities and Exchange Commission serving on the Audit Committee because the Board believes that the background and financial sophistication of its members are sufficient to fulfill the duties of the Audit Committee.

#### Compensation Committee

John Reardon is Chairman of the Compensation Committee. The members of the Compensation Committee are John Reardon, Per Bystedt and Thomas Eriksson. The Compensation Committee of the Board reviews and approves the overall compensation strategy and policies for the Company. The Compensation Committee duties include the following:

- reviews and approves corporate performance goals and objectives relevant to the compensation of the Company's executive officers and other senior management;
- reviews and approves the compensation and other terms of employment of the Company's Chief Executive Officer;
- reviews and approves the compensation and other terms of employment of the other executive officers; and
- administers and reviews the Company's stock option and purchase plans, pension and profit sharing plans, stock bonus plans, deferred compensation plans and other similar programs.

The Committee has the authority to obtain advice or assistance from consultants, legal counsel, accounting or other advisors as appropriate to perform its duties, and to determine the terms, costs and fees for such engagements. All members of the Company's Compensation Committee are independent. The Board has adopted a written Compensation Committee Charter that is available on the Company's website at [http://www.neonode.com/Documents/investor/compensation\\_committee\\_charter.pdf](http://www.neonode.com/Documents/investor/compensation_committee_charter.pdf).

The Compensation Committee conducts an annual performance and compensation review for each of our executive officers and determines salary adjustments and bonus and equity awards at one or more meetings generally held during the last quarter of the year. In addition, the Compensation Committee considers matters related to individual compensation, such as compensation for new executive hires, as well as various compensation policy issues throughout the year. For executives other than the Chief Executive Officer, the Compensation Committee receives and considers performance evaluations and compensation recommendations submitted to the Committee by the Chief Executive Officer. In the case of the Chief Executive Officer, the evaluation of his performance is conducted by the Compensation Committee, which determines any adjustments to his compensation as well as awards to be granted. The agenda for meetings of the Compensation Committee is usually determined by its Chairman with the assistance of the Company's Chief Executive Officer and Chief Financial Officer. Compensation Committee meetings are regularly attended by the Chief Executive and Chief Financial Officer.

The Committee approves routine on-hire option grants to employees of the Company, subject to specific limitations. For these grants, the exercise price must be equal to the closing price on the OTC BB of the Company's Common Stock on the trading on the date of grant.

#### Nominating and Governance Committee

John Reardon is Chairman of the Nominating and Governance Committee. The members of the Nominating and Governance Committee are John Reardon, Per Bystedt and Thomas Eriksson. The Nominating and Governance Committee of the Board is responsible for identifying, reviewing and evaluating candidates to serve as directors of the Company, consistent with criteria approved by the Board. The Nominating and Governance duties include the following:

- reviewing and evaluating incumbent directors;
- recommending candidates to the Board for election to the Board; and
- making recommendations to the Board regarding the membership of the committees of the Board.

A majority of the members of the Nominating and Governance Committee are not independent. The Board has adopted a written Nominating and Governance Committee Charter that is available on the Company's website at [http://www.neonode.com/Documents/investor/nominating\\_and\\_governance\\_committee\\_charter.pdf](http://www.neonode.com/Documents/investor/nominating_and_governance_committee_charter.pdf).

The Nominating and Governance Committee believes that candidates for director should have certain minimum qualifications, including being able to read and understand basic financial statements, being over 21 years of age, and having the highest personal integrity and ethics. The Nominating and Governance Committee also intends to consider such factors as possessing relevant expertise upon which to be able to offer advice and guidance to management, having sufficient time to devote to the affairs of the Company, demonstrated excellence in his or her field, having the ability to exercise sound business judgment and having the commitment to rigorously represent the long-term interests of the Company's stockholders. However, the Nominating and Governance Committee retains the right to modify these qualifications from time to time. Candidates for director nominees are reviewed in the context of the current composition of the Board, the operating requirements of the Company and the long-term interests of stockholders. In conducting this assessment, the committee considers diversity, age, skills, and such other factors as it deems appropriate given the current needs of the Board and the Company, to maintain a balance of knowledge, experience and capability.

In the case of incumbent directors whose terms of office are set to expire, the Nominating and Governance Committee reviews such directors' overall service to the Company during their term, including the number of meetings attended, level of participation, quality of performance, and any other relationships and transactions that might impair such directors' independence.

In the case of new director candidates, the Nominating and Governance Committee also determines whether the nominee must be independent pursuant to applicable SEC rules and regulations and the advice of counsel, if necessary. The Nominating and Governance Committee then uses its network of contacts to compile a list of potential candidates, but may also engage, if it deems appropriate, a professional search firm. The Nominating and Governance Committee conducts any appropriate and necessary inquiries into the backgrounds and qualifications of possible candidates after considering the function and needs of the Board. The Nominating and Governance Committee meets to discuss and consider such candidates' qualifications and then selects a nominee for recommendation to the Board by majority vote. To date, the Nominating and Governance Committee has not paid a fee to any third party to assist in the process of identifying or evaluating director candidates. To date, the Nominating and Governance Committee has not received any director nominations from stockholders of the Company.



