

Neonode, Inc
Form 10-Q
November 07, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

- Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2013
- Transition report pursuant to section 13 or 15(d) of the Securities and Exchange Act of 1934
For the transition period from _____ to _____

Commission file number 1-35526

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 No.)

2350 Mission College Blvd, Suite 190, Santa Clara, CA
95054 USA

(Address of principal executive offices and zip code)

(408) 496-6722

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or 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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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", "non-accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer Accelerated filer x
Non-accelerated filer Smaller reporting company o
(do not check if a smaller reporting company)

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

The number of shares of the registrant's common stock outstanding as of November 1, 2013, was 37,928,799.

NEONODE INC.

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PART I. Financial Information

Item 1. Financial Statements

NEONODE INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and per share amounts)

	September 30, 2013	December 31, 2012
	(Unaudited)	
ASSETS		
Current assets:		
Cash	\$ 10,568	\$ 9,097
Accounts receivable	1,085	2,123
Stock subscription receivable	286	--
Prepaid expenses and other current assets	1,010	550
Total current assets	12,949	11,770
Deposit	69	68
Property and equipment, net	365	330
Total assets	\$ 13,383	\$ 12,168
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 426	\$ 539
Accrued expenses	896	804
Deferred revenue	3,479	2,725
Total current liabilities	4,801	4,068
Total liabilities	4,801	4,068
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Series A Preferred stock, 444,541 shares authorized with par value \$0.001 per share; 0 and 83 shares issued and outstanding at September 30, 2013 and December 31, 2012, 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)	-	-
Series B Preferred stock, 54,425 shares authorized with par value \$0.001 per share; 83 and 95 shares issued and outstanding at September 30, 2013 and December 31, 2012, 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)	-	-
Common stock, 70,000,000 shares authorized with par value \$0.001 per share; 37,869,799 and 33,331,182 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	38	33
Additional paid-in capital	157,179	146,677
Accumulated other comprehensive income	13	5
Accumulated deficit	(148,648)	(138,615)
Total stockholders' equity	8,582	8,100
Total liabilities and stockholders' equity	\$ 13,383	\$ 12,168

See accompanying notes to condensed consolidated financial statements.

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

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net revenues	\$ 1,076	\$ 1,679	\$ 2,708	\$ 4,817
Cost of revenues	765	337	1,443	1,080
Gross margin	311	1,342	1,265	3,737
Operating expenses:				
Product research and development	2,211	1,451	5,286	3,616
Sales and marketing	406	920	2,104	3,437
General and administrative	972	1,086	3,813	3,772
Total operating expenses	3,589	3,457	11,203	10,825
Loss before provision for income taxes	(3,278)	(2,115)	(9,938)	(7,088)
Provision for income taxes	65	29	95	71
Net loss	\$ (3,343)	\$ (2,144)	\$ (10,033)	\$ (7,159)
Loss per common share:				
Basic and diluted loss per share	\$ (0.09)	\$ (0.06)	\$ (0.29)	\$ (0.22)
Basic and diluted – weighted average number of common shares outstanding	35,437	33,021	34,366	32,934

See accompanying notes to condensed consolidated financial statements.

NEONODE INC.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
 (In thousands)
 (Unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net loss	\$ (3,343)	\$ (2,144)	\$ (10,033)	\$ (7,159)
Other comprehensive income (loss):				
Foreign currency translation adjustments	(46)	67	8	39
Total comprehensive loss	\$ (3,389)	\$ (2,077)	\$ (10,025)	\$ (7,120)

See accompanying notes to condensed consolidated financial statements.

NEONODE INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)
(Unaudited)

	Nine months ended September 30,	
	2013	2012
Cash flows from operating activities:		
Net loss	\$ (10,033)	\$ (7,159)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	2,101	2,957
Depreciation and amortization	104	68
Loss on disposal of property and equipment	1	--
Changes in operating assets and liabilities:		
Accounts receivable	1,040	1,841
Prepaid expenses and other current assets	(458)	(135)
Accounts payable and accrued expenses	(32)	138
Deferred revenue	748	688
Net cash used in operating activities	(6,529)	(1,602)
Cash flows from investing activities:		
Purchase of property and equipment	(136)	(290)
Net cash used in investing activities	(136)	(290)
Cash flows from financing activities:		
Proceeds from issuance of common stock, net of offering costs	6,899	--
Proceeds from exercise of stock options	524	--
Proceeds from exercise of warrants	699	155
Net cash provided by financing activities	8,122	155
Effect of exchange rate changes on cash	14	43
Net increase (decrease) in cash	1,471	(1,694)
Cash at beginning of period	9,097	12,940
Cash at end of period	\$ 10,568	\$ 11,246
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest paid	\$ --	\$ --
Income taxes paid	\$ 95	\$ 71
Supplemental disclosure of non-cash investing and financing activities:		
Cashless exercise of warrants	\$ 3	\$ --
Stock subscription receivable	\$ 286	\$ --

See accompanying notes to condensed consolidated financial statements

NEONODE INC.
Notes to the Condensed Consolidated Financial Statements
(Unaudited)

1. Interim Period Reporting

The unaudited interim condensed consolidated financial statements, include all adjustments, consisting of normal recurring adjustments that are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations and cash flows for the interim periods presented. The results of operations for the three and nine months ended September 30, 2013 are not necessarily indicative of expected results for the full 2013 fiscal year.

The accompanying condensed consolidated financial statements as of September 30, 2013 and for the three and nine months ended September 30, 2013 and 2012 have been prepared by us, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally contained in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto contained in our annual report on Form 10-K for the fiscal year ended December 31, 2012.

Operations

Neonode Inc. (“we”, “us”, “our”, the “Company”), develops and licenses MultiSensing® user interfaces and optical multi-touch and proximity sensing solutions to Original Equipment Manufacturers (“OEMs”) and Original Design Manufacturers (“ODMs”) who embed the Neonode technology into devices that they produce and sell. The cornerstone of our offer is our patented touch technology zForce®.

2. Summary of Significant Accounting Policies

Fiscal Year

Our fiscal year is the calendar year.

Principles of Consolidation

The condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include the accounts of Neonode Inc. and its wholly owned subsidiaries. All inter-company accounts and transactions have been eliminated in consolidation.

The condensed consolidated statements of operations, and comprehensive loss for the three and nine months ended September 30, 2012 and consolidated statement of cash flows for the nine months ended September 30, 2012 include our accounts and those of our wholly owned subsidiary, Neonode Technologies AB (Sweden) (“NTAB”). All significant intercompany accounts and transactions have been eliminated.