The Nominating and Governance Committee will consider director candidates recommended by stockholders. The Nominating and Governance Committee does not intend to alter the manner in which it evaluates candidates, including the minimum criteria set forth above, based on whether the candidate was recommended by a stockholder or not. Stockholders who wish to recommend individuals for consideration by the Nominating and Governance Committee to become nominees for election to the Board may do so by delivering a written recommendation to the Nominating and Governance Committee at the following address: Neonode Inc., Linnegatan 89 SE 115 23 Stockholm, Sweden, at least six months prior to any meeting at which directors are to be elected. Submissions must include the full name of the proposed nominee, a description of the proposed nominee's business experience for at least the previous five years, complete biographical information, a description of the proposed nominee's qualifications as a director and a representation that the nominating stockholder is a beneficial or record owner of the Company's stock. Any such submission must be accompanied by the written consent of the proposed nominee to be named as a nominee and to serve as a director if elected.

#### Stockholder Communications with the Board of Directors

The Company adopted a policy for stockholder communications with the Board. Persons interested in communicating with any particular director, the independent directors or the Board as a whole may address correspondence to the intended recipient, in care of Neonode Inc. at Linnegatan 89, SE 115 23 Stockholm, Sweden. If no particular director is named, letters will be forwarded, depending on the subject matter, to the respective Chair of the Audit, Compensation, or Nominating and Governance Committee.

#### Code of Ethics

The Company adopted the Neonode Inc. Code of Business Conduct that applies to all officers, directors and employees. All of the Company's employees must carry out their duties in accordance with the policies set forth in the Code of Business Conduct and with applicable laws and regulations. The Code of Business Conduct contains a separate Code of Ethics that applies specifically to the Company's Chief Executive Officer and senior financial officers. The Code of Business Conduct and Code of Ethics is available on our website at [http://www.neonode.com/Documents/investor/business\\_code\\_of\\_conduct.pdf](http://www.neonode.com/Documents/investor/business_code_of_conduct.pdf). If the Company makes any substantive amendments to the Code of Business Conduct or grants any waiver from a provision of the Code to any executive officer or director, the Company will promptly disclose the nature of the amendment or waiver on its website.

#### Board's Role in Risk Oversight

The Board assesses on an ongoing basis the risks faced by the Company. These risks include financial, technological, competitive, and operational risks. The Board dedicates time at each of its meetings to review and consider the relevant risks faced by the Company at that time. In addition, the Audit Committee of the Board is responsible for the assessment and oversight of the Company's financial risk exposures.

#### ADDITIONAL INFORMATION - SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Exchange Act requires our directors and executive officers, and persons who own more than ten percent of a registered class of our equity securities, to file with the SEC initial reports of ownership and reports of changes in ownership of our common stock and other equity securities. Officers, directors and greater than ten percent stockholders are required by SEC regulation to furnish us with copies of all Section 16(a) forms they file.

To our knowledge, based solely on a review of the copies of such reports furnished to us and written representations that no other reports were required, during the fiscal year ended December 31, 2009, all Section 16(a) filing requirements applicable to our officers, directors and greater than ten percent beneficial owners were complied with.



## ITEM 11.

## EXECUTIVE COMPENSATION

The table below summarizes the total compensation paid to or earned by each of the named executive officers for the fiscal years ended December 31, 2009 and 2008:

## Summary Compensation Table

| Name and Principal Position                      | Year | Salary (\$) | Bonus (\$) | Stock Awards (\$)<br>(b) | Option or Warrant Awards (\$)<br>(a) | All Other Compensation (\$)<br>(c) | Total (\$) |
|--|------|-------------|------------|--------------------------|--------------------------------------|------------------------------------|------------|
| <b>Per Bystedt Chief Executive Officer</b>       |      |             |            |                          |                                      |                                    |            |
| (d)(e)   | 2009 | \$ 210,748  | -          | -                        | -                                    | -                                  | \$ 210,748 |
|  | 2008 | \$ 91,174   | -          | -                        | -                                    | -                                  | \$ 91,174  |
| <b>Thomas Eriksson(f)(g)</b>                     |      |             |            |                          |                                      |                                    |            |
|  | 2009 | \$ 216,417  | -          | -                        | -                                    | -                                  | \$ 216,417 |
| <b>Magnus Goertz(h)</b>                          |      |             |            |                          |                                      |                                    |            |
|  | 2009 | \$ 217,595  | -          | -                        | -                                    | -                                  | \$ 217,595 |
| <b>David W. Brunton, Chief Financial Officer</b> |      |             |            |                          |                                      |                                    |            |
|  | 2009 | \$ 85,000   | -          | -                        | \$ 77,934                            | -                                  | \$ 162,934 |
|  | 2008 | \$ 165,000  | -          | \$ 17,897                | \$ 144,120                           | \$ 1,040                           | \$ 328,057 |

- (a) Amounts are calculated as of the grant date of the option or warrant award in accordance with the provisions of applicable Accounting Standards. Please see Note 10. "Stock Based Compensation" in the Notes to the Consolidated Financial Statements as filed on Neonode Inc.'s annual report Form 10-K for the valuation assumptions made in the Black-Scholes option pricing used to calculate fair value of the option or warrant awards.
- (b) Amounts are the market value of common stock issued to Mr. Brunton under the pre-merger SBE, Inc. stock in-lieu of cash payroll plan that was implemented in 2007 as a cash preservation measure and the market value of common stock issued to Mr. Brunton in 2008 for payment of accrued vacation liability.
- (c) Includes \$1,040 attributable in fiscal 2008 to Mr. Brunton for premiums paid by the Company for group term life insurance.
- (d) Mr. Bystedt was appointed Chief Executive Officer in May 2008. He is a citizen of Sweden and is employed in Sweden and all payments to him are in Swedish Krona (SEK). The amounts in this table are displayed in U.S. Dollars (USD) and are converted from the SEK to USD using the average exchange rate for fiscal 2008 year 6.58 SEK to the USD. The Company accrued but did not pay 300,000 Krona (\$45,587 USD) salary for the first three months that Mr. Bystedt was employed as the CEO. Mr. Bystedt was paid 300,000 Kronor (\$45,587) of the amount owed to him for the next three months by the Swedish government pursuant to Swedish reconstruction laws. The accrued but unpaid balance of \$45,587 has not been paid and was forgiven in the Neonode AB bankruptcy.

- (e) Mr. Bystedt through his company, Iwo Jima SARL, entered into a consulting agreement with us whereby he has earned a total of \$210,748 salary plus applicable Swedish payroll taxes for his services as CEO of Neonode Inc. for the year ended December 31, 2009. As of December 31, 2009, \$159,000 is included in our accrued expenses. The amounts in this table are displayed in U.S. Dollars (USD) and are converted from the SEK to USD using the average exchange rate for fiscal 2009 year 7.65 SEK to the USD. Mr. Bystedt accrued a salary and applicable Swedish payroll taxes of 134,000 SEK per month.
- (f) On September 15, 2009, Mr. Eriksson was appointed to our Board. Mr. Eriksson serves as our Chief Executive Officer of Neonode Technologies AB and his compensation is related to his duties as CEO of this company. Mr. Eriksson does not receive any fees for his duties as a member of our Board.
- (g) Mr. Eriksson through his company, Wirelesstoys AB, entered into a consulting agreement with us whereby he has earned a total of \$216,417 for his services for the year ended December 31, 2009. We paid \$97,000 of the amount owed to Wirelesstoys AB during the year ended December 31, 2009 and \$119,000 is included in our accrued expenses at December 31, 2009. The amounts in this table are displayed in U.S. Dollars (USD) and are converted from the SEK to USD using the average exchange rate for fiscal 2009 year 7.65 SEK to the USD. Mr. Eriksson accrued a salary and applicable Swedish payroll taxes of 134,000 SEK per month.
- (h) Mr. Goertz through his company, Athemis Ltd., entered into a consulting agreement to perform duties as a lead engineer with us whereby he has earned a total of \$217,595 for his services for the year ended December 31, 2009. We paid \$71,000 of the amount owed to Athemis Ltd. during the year ended December 31, 2009 and \$147,000 is included in our accrued expenses at December 31, 2009. The amounts in this table are displayed in U.S. Dollars (USD) and are converted from the SEK to USD using the average exchange rate for fiscal 2009 year 7.65 SEK to the USD. Mr. Goertz accrued a salary and applicable Swedish payroll taxes of 134,000 SEK per month.

| Name & Principal Position | Grant Date    | Number of Securities Underlying Unexercised Options or Warrants (#) Exercisable | Number of Securities Underlying Unexercised Options (#) Unexercisable | OPTION AWARDS   |                            |                        |
|---------------------------|---------------|---|---|---|----------------------------|------------------------|
|                           |               |   |   | Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#) | Option Exercise price (\$) | Option Expiration Date |
| Per Bystedt, CEO          | 1/2/2008      | 40,000 (3)  | -   | -   | \$3.45                     | 1/2/2015               |
| David W. Brunton, CFO     | 4/12/2004     | 5,000   | -   | -   | \$22.25                    | 4/12/2011              |
|                           | 3/31/2005     | 20,000  | -   | -   | \$14.75                    | 8/8/2012               |
|                           | 3/21/2006     | 5,000   | -   | -   | \$5.00                     | 3/21/2013              |
|                           | 5/30/2007     | 15,000  | -   | -   | \$2.33                     | 5/30/2014              |
|                           | 8/10/2007     | 104,999   | 75,001 (1)  | -   | \$4.90                     | 8/10/2014              |
|                           | 8/25/2009 (2) | 4,000,000   | -   | -   | \$0.02                     | 8/25/2016              |

- (1) Stock Option Grants vest 25% on first anniversary date of grant and monthly thereafter for the next 36 months.
- (2) On August 25, 2009, Mr. Brunton was granted a warrant to purchase 4,000,000 shares of our common stock at an exercise price of \$0.02 per share. The warrant fully vested on the grant date.
- (3) Mr. Bystedt was granted 40,000 stock options that vested one year after the grant date for services as a member of our Board of Directors.

#### Employment Agreements and Change of Control Arrangements.

David W. Brunton

Change in Control Termination. If Mr. Brunton's employment terminates due to a Change in Control Termination, Mr. Brunton will be entitled to receive the following benefits:

1. Salary Continuation. Mr. Brunton shall continue to receive an amount equal to six (6) months of Base Salary. Such amount shall be paid in equal monthly installments over the six (6) months following Change in Control Termination and shall be subject to all required tax withholding.
2. Bonus Payment. Within fifteen (15) days following the last day of the fiscal quarter during which Change in Control Termination occurs. Mr. Brunton shall receive the pro-rata share of any bonus to which he would have been entitled had his employment with the Company continued. The bonus amount paid will be the product of the bonus percentage of Base Salary derived per his bonus plan multiplied by his Base Salary from the beginning of the Fiscal Year through the date of his Involuntary Termination Without Cause. Such payment shall be subject to all required tax withholding.
3. Acceleration of Option Vesting. Effective as of the date of Change in Control Termination, Mr. Brunton shall be credited with full vesting under all options to purchase the Company's Common Stock that he holds on such date.

Per Bystedt, Thomas Eriksson and Magnus Goertz

Employment Contract. Mr. Bystedt, Thomas Eriksson and Magnus Goertz each entered into employment contracts with Neonode Technologies AB on December 29, 2008, effective January 22, 2009 with a termination date of July 1, 2010, and are entitled to receive the following salary and benefits:

1. Salary - 100,000 SEK per month.
2. Vacation – 30 days per annum.
3. Notice period for resignation – 18 months.
4. Non- Competition agreement for one year after employment period ends.