The condensed consolidated balance sheet at September 30, 2013 and the condensed consolidated statements of operations, and comprehensive loss for the three and nine months ended September 30, 2013 and consolidated statements of cash flows for the nine months ended September 30, 2013 include our accounts and those of our wholly owned subsidiaries, NTAB, Neonode Americas Inc. (U.S.) (“NAI”), Neonode KK (Japan) (“NJK”), NEON Technology Inc. (U.S.) (“NTI”) and Neonode UI AB (Sweden) (“NUIAB”). All significant intercompany accounts and transactions have been eliminated.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires making estimates and assumptions that affect, at the date of the financial statements, the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities, and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from these estimates. Significant estimates include, but are not limited to, collectability of accounts receivable, recoverability of long-lived assets, the valuation allowance related to our deferred tax assets and the fair value of securities, such as options and warrants issued for stock-based compensation.

Cash

We have not had any liquid investments other than normal cash deposits with bank institutions to date. If in the future the Company purchases cash equivalents, the Company will consider all highly liquid investments with original maturities of three months or less to be cash equivalents.

Concentration of Cash Balance Risks

Cash balances are maintained at various banks in the U.S., Japan and Sweden. At times, deposits held with financial institutions in the United States of America may exceed the amount of insurance provided by the Federal Deposit Insurance Corporation ("FDIC"), which provides basic deposit coverage with limits up to \$250,000 per owner. The Swedish government provides insurance coverage up to 100,000 euro per customer and covers deposits in all types of accounts. The Japanese government provides insurance coverage up to 10,000,000 Yen per customer. As of September 30, 2013, the Company has approximately \$9.3 million in excess of insurance limits.

Accounts Receivable and Allowance for Doubtful Accounts

Our 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 collectability 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. We determined that an allowance for doubtful accounts was not necessary at September 30, 2013 or December 31, 2012.

Property and Equipment

Property 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 three to five years as follows:

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 or the term of the lease, whichever is shorter.

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. At September 30, 2013, 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 and Transaction Gains and Losses

The functional currency of our foreign subsidiaries is the applicable local currency, the Swedish Krona or the Japanese Yen. The translation from Swedish Krona or Japanese Yen 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. Foreign currency translation gain (loss) were \$(46,000) and \$67,000 for the three months ended September 30, 2013 and 2012, respectively, and were \$8,000 and \$39,000 for the nine months ended September 30, 2013 and 2012, respectively. Gains or losses resulting from translation are included

as a separate component of accumulated other comprehensive income (loss). Gains or (losses) resulting from foreign currency transactions are included in general and administrative expense in the accompanying condensed consolidated statements of operations. Foreign currency transaction gains (losses) were \$(33,000) and \$71,000 during the three months ended September 30, 2013 and 2012, respectively, and \$157,000 and \$82,000 during the nine months ended September 30, 2013 and 2012, respectively.

Concentration of Credit and Business Risks

Our accounts receivable as of September 30, 2013 was due from sixteen customers, one of which accounted for 31% of our accounts receivable as of September 30, 2013.

Our accounts receivable as of December 31, 2012 was due from fifteen customers, none of which accounted for more than 10% of our accounts receivable as of December 31, 2012.

Our net revenues for the three months ended September 30, 2013 were earned from fifteen customers. Our customers are located in North America, Europe and Asia. Customers who accounted for 10% or more of our net revenues during the three months ended September 30, 2013 are as follows:

Leap Frog Enterprises Inc. - 36%

Sony Corporation – 16%

Pro Point – 12%

Our net revenues for the nine months ended September 30, 2013 were earned from twenty-five customers. Our customers are located in North America, Europe and Asia. Customers who accounted for 10% or more of our net revenues during the nine months ended September 30, 2013 are as follows:

Kobo Inc. - 19%

Leap Frog Enterprises Inc. - 16%

Sony Corporation – 15%

Netronix Inc. – 14%

Our net revenues for the three months ended September 30, 2012 was earned from nine customers. Our customers are located in North America, Europe and Asia. Customers who accounted for 10% or more of our net revenues during the three months ended September 30, 2012 are as follows:

Amazon - 31%

Kobo Inc. - 27%

Sony Corporation. -18%

Barnes & Noble – 13%

Our net revenues for the nine months ended September 30, 2012 was earned from eighteen customers. Our customers are located in North America, Europe and Asia. Customers who accounted for 10% or more of our net revenues during the nine months ended September 30, 2012 are as follows:

Amazon - 46%

Kobo Inc. -16%

Sony Corporation – 14%

Revenue Recognition

Licensing Revenues:

We derive revenue from the licensing of internally developed intellectual property (“IP”). We enter into IP licensing agreements that generally provide licensees the right to incorporate our IP components in their products with terms and conditions that vary by licensee. The IP licensing agreements generally include a nonexclusive license for the underlying IP. Fees under these agreements may include license fees relating to our IP and royalties payable following the distribution 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. Neonode meets all the accounting requirements for revenue recognition as per unit royalty products are distributed or licensed by the Company’s

customers. For technology license arrangements that do not require significant modification or customization of the underlying technology, we recognize technology license revenue when: (1) we enter into a legally binding arrangement with a customer for the license of technology; (2) the customer distributes or licenses the products; (3) the customer payment is deemed fixed or determinable and free of contingencies or significant uncertainties; and (4) collection is reasonably assured. Our customers report to us the quantities of products distributed or licensed by them after the end of the reporting period stipulated in the contract, generally 30 to 45 days after the end of the month or quarter.

Explicit return rights are not offered to customers. There have been no returns through September 30, 2013.

Engineering Services:

We may sell engineering consulting services to our customers on a flat rate or hourly rate basis. We recognize revenue from these services when all of the following conditions are met: (1) evidence existed of an arrangement with the customer, typically consisting of a purchase order or contract; (2) our services were performed 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 has not been satisfied, we defer recognition of revenue. Generally, we recognize revenue as the engineering services stipulated under the contract are completed and accepted by our customers.

Deferred Revenue

From time-to-time the Company receives pre-payments from its customers related to future services or future license fee revenues. We defer the license fees until we have met all accounting requirements for revenue recognition as per unit royalty products are distributed or licensed by the Company's customers and the engineering development fee revenue until such time as the engineering work has been completed and accepted by our customers.

Advertising

Advertising costs are expensed as incurred. Advertising costs for the three and nine months ended September 30, 2013 and 2012 amounted to approximately \$31,000 and \$20,000, and \$160,000 and \$302,000, respectively.

Product 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 stock options, based on the fair value of the award on the grant date, and recognize the value 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. The measurement date for the fair value for the equity instruments issued is determined at the earlier of (i) the date at which a commitment for performance by the consultant or vendor is reached, or (ii) the date at which the consultant or vendor's performance is complete. In the case of equity instruments issued to consultants, the fair value of the equity instruments is primarily recognized over the term of the consulting agreement. The fair value of the stock-based compensation is periodically re-measured and expense is recognized during the vesting term.

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.

Income Taxes

We recognize deferred tax liabilities and assets for the expected future tax consequences of items that have been included in the consolidated 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 when, in our opinion, realization is uncertain based on the “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 September 30, 2013 and December 31, 2012. 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 determination was made. The provision for income taxes represents the net change in deferred tax amounts, plus income taxes paid or payable for the current period.

We follow 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 did not recognize a liability for unrecognized tax benefits. As of September 30, 2013 and December 31, 2012, 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 three and nine months ended September 30, 2013 and 2012 exclude the potential common stock equivalents, as the effect would be anti-dilutive (See Note 8).

Comprehensive Income (Loss)

Accounting Standards Codification (“ASC”) Topic 220, Comprehensive Income, establishes standards for reporting and displaying comprehensive income (loss) and its components in the condensed consolidated financial statements. Accumulated other comprehensive income (loss) includes foreign currency translation gains or losses as a result of consolidation.

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 and comprehensive loss was 6.55 and 6.67 Swedish Krona to one U.S. Dollar for the three months ended September 30, 2013 and 2012, respectively. The weighted-average exchange rate for the condensed consolidated statements of operations and comprehensive loss was 6.51 and 6.79 Swedish Krona to one U.S. Dollar for the nine months ended September 30, 2013 and 2012, respectively. The exchange rate for the condensed consolidated balance sheets was 6.43 and 6.52 Swedish Krona to one U.S. Dollar as of September 30, 2013 and December 31, 2012, respectively. The weighted-average exchange rate for the consolidated statement of operations and comprehensive loss was 98.88 and 96.63 Japanese Yen to one U.S. Dollar for the three and nine months ended September 30, 2013, respectively. The exchange rate for the consolidated balance sheet was 98.22 Japanese Yen to one U.S. Dollar as of September 30, 2013.

Recent Accounting Announcements

Proposed Amendments to Current Accounting Standards. The FASB is currently working on current amendments to existing accounting standards governing a number of areas including, but not limited to, revenue recognition and lease accounting.

In June 2010, FASB issued an exposure draft, Revenue from Contracts with Customers, which would supersede most of the existing guidance on revenue recognition in ASC Topic 605, Revenue Recognition. In November 2011, the FASB re-Exposed this draft and it expects a final standard to be issued in the first quarter of calendar 2014. As the standard-setting is still ongoing, the Company is unable to determine the impact this proposed change in accounting will have in the Company’s condensed consolidated financial statements at this time.

In August 2010, the FASB issued an exposure draft, Leases, which would result in significant changes to the accounting requirements for both leases and lessors in ASC Topic 840, Leases. In May 2013, the FASB re-exposed this draft and the comment period was closed in September 2013. As the standard-setting is still ongoing, the Company is unable to determine the impact this proposed change in accounting will have in the Company’s condensed consolidated financial statements at this time.

3. Stockholders’ Equity

On February 29, 2012, the Company filed a Certificate of Correction with the Secretary of State of Delaware effectively reducing the amount of its authorized shares from 848,000,000 shares of Common Stock and 2,000,000 shares of Preferred Stock to 70,000,000 shares of Common Stock and 1,000,000 shares of Preferred Stock. This correction reflects the new capital structure of the Company following its 1-for-25 reverse split that became effective at the close of business on March 25, 2011.

On May 1, 2012, the Company began trading its common stock on the NASDAQ Stock Market under trading symbol NEON.

Common Stock

During the nine months ended September 30, 2013, warrant holders (excluding our CEO, CFO and member of our Board of Directors) exercised warrants to purchase 1,815,369 shares of common stock using the cashless exercise provision allowed in the warrant and received 1,384,719 shares of our common stock. In addition, warrant holders exercised warrants to purchase 424,536 shares of common stock and paid a cash exercise price ranging between \$1.00 and \$3.13 per share for total cash proceeds of \$698,538.

On February 26, 2013, David Brunton, our CFO, exercised warrants to purchase 320,000 shares of common stock using the cashless exercise provision allowed in the warrant and received 266,228 shares of our common stock.

On August 12, 2013, Thomas Eriksson, our CEO, exercised warrants to purchase 400,000 shares of common stock using the cashless exercise provision allowed in the warrant and received 326,608 shares of our common stock.

On August 12, 2013, Per Bystedt, the Chairman of our Board of Directors (“Board”), exercised warrants to purchase 387,773 shares of common stock using the cashless exercise provision allowed in the warrant and received 316,624 shares of our common stock.

On August 12, 2013, Phenning Holdings Ltd, a company controlled by Per Bystedt, the Chairman of our Board, exercised warrants to purchase 227,661 shares of common stock using the cashless exercise provision allowed in the warrant and received 185,890 shares of our common stock.

On August 12, 2013, Davisa Ltd, a company controlled by Mats Dahlin, a member of our Board, exercised warrants to purchase 215,724 shares of common stock using the cashless exercise provision allowed in the warrant and received 176,143 shares of our common stock.

On August 12, 2013, John Reardon, a member of our Board, exercised warrants to purchase 80,000 shares of common stock using the cashless exercise provision allowed in the warrant and received 65,322 shares of our common stock.

On September 16, 2013, we issued 1,168,939 shares of our common stock to investors in connection with an equity financing transaction in which we raised approximately \$7.7 million and received approximately \$6.9 million in cash, net of direct offering costs including legal, audit and other regulatory costs of approximately \$0.8 million.

Preferred Stock

On March 21, 2013, Series A Preferred stockholders exchanged 83 shares of Series A Preferred stock for 39,790 shares of our common stock, eliminating all Series A Preferred shares outstanding.

On February 27, 2013, Series B Preferred stockholders exchanged 4 shares of Series B Preferred stock for 528 shares of our common stock.

On March 21, 2013, Series B Preferred stockholders exchanged 8 shares of Series B Preferred stock for 929 shares of our common 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 (see below). 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.