## Compensation of Directors

Effective January 1, 2009, each non-employee director of the Company received an annual retainer of \$24,000, payable monthly in arrears. The annual retainer was reduced to \$12,000 per year effective June 1, 2009. The Chairman of the Board receives an annual retainer of \$30,000, payable monthly in arrears. No director is entitled to receive a per-meeting fee. The members of the Board are also eligible for reimbursement for their expenses incurred in attending Board meetings in accordance with Company policy. Mr. Olson resigned on June 1, 2009 and Ms. Major resigned on September 15, 2009. The Directors have not been paid their fees for the months of January through December 2009, except Mr. Reardon who was paid a total of \$4,000 for fees earned and accrued.

Effective January 2, 2008, on January 2 of each year (or the next business day if that date is a legal holiday), each non-employee director is automatically granted an additional option to purchase 40,000 shares of common stock of the Company. However, the Company did not grant the non-employee directors any stock options on January 2, 2009 or January 2, 2010. The exercise price of options granted is 100% of the fair market value of the common stock subject to the option on the date of the option grant. Options granted to Directors may not be exercised until the date upon which the optionee (or the affiliate of the optionee) has provided one year of continuous service as a non-employee director following the date of grant of such option, at which point 100% of the option becomes exercisable. The options will fully vest upon a change of control, unless the acquiring company assumes the options or substitutes similar options. The term of options granted is 10 years.

As of the date of this Form 10K, no options granted to directors had been exercised.

The table below summarizes the compensation paid by the Company to our Directors for the fiscal year ended December 31, 2009:

| Name(a)                  | Director Compensation                        |                         |   |   |  |  |           | Total<br>(\$) |
|--------------------------|--|-------------------------|---|---|--|--|-----------|---------------|
|                          | Fees<br>Earned or<br>Paid in<br>Cash<br>(\$) | Stock<br>Awards<br>(\$) | Option or<br>Warrant<br>Awards<br>(\$)<br>(b) | Non-Equity<br>Incentive<br>Plan<br>Compensation<br>(\$) | Nonqualified<br>Deferred<br>Compensation<br>Earnings | All Other<br>Compensation<br>(\$)<br>(h) |           |               |
| Susan Major<br>(c)(d)(g) | \$14,000                                     | -                       | \$38,967                                      | -   | -  | -  | \$52,967  |               |
| John Reardon<br>(c)(f)   | \$18,000                                     | -                       | \$97,418                                      | -   | -  | -  | \$115,418 |               |
| Kenneth<br>Olson (c) (e) | \$12,000                                     | -                       | -   | -   | -  | -  | \$12,000  |               |

- (a) All compensation paid to Per Bystedt and Thomas Eriksson is disclosed in the footnotes to the Summary Compensation Table. Neither Mr. Bystedt nor Mr. Eriksson receives any fees for serving on the Company's Board of Directors.
- (b) Amounts are calculated as of the grant date of the options award in accordance with the provisions of applicable Accounting Standards. Please see Note 10. "Stock Based Compensation" in the Notes to the Consolidated Financial Statements as filed on Neonode Inc.'s annual report Form 10-K for the valuation assumptions made in the Black-Scholes option pricing used to calculate fair value of the option or warrant awards.



(c) Ms. Major and Mr. Olson earned a fee equal to \$2,000 per month as a member of the Board of Directors. The amounts earned by each during the months January through June 2009 were accrued but will not be paid until such time that the Company earns sufficient cash flow from operations to make such payment. Ms. Major was paid a fee equal to \$1,000 per month as a member of the Board of Directors. The amounts earned by her for the months June through September 2009 were accrued but will not be paid until such time that the Company earns sufficient cash flow from operations to make such payment. A total of \$26,000 is accrued related to fees owed to Ms. Major at December 31, 2009. A total of \$20,000 is accrued related to fees owed to Mr. Olson at December 31, 2009. Mr. Reardon also earned a fee as a member of the Board of Directors. The amounts earned by him for the months January through June 2009 were \$2,000 per month, which was accrued but will not be paid until such time that the Company earns sufficient cash flow from operations to make such payment. Mr. Reardon was paid a fee equal to \$1,000 per month for the months June through December 2009 was paid a total of \$4,000 in cash for fees earned during 2009. A total of \$27,000 is accrued related to fees owed to Mr. Reardon at December 31, 2009.

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

The following table sets forth, as of March 31, 2010 certain information regarding the estimated ownership of our common stock assuming conversion of all issued and outstanding Series A and Series B Preferred Stock by: (i) each director; (ii) each of our “named executive officers,” as defined in Item 402 under Regulation S-K promulgated by the Securities and Exchange Commission; (iii) all executive officers and directors of Neonode as a group; and (iv) all those known by us to be beneficial owners of more than five percent of our common stock. Unless otherwise indicated, the address for each of the persons and entities set forth below is c/o Neonode Inc. - Stockholder address.