Conversion of Preferred Stock Issued to Common Stock

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 September 30, 2013.

	Shares of Preferred Stock Not Exchanged as of September 30, 2013	Conversion Ratio	Shares of Common Stock after Conversion of all Outstanding Shares of Preferred Stock Not yet Exchanged at September 30, 2013
Series B Preferred stock	83	132.07	10,962

4. Deferred Revenue

As of September 30, 2013 and December 31, 2012, we have \$2.5 million and \$2.1 million, respectively, of deferred license fee revenue related to prepayments for future license fees from three customers and a total of \$1.0 million and \$0.6 million, respectively, of deferred engineering development fees from seventeen and thirteen customers, respectively. We defer the license fees until we have met all accounting requirements for revenue recognition as per unit royalty products are distributed or licensed by the Company's customers and the engineering development fee revenue until such time as the engineering work has been completed and accepted by our customers.

5. Stock-Based Compensation

We have three 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 September 30, 2013, we had two equity incentive plans:

The 1998 Non-Officer Stock Option Plan (the 1998 Plan), which expired in June 2008 ;

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The 2006 Equity Incentive Plan (the 2006 Plan).

We also had one non-employee director stock option plan as of September 30, 2013:

The 2001 Non-Employee Director Stock Option Plan (the Director Plan), which expired in March 2011.

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

	Number of Options Outstanding	Weighted Average Exercise Price
Outstanding at January 1, 2013	1,715,200	\$ 5.04
Granted	130,000	6.12
Cancelled or expired	(18,256)	5.57
Exercised	(182,361)	4.44
Outstanding at September 30, 2013	1,644,583	\$ 5.18

On May 6, 2013, the Company's shareholders approved an increase of the number of common stock authorized for issuance as incentive stock options under the 2006 Plan by 2 million shares.

The aggregate intrinsic value of the 1,644,583 stock options that are outstanding, vested and expected to vest at September 30, 2013 is \$3.2 million.

During the nine months ended September 30, 2013, the Company received an aggregate of \$524,000 from four employees in connection with the exercise of stock options into 120,011 shares of common stock. During the nine months ended September 30, 2013, four option holders provided the Company with notice to exercise 62,350 stock options. The Company recorded a stock subscription receivable of \$286,000 as of September 30, 2013 related to the net proceeds in consideration for the exercise of the 62,350 stock options. The proceeds were received in October 2013. The intrinsic value of the options exercised was \$409,000 on the date of exercise.

We granted options to purchase 130,000 shares of our common stock to three employees during the nine months ended September 30, 2013 with an aggregate grant date fair value of \$682,500 computed using the Black-Scholes option pricing model. The options have a 7-year life and 1/3 of the options are vested on the one year anniversary date of grant with the remaining to vest monthly over the remaining 24-months.

During the three and nine months ended September 30, 2012, we granted 45,000 and 1,145,000 options to purchase shares of our common stock to employees and 0 and 360,000 options to purchase shares of our common stock to members of our Board. The options have a 7-year life and 1/3 of the options are vested on the date of grant with the remaining to vest monthly over the remaining 24-months.

For the three and nine months ended September 30, 2013, the Company recorded \$0.7 million and \$1.9 million, respectively, of compensation expense related to the vesting of stock options. For the three and nine months ended September 30, 2012, the Company recorded \$0.6 million and \$2.9 million, respectively, of compensation expense related to the vesting of stock options. The fair value of the stock-based compensation was calculated using the Black-Scholes option pricing model as of the date of grant of the stock option.

See below for assumptions used in the valuation of stock options:

	For the Nine Months Ended September 30, 2013
Annual dividend yield	--
Expected life (years)	4.3
Risk-free interest rate	0.65% - 1.33%
Expected volatility	135% - 154%
	For the Nine Months Ended September 30, 2012
Annual dividend yield	--
Expected life (years)	3.85
Risk-free interest rate	0.43% - 0.58%
Expected volatility	177% - 186%

The 1998 Plan terminated effective June 15, 2008 and the Director Plan terminated effective March 2011. 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 vested 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 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.

Warrants

During the nine months ended September 30, 2013, certain warrant holders exercised their warrants under the cash and cashless exercise provisions, as defined in the agreements. See Note 3 for details of such exercises and number of common stock shares issued.

On December 3, 2010, we issued 120,000 warrants at an exercise price of \$1.63 per share to an employee. The fair value of the warrants was \$198,000 on the date of grant, using the Black-Scholes option pricing model, which has been amortized to expense over 24 months. During the nine months ended September 30, 2012, we recorded \$25,000 of stock based compensation expense related to vesting of such warrants.

On September 12, 2011, we issued 20,000 three-year stock purchase warrants to an employee at an exercise price of \$3.90 per share with a vesting period over 24 months. The warrant granted to an employee had a fair value on the date of grant of \$75,000. This amount is expensed over the vesting period of which \$6,000 and \$25,000 and \$9,000 and \$28,000 of expense related to this warrant is included in product research and development expense for the three and nine months ended September 30, 2013 and 2012, respectively. The fair value of stock-based compensation related to the issuance of warrants is calculated using the Black-Scholes option pricing model as of the grant date of the underlying warrant.

On April 4, 2013, we extended a 40,000 stock purchase warrant with an exercise price of \$1.00 per share that expired on January 28, 2013 that was issued to an investor in a previous convertible debt financing. The fair value of the warrant was \$166,000 on the date of grant, using the Black-Scholes option pricing model, which has been expensed during the nine months ended September 30, 2013. The warrant holder exercised the warrant on April 4, 2013 and the Company received cash proceeds of \$40,000 (see Note 3).

The stock-based compensation expense for the three and nine months ended September 30, 2013 and 2012 reflects the fair value of the vested portion of options and warrants granted to directors, employees and non-employees. Stock-based compensation expense in the accompanying consolidated statements of operations is as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Product research and development	\$ 69	\$ 73	\$ 187	\$ 260
Sales and marketing	\$ 364	250	749	1,200
General and administrative	\$ 329	284	1,165	1,497
Stock compensation expense	\$ 762	\$ 607	\$ 2,101	\$ 2,957
			Remaining unamortized expense at September 30, 2013	
Stock-based compensation		\$ 2,242		

The remaining unamortized expense related to stock options will be recognized on a straight line basis monthly as compensation expense over the remaining vesting period which approximates 1.6 years.

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 option pricing 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.

A summary of all warrant activity is set forth below:

		September 30, 2013	
	Warrants	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life
Outstanding and exercisable January 1, 2013	4,704,636	\$ 1.61	1.41

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Issued	--	--	--
Expired/forfeited	--	--	--
Exercised	(3,871,063)	1.45	--
Outstanding and exercisable, September 30, 2013	833,573	\$ 2.40	2.31

Below is a summary of Outstanding Warrants to Purchase
Common Stock as of September 30, 2013:

Description	Issue Date	Exercise Price	Shares	Expiration Date
August 2009 Employee Warrants	8/25/2009	\$ 0.50	80,000	8/25/2016
2007 Debt Extension Warrants	9/22/2010	\$ 1.00	16,000	9/22/2015
December 2010 Employee Warrants	12/3/2010	\$ 1.63	200,000	12/3/2015
January 2011 Employee Warrant	1/21/2011	\$ 2.00	7,000	1/21/2014
February 2011 Legal Advisor Warrant	2/22/2011	\$ 2.50	80,000	2/22/2016
March 2011 Investor Warrants	3/9/2011	\$ 3.13	376,473	3/9/2016
March 2011 Investor Warrants	4/7/2011	\$ 3.13	34,100	4/7/2016
May 2011 Consultant Warrant	5/17/2011	\$ 4.05	20,000	5/17/2014
September 2011 Employee Warrant	9/12/2011	\$ 3.90	20,000	9/12/2014
Total Warrants Outstanding			833,573	

6. Commitments and Contingencies

Non-Recurring Engineering Development Costs

Neonode and Texas Instruments Inc. (“TI”) entered into an Analog Device Development Agreement (“2010 TI Agreement”) on January 24, 2010 where TI integrated Neonode’s intellectual property into an Application Specific Integrated Circuit (“ASIC”) developed by TI. The TI ASIC is designated as NN1001 and can be sold by TI exclusively to licensees of Neonode. Under the terms of the 2010 TI Agreement, Neonode is obligated to contribute \$500,000 of non-recurring engineering development costs (“NRE”) to TI based on shipments of the NN1001. Neonode will contribute to TI the NRE as follows:

For each of the first one million units sold: \$0.08 per unit.

For the next eight million units sold: \$0.05 per unit.

In the three and nine months ended September 30, 2013, \$74,000 and \$344,000, respectively, of NRE expense related to this agreement is included in product research and development in the condensed consolidated statement of operations. Through September 30, 2013, the Company has made total payments of \$344,000 under the 2010 TI Agreement. No amounts were recorded in the three and nine months ended September 30, 2012 as no shipments of NN1001 took place.

Neonode and TI entered into an additional Analog Device Development Agreement (“2013 TI Agreement”) on April 25, 2013 where TI will integrate Neonode’s intellectual property into an ASIC developed by TI. The TI ASIC is designated as NN1002 and can be sold by TI exclusively to licensees of Neonode. Under the terms of the 2013 TI Agreement, Neonode is obligated to contribute \$500,000 of NRE to TI based on shipments of the NN1002. The NN1002 is currently in development and has not been released to mass production.

When the NN1002 is released in the future to mass production, Neonode will contribute to TI the NRE fee of \$0.25 per unit for each of the first two million units sold.

Operating Leases

NTAB has a lease with Vasakronan Fastigheter AB for 2,723 square feet of office space located at Linnegatan 89D, Stockholm, Sweden for approximately \$8,000 per month including property tax (excluding VAT). The annual payment for this space equates to approximately \$93,000 per year including property tax (excluding VAT). This lease is valid thru December 31, 2014, with a nine month notice period. On September 12, 2013, the Company entered into a sublease agreement with Goo Technologies AB (“Goo”) for this office space. Goo will pay monthly sublease payment of approximately \$9,700 to the Company until December 31, 2014.

On April 15, 2012, NTAB entered into a lease with No Picnic for 2,853 square feet of office space located at Storgatan 23C, Stockholm, Sweden for approximately \$14,000 per month including property tax (excluding VAT). The annual payment for this space equates to approximately \$174,000 per year including property tax (excluding VAT). This lease was valid through April 15, 2013. On April 16, 2013, this lease was extended for one year until April 15, 2014 under the same terms and conditions. Rent remained at approximately \$14,000 per month including property tax (excluding VAT). This lease was terminated on July 1, 2013.

On March 22, 2012, we entered into a three year lease with 2350 Mission Investors LLC for 3,185 square feet of office space located at 2350 Mission College Blvd, Suite 190, Santa Clara, CA 95054 USA. The initial lease payment is \$7,007 per month, increasing to \$7,657 per month over the term of the lease. This lease is valid through July 31, 2015. The annual payment for this space equates to approximately \$86,000 per year.

On October 12, 2012, we entered into a two year lease with Space Design Inc., Meiko Building 3F, 1-18-2 Shimbashi, Minato-ku, 105-0004 Tokyo for office space located at 608 Bureau Shinagawa, 4-1-6 Konan, Minato-ku, 108-0075 Tokyo, Japan. The lease payment is approximately \$3,000 per month. This lease is valid through October 12, 2014. The annual payment for this space equates to approximately \$36,000 per year.

On July 1, 2013, NTAB entered into a lease with No Picnic for 5,480 square feet of office space located at Storgatan 23C, Stockholm, Sweden for approximately \$38,000 per month including property tax (excluding VAT). The annual payment for this space equates to approximately \$458,000 per year including property tax (excluding VAT). This lease is valid through June 30, 2014. The lease can be extended on a yearly basis with three months written notice.

For the nine months ended September 30, 2013 and 2012, the Company recorded approximately \$399,000 and \$235,000, respectively, for rent expense.

A summary of future minimum payments under non-cancellable operating lease commitments as of September 30, 2013 is as follows (in thousands):

Year ending December 31,	Total
2013 (remaining three months)	\$ 140
2014	319
2015	53
	\$ 512

7. Segment Information

The Company has one reportable segment, which is comprised of the touchscreen technology licensing business. All of our sales for the three and nine months ended September 30, 2013 and 2012 were to customers located in the North America, Europe and Asia.