Percentage ownership is based on 824,329,488 shares, the estimated number of shares of common stock outstanding after the conversion of the Series A and B Preferred Stock and the conversion of the outstanding warrants and convertible debt.

| Beneficial Owner  | Beneficial Ownership (1) |                  |
|---|--------------------------|------------------|
|   | Number of Shares         | Percent of Total |
| Per Bystedt (2)(3)(4)<br>CEO and Director                       | 95,833,446               | 11.63 %          |
| Magnus Goertz<br>Founder  | 62,759,021               | 7.61 %           |
| Thomas Eriksson<br>CEO Neonode Technologies AB and Director     | 73,993,853               | 8.98 %           |
| David Brunton (2)(5)(6)<br>CFO                                  | 11,559,451               | 1.4 %            |
| John Reardon (2)(5)<br>Director                                 | 5,309,817                | 0.64 %           |
| All executive officers and directors as a group (5 persons) (2) | 249,455,588              | 30.26 %          |



This table is based upon information supplied by officers, directors and principal stockholders. Unless otherwise indicated in the footnotes to this table and subject to community property laws where applicable, we believe that each of the stockholders named in this table has sole voting and investment power with respect to the shares indicated as beneficially owned.

2. Includes, 40,000, 225,000 and 232,095 shares of common stock that Messrs. Bystedt, Brunton and Reardon, respectively, have the right to acquire within 60 days after the date of this table under outstanding stock options.

3. Includes 73,635,848 shares of common stock, 5,691,532 warrants to purchase shares of common stock at an exercise price of \$0.04 per share and \$218,052 of convertible debt that can be converted into 11,383,064 shares of common stock that is held by Iwo Jima SARL. Iwo Jima SARL may be deemed an affiliate of Mr. Bystedt.

4. Includes 1,694,325 warrants to purchase shares of common stock at an exercise price of \$0.04 per share and \$67,773 of convertible debt that can be converted into 3,388,650 shares of common stock that is held by Mr. Bystedt.

5. Includes 4,000,000 and 5,000,000 warrants to purchase shares of common stock at an exercise price of \$0.02 per share held by Messrs. Brunton and Reardon, respectively.

6. On December 31, 2008, Mr. Brunton purchased 14,564.22 shares of Series A Preferred Stock from the Neonode Technologies AB Stockholders, (Iwo Jima SARL, Wirelesstoys AB, and Athemis Ltd.), which shares have since been exchanged for 7,000,001 shares of our Common Stock.

The following table includes information regarding our equity incentive plans as of the end of fiscal 2009:

Equity Compensation Plan Information

| Plan category  | Number of securities to be issued upon exercise of outstanding options, warrants and rights<br>(a) | Weighted-average exercise price of outstanding options, warrants and rights<br>(b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))<br>(c) |
|--|--|--|--|
| Equity compensation plans approved by security holders     | 474,899  | \$ 4.19  | 157,554  |
| Equity compensation plans not approved by security holders | 192,511,338  | \$ 0.02  | --   |
| <b>Total</b>   | <b>192,886,237</b>   | <b>\$ 0.03</b>   | <b>157,554</b>   |

The following table details the outstanding options to purchase shares of our common stock pursuant to each plan at December 31, 2009:

| Plan            | Options Outstanding | Available for Issue | Outstanding Options Vested |
|-----------------|---------------------|---------------------|----------------------------|
| 1996 Plan       | 25,000              | ---                 | 25,000                     |
| 1998 Plan (1)   | 28,000              | ---                 | 28,000                     |
| Neonode Plan(2) | 176,595             | ---                 | 176,595                    |
| 2006 Plan       | 225,000             | 157,554             | 149,999                    |
| Director Plan   | 42,500              | ---                 | 42,500                     |
| <b>Total</b>    | <b>497,095</b>      | <b>157,554</b>      | <b>422,094</b>             |

(1) The 1998 Plan has not been approved by our shareholders.

(2) The 2007 Neonode Plan was assumed by Neonode upon the consummation of the August 2007 SBE Merger with Neonode.

#### Summary of 1998 Non-Officer Stock Option Plan

The purpose of the 1998 Non-officer Stock Option Plan is to provide a means by which eligible recipients of options may be given an opportunity to benefit from increases in value of our common stock through the granting of nonstatutory stock options. The plan permits the grant of nonstatutory stock options. Nonstatutory stock options may be granted under the 1998 Plan to our employees or consultants who are not, at the time of such grants, directors or officers. The administrator, in its discretion, selects the persons to whom options are granted, the time or times at which such options are granted, and the exercise price and number of shares subject to each such grant. We do not expect to issue any further options under the 1998 Plan.

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

Transactions with Per Bystedt

Mr. Per Bystedt, our Chairman of the Board and Chief Executive Officer is personally involved in our refinancing and capital raising activities. Mr. Bystedt is the beneficial holder of approximately 82.4 million shares of our common stock, or approximately 12%, of the Company's outstanding shares of common stock as of December 31, 2009 on a fully diluted basis, and is the beneficial owner of Iwo Jima SARL.

Iwo Jima SARL invested \$100,000 in the Company's December 2008 financing transaction and received 10,000 shares of our Series A Preferred stock that was exchanged for 4,806,300 shares of our Common Stock. Iwo Jima SARL also surrendered warrants in exchange for 7,210.96 shares Series B Preferred Stock. The Series B Preferred stock was exchanged for 952,351 shares of our Common Stock. Iwo Jima SARL was one of the three Neonode Technologies AB Stockholders which participated in the share exchange transaction with the Company pursuant to the Share Exchange Agreement on December 29, 2008. Iwo Jima SARL received 151,788.17 shares of our Series A Preferred Stock that was exchanged for 72,906,894 shares of our common Stock. On November 6, 2009, Iwo Jima SARL transferred 4,000,000 shares of our Common Stock to certain employees of the Company.