The following table presents net revenues by geographic region for the three and nine months ended September 30, 2013 and 2012 (dollars in thousands):

	Three months ended September 30, 2013		Three months ended September 30, 2012	
	Amount	Percentage	Amount	Percentage
Net revenues from customers in North America	\$ 459	43%	\$ 877	52%
Net revenues from customers in Asia	420	39%	802	48%
Net revenues from customers in Europe	197	18%	--	--
	\$ 1,076	100%	\$ 1,679	100%
	Nine months ended September 30, 2013		Nine months ended September 30, 2012	

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	Amount	Percentage	Amount	Percentage
Net revenues from customers in North America	\$ 1,208	45%	\$ 2,809	58%
Net revenues from customers in Asia	1,193	44%	2,008	42%
Net revenues from customers in Europe	307	11%	--	--
	\$ 2,708	100%	\$ 4,817	100%

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8. Net Loss Per Share

Basic net loss per common share for the three and nine months ended September 30, 2013 and 2012 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 413,000 and 103,000 stock options outstanding under the treasury stock method, 0.5 million and 3.2 million outstanding stock warrants under the treasury stock method and 11,000 and 52,000 shares issuable upon conversion of preferred stock are excluded from the diluted earnings per share calculation for the nine months ended September 30, 2013 and 2012, respectively, due to their anti-dilutive effect.

(in thousands, except per share amounts)	Three Months ended September 30,	
	2013	2012
BASIC AND DILUTED		
Weighted average number of common shares outstanding	35,437	33,021
Number of shares for computation of net loss per share	35,437	33,021
Net loss	\$ (3,343)	\$ (2,144)
Net loss per share - basic and diluted	\$ (0.09)	\$ (0.06)

(in thousands, except per share amounts)	Nine Months ended September 30,	
	2013	2012
BASIC AND DILUTED		
Weighted average number of common shares outstanding	34,366	32,934
Number of shares for computation of net loss per share	34,366	32,934
Net loss	\$ (10,033)	\$ (7,159)
Net loss per share - basic and diluted	\$ (0.29)	\$ (0.22)

9. Subsequent Events

We have evaluated subsequent events through the filing date of this Form 10-Q, and have determined that no subsequent events have occurred that would require recognition in the condensed consolidated financial statements or disclosure in the notes thereto.

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

Forward Looking Statements

This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, adopted pursuant to the Private Securities Litigation Reform Act of 1995. Statements that are not purely historical may be forward-looking. You can identify some forward-looking statements by the use of words such as "believes," "anticipates," "expects," "intends" and similar expressions. Forward-looking statements involve inherent risks and uncertainties regarding events, conditions and financial trends that may affect our future plans of operation, business strategy, results of operations and financial position. A number of important factors could cause actual results to differ materially from those included within or contemplated by such forward-looking statements, including, but not limited to 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 and our dependence on a limited number of customers, 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, For a discussion of these and other factors that could cause actual results to differ from those contemplated in the forward-looking statements, please see the discussion under "Risk Factors" contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 and in our publicly available filings with the Securities and Exchange Commission. Forward-looking statements reflect our analysis only as of the date hereof. Actual events or results may differ materially from the results discussed in or implied by the forward-looking statements. We do not undertake any responsibility to update or revise any of these factors or to announce publicly any revisions to forward-looking statements, whether as a result of new information, future events or otherwise.

The following management's discussion and analysis of the Company's financial condition and results of the operations should be read in conjunction with the condensed consolidated financial statements and the notes thereto included in Item 1 of this Quarterly Report on Form 10-Q and consolidated financial statements and notes thereto as of December 31, 2012 and 2011 and for the years then ended included in our Annual Report on Form 10-K.

Overview

Neonode develops and licenses MultiSensing® user interfaces and optical multi-touch and proximity sensing solutions. Based on zForce®, our patented touch technology, Neonode has developed a variety of features that sense an object's size, its pressure on a surface, its depth, its velocity and its proximity to any type of surface. Neonode licenses MultiSensing touch technology to Original Equipment Manufacturers ("OEMs") and Original Design Manufacturers ("ODMs") who embed our technology into devices that they produce and sell. Our technology licensing model allows us to focus on the development of solutions for multi-touch enabled screens, and thus we do not manufacture products or components. We license the right to use zForce and Neonode MultiSensing software which, together with standard components from partners, create an optical touch solution.

During the three and nine months ended September 30, 2013, we had eight and twelve customers, respectively, using our touchscreen technology in products that were shipping to customers. We had an additional fifteen customers with signed license agreements currently in the product development stage. 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 our technology license agreements.

As of September 30, 2013, we have signed thirty-three technology license agreements with global OEMs. Twelve of our customers are currently shipping products and we anticipate others will initiate product shipments as they complete their final product development and manufacturing cycle throughout the remainder of 2013 and 2014. In addition, we are currently developing prototype products and are engaged in product engineering design discussions with numerous global OEMs who are in the process of qualifying our touchscreen technology for incorporation in various products such as laptop Microsoft Windows 8 and Google Chrome computers, printer products, GPS devices, e-Readers, tablets, touch panels for automobiles, household appliances, mobile phones, wearable electronics and games and toys. The development and product release cycle for these products typically takes six to eighteen months.

Neonode management has made several strategic decisions to establish the Company's presence in international markets to provide access to tier one customers and demonstrate Neonode's long term commitment to these markets. Neonode KK (Japan) ("NJK"), was created in January 2013 to reach out to customers with global reach in electronics, automotive and home appliance markets. Neonode UI AB (Sweden) ("NUIAB") was created to address particular opportunities that exist in this significant user interface arena as some aspects of our technology lends itself to ease of interacting with electronic devices. NEON Technology Inc. (U.S.) and Neonode Americas Inc. (U.S.) ("NAI") were established to create a more focused organization with specific marketing, research and development goals. Furthermore, by creating separate entities, their performances can be directed and observed more clearly.

On September 3, 2013, we announced that our Board of Directors has authorized the exploration of strategic alternatives with respect to our user-interface patent and licensing subsidiary. This unit's intellectual property portfolio principally relates to user-interface gestures utilized in a touchscreen. The Board intends to consider a broad range of alternatives including, but not limited to, a merger, sale, or spin-off. There can be no assurance that the Board's evaluation process will result in any transaction, or that any transaction, if pursued, will be consummated.

Results of Operations

Net Revenues

Net revenues for the three and nine months ended September 30, 2013 was \$1.1 million and \$2.7 million, respectively, compared to net revenue for the three and nine months ended September 30, 2012 of \$1.7 million and \$4.8 million, respectively. Our net revenues for the three and nine months ended September 30, 2013 included \$0.9 million and \$2.1 million, respectively, from license fees and \$0.2 million and \$0.6 million, respectively, in fees for engineering design services related to our touch screen solution for customers. Our net revenues for the three and nine months ended September 30, 2012 included \$1.6 million and \$4.1 million, respectively, from license fees and \$0.1 million and \$0.7 million, respectively, in fees for engineering design services related to our touch screen solution for customers.

The decrease in overall net revenues in the three and nine months ended September 30, 2013 compared to the same periods in 2012 is primarily due to a decrease in license fees primarily from Amazon when they did not include our technology in the Kindle Paperwhite eReader. Amazon contributed approximately forty-six percent of our total net revenues during the nine months ended September 30, 2012 compared to less than 1% in the nine months ended September 30, 2013. The decrease in net revenues earned from Amazon was partially offset by an increase in net revenues earned from Kobo Inc., Leap Frog Enterprises Inc. and Netronix Inc.

Gross Margin

Gross margin was \$0.3 million and \$1.3 million for the three and nine months ended September 30, 2013, respectively, compared to \$1.3 million and \$3.7 million for the same periods in 2012. Our cost of revenues includes the direct cost of production of certain customer prototypes, costs of Company employed engineering personnel and engineering consultants to complete the engineering design contract. Our gross margin decreased due to the decrease in our total revenues particularly our license fee revenue. The gross margin related to our license fees is 100% and when license fees as a percentage of our total revenues decrease our gross margin will decrease.

Product Research and Development

Product research and development (“R&D”) expenses for the three and nine months ended September 30, 2013 were \$2.2 million and \$5.3 million, respectively, compared to \$1.5 million and \$3.6 million, for the same periods in 2012. R&D costs mainly consist of personnel related costs in addition to some external consultancy costs such as testing, certifying and measurements. Factors that contributed to the increase in R&D costs include an increase in the amount of time our engineering department spends engaged in R&D activities. Included in R&D expenses is \$69,000 and \$187,000 of non-cash stock option and warrant expense for the three and nine months ended September 30, 2013, respectively, compared to \$73,000 and \$260,000, for the same periods in 2012. Other costs related to customer specific activities are included in our cost of revenue.

Sales and Marketing

Sales and marketing (“S&M”) expenses for the three and nine months ended September 30, 2013 were \$0.4 million and \$2.1 million, respectively, compared to \$0.9 million and \$3.4 million, respectively, for the same periods in 2012. This decrease in 2013 as compared to 2012 is primarily related to a decrease in salaries, marketing activities, travel and stock-based compensation related costs. Total marketing related expense decreased to \$31,000 and \$160,000 for the three and nine months ended September 30, 2013 respectively, compared to \$20,000 and \$302,000, respectively, for the same periods in 2012. Included in S&M expenses is \$364,000 and \$749,000 of non-cash stock-based compensation expense for the three and nine months ended September 30, 2013, respectively, compared to \$250,000 and \$1.2 million for the same periods in 2012.

General and Administrative

General and administrative (“G&A”) expenses for the three and nine months ended September 30, 2013 were \$1.0 million and \$3.8 million, respectively, compared to \$1.1 million and \$3.8 million, respectively, for the same periods in 2012. This slight decrease in 2013 as compared to 2012 is primarily related to a slight decrease in salary expense, legal expenses related to patent filings, corporate and SEC compliance and customer contracts. The decrease in G&A was also related a decrease in non-cash stock option and warrant expense for the three and nine months ended September 30, 2013. Included in G&A expenses is \$329,000 and \$1.2 million of non-cash stock option and warrant expense for the three and nine months ended September 30, 2013 compared to \$284,000 and \$1.5 million, respectively, for the same periods in 2012.

Income Taxes

Our tax provision for the three and nine months ended September 30, 2013 and 2012 represents income taxes withheld by one of our foreign customers. We recorded valuation allowances for the three and nine months ended September 30, 2013 and 2012 for deferred tax assets related to net operating losses due to the uncertainty of realization. In the event of future taxable income, our effective income tax rate in future periods could be lower than the statutory rate as such tax assets are realized.

Net Loss

As a result of the factors discussed above, we recorded a net loss of \$3.3 million and \$10.0 million for the three and nine months ended September 30, 2013, respectively, compared to a net loss of \$2.1 million and \$7.2 million in the comparable periods in 2012.

Off-Balance Sheet Arrangements

We do not have any transactions, arrangements, or other relationships with unconsolidated entities that are reasonably likely to affect our liquidity or capital resources other than the operating leases noted in Note 6 of the accompanying condensed consolidated financial statements. We have no special purpose or limited purpose entities that provide off-balance sheet financing, liquidity, or market or credit risk support; or engage in leasing, hedging, research and development services, or other relationships that expose us to liability that is not reflected on the face of the condensed consolidated financial statements.

Contractual Obligations and Commercial Commitments

Non-Recurring Engineering Development Costs

Neonode and Texas Instruments Inc. (“TI”) entered into an Analog Device Development Agreement (“2010 TI Agreement”) on January 24, 2010 where TI integrated Neonode’s intellectual property into an Application Specific Integrated Circuit (“ASIC”) developed by TI. The TI ASIC is designated as NN1001 and can be sold by TI exclusively to licensees of Neonode. Under the terms of the 2010 TI Agreement, Neonode is obligated to contribute \$500,000 of non-recurring engineering development costs (“NRE”) to TI based on shipments of the NN1001. Neonode will contribute to TI the NRE as follows:

For each of the first one million units sold: \$0.08 per unit.

For the next eight million units sold: \$0.05 per unit.

In the three and nine months ended September 30, 2013, \$74,000 and \$344,000, respectively, of NRE expense related to this agreement is included in product research and development in the condensed consolidated statement of operations. Through September 30, 2013, the Company has made total payments of \$344,000 under the 2010 TI Agreement. No amounts were recorded in the three and nine months ended September 30, 2012 as no shipments of NN1001 took place.

Neonode and TI entered into an additional Analog Device Development Agreement (“2013 TI Agreement”) on April 25, 2013 where TI will integrate Neonode’s intellectual property into an ASIC developed by TI. The TI ASIC is designated as NN1002 and can be sold by TI exclusively to licensees of Neonode. Under the terms of the 2013 TI Agreement, Neonode is obligated to contribute \$500,000 of NRE to TI based on shipments of the NN1002. The NN1002 is currently in development and has not been released to mass production.

When the NN1002 is released in the future to mass production, Neonode will contribute to TI the NRE fee of \$0.25 per unit for each of the first two million units sold.