On September 15, 2009, Iwo Jima SARL purchased \$64,000 in convertible notes that may be converted, at the option of Iwo Jima SARL, into 3,215,450 shares of our Common Stock and also received a warrant that when exercised can be converted into 1,607,725 share of our Common Stock at a conversion price of \$0.04 per share. On September 15, 2009, Mr. Bystedt directly purchased \$51,000 in convertible notes that may be converted, at the option of Mr. Bystedt, into 2,569,150 shares of our Common Stock and also received a warrant that, when exercised, can be converted into 1,284,575 shares of our Common Stock at a conversion price of \$0.04 per share. Mr. Bystedt holds 40,000 employee stock options to purchase our common stock at \$3.45 per share.

On January 1, 2009, Mr. Bystedt through his company, Iwo Jima SARL, entered into a consulting agreement with us whereby he has earned a total of \$211,000 for his services as the CEO of Neonode Inc for the year ended December 31, 2009. As of December 31, 2009, \$159,445 is included in our accrued expenses.

Mr. Per Bystedt, our Chairman and Chief Executive Officer, and a company controlled by Mr. Bystedt invested a total of \$180,000 of the \$987,000 raised in the private placement financing transaction. Mr. Bystedt and a company controlled by Mr. Bystedt received a total of 4,493,557 warrants to purchase our common stock and the convertible notes can be converted into a total of 8,987,114 shares of our common stock. We are not obligated to register the common stock related to the convertible debt or the warrants.

On January 18, 2010, Mr. Bystedt purchased \$16,000 of convertible notes that may be converted into 819,500 shares of our Common Stock and also received a warrant that, when exercised, can be converted into 419,750 shares of our Common Stock at a conversion price of \$0.04 per share. In addition, Iwo Jima SARL, converted \$161,000 of amounts owed to Iwo Jima SARL for Mr. Bystedt's consulting services into convertible notes that may be converted into 8,167,614 shares of our Common Stock and also received a warrant that, when exercised, can be converted into 4,083,807 shares of our Common Stock at a conversion price of \$0.04 per share.

Transactions with Thomas Eriksson

Mr. Thomas Eriksson, Chief Executive Officer of our wholly owned subsidiary, Neonode Technologies AB and a member of our Board, is the beneficial holder of approximately 73.0 million shares of our common stock, or approximately 11% of our outstanding shares of common stock as of December 31, 2009 on a fully diluted basis, and

is the beneficial owner of Wirelesstoys AB, which company is one of the three Neonode Technologies AB Stockholders who participated in the share exchange transaction with the Company pursuant to the Share Exchange Agreement.

As part of the share exchange transaction, Wirelesstoys AB received 151,788.17 shares of our Series A Preferred Stock, which shares have since been exchanged for 72,906,894 shares of our common Stock.

On November 6, 2009, Wirelesstoys AB transferred 4,000,000 shares of our Common Stock to certain employees of the Company.

On January 1, 2009, Mr. Eriksson through his company, Wirelesstoys AB, entered into a consulting agreement with us whereby he has earned a total of \$216,000 for his services as the CEO of Neonode Technologies AB for the year ended December 31, 2009. We paid \$119,000 of the amount owed to Wirelesstoys AB during the year ended December 31, 2009 and \$97,000 is included in our accrued expenses at December 31, 2009.

#### Transactions with Magnus Goertz

Mr. Magnus Goertz, one of our founders, is the beneficial holder of approximately 62.8 million shares of our common stock, or approximately 9% of our outstanding shares of common stock as of December 31, 2009 on a fully diluted basis, and is the beneficial owner of Athemis Ltd., which company is one of the three Neonode Technologies AB Stockholders who participated in the share exchange transaction with the Company pursuant to the Share Exchange Agreement.

As part of the share exchange transaction, Athemis Ltd received 151,788.17 shares of our Series A Preferred Stock, which shares have since been exchanged for 72,906,894 shares of our common Stock.

On November 6, 2009, Athemis Ltd transferred 12,000,000 shares of our Common Stock to certain employees of the Company.

On January 1, 2009, Mr. Goertz, through his company, Rector AB, entered into a consulting agreement with us whereby he has earned a total of \$218,000 for his services and an engineer for the year ended December 31, 2009. We paid \$71,000 of the amount owed to Rector AB during the year ended December 31, 2009 and \$147,000 is included in our accrued expenses at December 31, 2009.

#### Transactions with Mats Dahlin

Mr. Mats Dahlin, a member of the Board of Directors of our wholly owned subsidiary, Neonode Technologies AB, is the beneficial owner of Davisa Ltd. On October 9, 2009 and December 15, 2009, Davisa Ltd purchased a total of \$50,000 in convertible notes that may be converted, at the option of Davisa Ltd, into 2,482,516 shares of our Common Stock and also received warrants that, when exercised, can be converted into 1,241,258 shares of our Common Stock at a conversion price of \$0.04 per share. On August 25, 2009, Davisa Ltd was granted a warrant to purchase 4,660,000 shares of our Common Stock at an exercise price of \$0.02 per share in consideration for Mr. Dahlin's services as a board member and advisor to the company. In June 2009, Mr. Dahlin, through his company, Davisa Ltd, entered into a consulting agreement with us whereby he earned a total of \$28,000 for his services for the year ended June 30, 2010. In lieu of a cash payment, On December 15, 2009, we converted the \$28,000 to a convertible note and a warrant under the same terms and conditions as the September 2009 convertible debt financing transaction. Davisa Ltd received a total of \$28,000 in convertible notes that may be converted, at the option of Davisa Ltd, into 1,400,000 shares of our Common Stock and also received warrants that, when exercised, can be converted into 700,000 shares of our Common Stock at a conversion price of \$0.04 per share. As of December 31, 2009, Mr. Dahlin is the beneficial owner of approximately 10.5 million shares of our common stock or approximately 1.5% of our outstanding shares of common stock on a fully diluted basis.

On March 21, 2010, we issued 875,000 shares of our common stock and a warrant to purchase 875,000 of our common stock an exercise price of \$0.04 per share to Davisa Ltd, a company controlled by Mr. Mats Dahlin, a member of the Board of Directors of Neonode Technologies AB, for services provided for the private placement of convertible note and warrant in the March 2010 financing transaction. On February 18, 2010, Davisa Ltd purchased a total of \$138,000 convertible notes that may be converted, at the option of Davisa Ltd, into 6,903,700 shares of our Common Stock and also received warrants that, when exercised, can be converted into 3,451,850 shares of our Common Stock at a conversion price of \$0.04 per share.



### Independence of the Board of Directors

The Board affirmatively determined that as of December 31, 2009, only John Reardon is an independent director within the meaning of the applicable NASDAQ listing standards. The Board has three committees: an Audit Committee, a Compensation Committee, and a Nominating and Governance Committee. John Reardon, Kenneth Olson and Susan Major, each independent director, constituted the members of each committee until the resignation of Kenneth Olson on June 1, 2009 and Susan Major on September 15, 2009. John Reardon remains an independent director and has been joined on each of the Board's committee by Per Bystedt and Thomas Eriksson.

### ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The Audit Committee of the Board has selected KMJ Corbin & Company LLP as our independent auditors for the fiscal year ended December 31, 2009 and BDO Feinstein International AB as our independent auditors for the fiscal year ended December 31, 2008. BDO Feinstein International AB audited our financial statements for the years 2006 through 2008.

#### Independent Registered Public Accounting Firm's Fees

The following table represents aggregate fees billed to us for fiscal years ended December 31, 2009, by KMJ Corbin & Company LLP, our principal accountant for 2009,

|                       | Fiscal Year Ended<br>(in thousands)<br>2009 |
|-----------------------|---|
| Audit Fees            | \$ 132                                      |
| Audit-related Fees(1) | -   |
| Tax Fees (2)          | -   |
| All Other Fees        | -   |
| <b>Total Fees</b>     | <b>\$ 132</b>                               |

(1) Fees paid for registration, proxy and review of other regulatory filings.

(2) Fees paid for preparation and filing of our federal and state income tax returns.

All fees described above were pre-approved by the Audit Committee. The Audit Committee has determined that the rendering of the foregoing services separate from the audit services by and KMJ Corbin & Company LLP are compatible with maintaining the principal accountant's independence.

#### Pre-Approval of Audit and Non-Audit Services

The Audit Committee has not approved any formal policy concerning pre-approval of the auditors to perform both audit and non-audit services (services other than audit, review and attest services). Instead, on a case by case basis, any audit or non-audit services proposed to be performed are considered by and, if deemed appropriate, approved by the Audit Committee in advance of the performance of such services. All of the fees earned by KMJ Corbin & Company LLP described above were attributable to services pre-approved by the Audit Committee.

## PART IV

## ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

## Financial Statements

The financial statements of the registrant are listed in the index to the financial statements and filed under Item 8 of this report.

## Financial Statement Schedule

Not applicable.

## Exhibits

| Exhibit # | Description  |
|-----------|--|
| 2.1       | Agreement and Plan of Merger and Reorganization between SBE, Inc. and Neonode Inc., dated January 19, 2007 (incorporated by reference to Exhibit 2.1 of our Current Report on Form 8-K filed on January 22, 2007 ) ( In accordance with Commission rules, we supplementally will furnish a copy of any omitted schedule to the Commission upon request ) |
| 2.2       | Amendment No. 1 to the Agreement and Plan of Merger and Reorganization between SBE, Inc. and Neonode Inc., dated May 18, 2007, effective May 25, 2007 ( incorporated by reference to Exhibit 2.1 of our Current Report on Form 8-K filed on May 29, 2007 )   |
| 3.1       | Amended and Restated Certificate of Incorporation of Neonode Inc., dated April 17, 2009 (incorporated by reference to Exhibit 10.22 of our Quarterly Report on Form 10-Q filed on August 4, 2009).   |
| 3.2       | Bylaws, as amended through December 5, 2007  |
| 4.1       | Certificate of Designations, Preferences and Rights of the Series A and Series B Preferred Stock dated 29 December 2008 (incorporated by reference as Exhibit 4.1 of our Current Report on Form 8-K filed on December 31, 2008 )   |
| 4.2       | Certificate of Increase of Designation of Series B Preferred Stock dated 2 January 2009  |
| 4.3       | Certificate of Increase of Designation of Series B Preferred Stock dated 28 January 2009   |
| 10.1      | Senior Secured Note, dated August 8, 2007 (incorporated by reference to Exhibit 10.22(a) of our Current Report on Form 8-K filed on October 2, 2007 )  |
| 10.2      | Amendment to Senior Secured Note, dated September 10, 2007 (incorporated by reference to Exhibit 10.22(b) of our Current Report on Form 8-K filed on October 2, 2007 )   |
| 10.3      | Form of Common Stock Purchase Warrant issued pursuant to Amendment to Senior Secured Notes, dated September 10, 2007 (incorporated by reference to Exhibit 10.22(c) of our Current Report on   |

Form 8-K filed on October 2, 2007 )

- 10.4 Subscription Agreement, dated September 10, 2007 (incorporated by reference to Exhibit 10.23 of our Current Report on Form 8-K filed on October 2, 2007 )
- 10.5 Convertible Promissory Note (incorporated by reference to Exhibit 10.24 of our Current Report on Form 8-K filed on October 2, 2007 )
- 10.6 Form of Common Stock Purchase Warrant (incorporated by reference to Exhibit 10.25 of our Current Report on Form 8-K filed on October 2, 2007 )
- 10.7 Form of Unit Purchase Warrant (incorporated by reference to Exhibit 10.26 of our Current Report on Form 8-K filed on October 2, 2007 )
- 10.8 Subscription Agreement, dated March 4, 2008 (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on March 3, 2008 )
- 10.11 1998 Non-Officer Stock Option Plan, as amended (incorporated by reference to Exhibit 99.2 of our Registration Statement on Form S-8 (333-63228) filed on June 18, 2001 )+
- 10.12 2001 Non-Employee Directors' Stock Option Plan, as amended (incorporated by reference to Exhibit 10.2 of our Annual Report on Form 10-K for the fiscal year ended October 31, 2002, as filed on January 27, 2003 )+
- 10.13 Director and Officer Bonus Plan, dated September 21, 2006 ( incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on September 26, 2006 )+
- 10.14 Executive Severance Benefits Agreement with David W. Brunton, dated April 12, 2004 (incorporated by reference to Exhibit 10.13 of our Quarterly Report on Form 10-Q for the period ended January 31, 2005, as filed on March 2, 2005 )+

|       |   |
|-------|---|
| 10.15 | Note Conversion Agreement, dated December 31, 2008 (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on December 31, 2008)             |
| 10.16 | Share Exchange Agreement, dated December 30, 2008 (incorporated by reference to Exhibit 10.4 of our Current Report on Form 8-K filed on December 31, 2008)              |
| 10.17 | Series A Stock Subscription Agreement, dated December 31, 2008 (incorporated by reference to Exhibit 10.3 of our Current Report on Form 8-K filed on December 31, 2008) |
| 10.18 | Warrant Conversion Agreement, dated December 31, 2008 (incorporated by reference to Exhibit 10.2 of our Current Report on Form 8-K filed on December 31, 2008 )         |
| 10.19 | Employment Agreement with Per Bystedt (incorporated by reference to Exhibit 10.19 to our Annual Report on Form 10-K filed on April 15, 2009)                            |
| 10.20 | Employment Agreement with Thomas Eriksson (incorporated by reference to Exhibit 10.20 to our Annual Report on Form 10-K filed on April 15, 2009)                        |
| 10.21 | Employment Agreement with Magnus Goertz (incorporated by reference to Exhibit 10.21 to our Annual Report on Form 10-K filed on April 15, 2009)                          |
| 10.22 | Convertible Note Agreement, dated September 9, 2009 (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on September 14, 2009 )          |
| 10.23 | Convertible Promissory Note (incorporated by reference to Exhibit 10.2 of our Current Report on Form 8-K filed on September 14, 2009 )                                  |
| 10.24 | Form of Common Stock Purchase Warrant (incorporated by reference to Exhibit 10.3 of our Current Report on Form 8-K filed on September 14, 2009 )                        |
| 10.25 | Convertible Note Agreement, dated January 18, 2010 (incorporated by reference to Exhibit 10.1 of our Current Report on Form 8-K filed on February 23, 2010 )            |
| 10.26 | Convertible Promissory Note (incorporated by reference to Exhibit 10.2 of our Current Report on Form 8-K filed on February 23, 2010 )                                   |
| 10.27 | Form of Common Stock Purchase Warrant (incorporated by reference to Exhibit 10.3 of our Current Report on Form 8-K filed on February 23, 2010 )                         |
| 21    | Subsidiaries of the registrant  |
| 23.1  | Consent of BDO Feinstein International AB, Independent Registered Public Accounting Firm  |
| 23.2  | Consent of KMJ Corbin & Company LLP, Independent Registered Public Accounting Firm  |
| 31.1  | Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act Of 2002  |
| 31.2  |   |

Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act Of 2002

32 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

+ Management contract or compensatory plan or arrangement

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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.

NEONODE INC.  
(Registrant)

Date: May 12, 2010

By: /s/ David W. Brunton  
David W. Brunton  
Chief Financial Officer,  
Vice President, Finance and  
Secretary

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each of the undersigned officers and directors of the registrant constitutes and appoints, jointly and severally, Per Bystedt and David W. Brunton, and each of them, as lawful attorneys-in-fact and agents for the undersigned and for each of them, each with full power of substitution and resubstitution, for and in the name, place and stead of each of the undersigned officers and directors, in any and all capacities, to sign any and all amendments to this report, and to file the same, with all exhibits thereto and all other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing necessary or appropriate to be done in and about the premises, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that each of said attorneys-in-fact or any of them, or any of their substitutes, may lawfully do or cause to be done by virtue hereof.

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

| Name                                     | Title   | Date           |
|--|---|----------------|
| /s/ Per Bystedt<br>Per Bystedt           | Chief Executive Officer,<br>and Director, Chairman of the Board<br>(Principal Executive Officer)                  | May 12, 2010   |
| /s/ David W. Brunton<br>David W. Brunton | Chief Financial Officer, Vice President, Finance<br>and Secretary<br>(Principal Financial and Accounting Officer) | May 12, 2010   |
| /s/ John Reardon<br>John Reardon         | Director  | May 12, 2010   |
| /s/ Thomas Eriksson<br>Thomas Eriksson   | Director  | March 12, 2010 |

SUBSIDIARIES OF THE REGISTRANT

| Name                    | Jurisdiction |
|-------------------------|--------------|
| Neonode Technologies AB | Sweden       |