Operating Leases

NTAB has a lease with Vasakronan Fastigheter AB for 2,723 square feet of office space located at Linnegatan 89D, Stockholm, Sweden for approximately \$8,000 per month including property tax (excluding VAT). The annual payment for this space equates to approximately \$93,000 per year including property tax (excluding VAT). This lease is valid thru December 31, 2014, with a nine month notice period. On September 12, 2013, the Company entered into a sublease agreement with Goo Technologies AB (“Goo”) for this office space. Goo will pay monthly sublease payment of approximately \$9,700 to the Company until December 31, 2014.

On April 15, 2012, NTAB entered into a lease with No Picnic for 2,853 square feet of office space located at Storgatan 23C, Stockholm, Sweden for approximately \$14,000 per month including property tax (excluding VAT).

The annual payment for this space equates to approximately \$174,000 per year including property tax (excluding VAT). This lease was valid through April 15, 2013. On April 16, 2013, this lease was extended for one year until April 15, 2014 under the same terms and conditions. Rent remained at approximately \$14,000 per month including property tax (excluding VAT). This lease was terminated on July 1, 2013.

On March 22, 2012, we entered into a three year lease with 2350 Mission Investors LLC for 3,185 square feet of office space located at 2350 Mission College Blvd, Suite 190, Santa Clara, CA 95054 USA. The initial lease payment is \$7,007 per month, increasing to \$7,657 per month over the term of the lease. This lease is valid through July 31, 2015. The annual payment for this space equates to approximately \$86,000 per year.

On October 12, 2012, we entered into a two year lease with Space Design Inc., Meiko Building 3F, 1-18-2 Shimbashi, Minato-ku, 105-0004 Tokyo for office space located at 608 Bureau Shinagawa, 4-1-6 Konan, Minato-ku, 108-0075 Tokyo, Japan. The lease payment is approximately \$3,000 per month. This lease is valid through October 12, 2014. The annual payment for this space equates to approximately \$36,000 per year.

On July 1, 2013, NTAB entered into a lease with No Picnic for 5,480 square feet of office space located at Storgatan 23C, Stockholm, Sweden for approximately \$38,000 per month including property tax (excluding VAT). The annual payment for this space equates to approximately \$458,000 per year including property tax (excluding VAT). This lease is valid through June 30, 2014. The lease can be extended on a yearly basis with three months written notice.

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.

At September 30, 2013, we had cash of \$10.6 million, as compared to \$9.1 million at December 31, 2012.

Working capital (current assets less current liabilities) was \$8.1 million at September 30, 2013, compared to working capital of \$7.7 million at December 31, 2012.

Net cash used in operating activities for the nine months ended September 30, 2013 was \$6.5 million and was primarily the result of (i) a net loss of approximately \$10.0 million and (ii) approximately \$1.3 million in net cash provided by changes in operating assets and liabilities, primarily accounts receivable. Cash used to fund net losses is reduced by approximately \$2.2 million in non-cash operating expenses, comprised of depreciation and amortization and stock-based compensation.

Accounts receivable decreased approximately \$1.0 million at September 30, 2013 compared with December 31, 2012, primarily as a result of an increase in net revenues from approximately \$2.3 million in the fourth quarter of 2012 compared to approximately \$2.7 million in the first nine months of 2013 combined with successful collection of cash from net revenues earned from our customers in accordance with our standard payment terms.

Deferred revenue increased approximately \$0.7 million during the nine months ended September 30, 2013 compared with December 31, 2012, primarily as a result of additional license technology agreements and engineering projects entered into during the nine months ended September 30, 2013.

In the nine months ended September 30, 2013, we purchased \$136,000 of property and equipment, primarily computers and test equipment.

Net cash provided by financing activities was the result of net proceeds of \$1.2 million received in connection with the exercise of stock options and warrants for shares of our common stock during the nine months ended September 30, 2013. In addition, on September 16, 2013, we issued 1,168,939 shares of our common stock to investors in connection with an equity financing transaction in which we raised approximately \$7.7 million and received approximately \$6.9 million in cash, net of direct selling costs including legal, audit and other regulatory costs of approximately \$0.8 million.

In the future, we may require sources of capital in addition to cash on hand to continue operations and to implement our strategy. If our operations do not become cash flow positive, 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.

The functional currency of our foreign subsidiaries in Sweden is the Swedish Krona and in Japan is the Japanese Yen. They are 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 or Japanese Yen will impact Neonode's future operating results.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to risks associated with changes in currency exchange rates. All of our revenue and approximately 51% of our consolidated costs are denominated in U.S. dollars. We do not believe changes in foreign currency exchange rates will be material to our financial position or results of operation. We do not currently enter into forward-exchange contracts to hedge exposure denominated in foreign currencies or any other derivative financial instruments for trading or speculative purposes. In the future, if our operations change and we determine that our foreign exchange exposure has increased, we may consider entering into hedging transactions to mitigate such risk.

Item 4. Controls and Procedures

Evaluation of 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 December 31, 2012. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Changes in internal control over financial reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the period covered by this report that have materially affected or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. Other Information

ITEM 1. Legal Proceedings

We are not currently involved in any material legal proceedings. However, from time to time, we may become subject to legal proceedings, claims, and litigation arising in the ordinary course of business, including, but not limited to, employee, customer and vendor disputes.

ITEM 1A. Risk Factors

With the exception of the new risk factor below, there have been no material changes from the risk factors as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012.

Risks Related to Our Business

We are exploring strategic alternatives with respect to our user-interface patent and licensing subsidiary. There is no assurance any transaction will be pursued or consummated.

On September 3, 2013, we announced that our Board of Directors has authorized the exploration of strategic alternatives with respect to our user-interface patent and licensing subsidiary. This unit's intellectual property portfolio principally relates to user-interface gestures utilized in a touchscreen. The Board intends to consider a broad range of alternatives including, but not limited to, a merger, sale, or spin-off. There can be no assurance that the Board's evaluation process will result in any transaction, or that any transaction, if pursued, will be consummated.

ITEM 6. Exhibits

Exhibits

Exhibit #	Description
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).
3.1.1	Certificate of Amendment, dated December 13, 2010 (incorporated by reference to Exhibit 3.1.1 of our Annual Report on Form 10-K filed on March 31, 2011)
3.1.2	Certificate of Amendment, dated March 18, 2011 (incorporated by reference to Exhibit 3.1 of our Current Report on Form 8-K filed on March 28, 2011)
3.1.3	Certificate of Correction, dated February 29, 2011 (incorporated by reference to Exhibit 3.1.3 of our Annual Report on Form 10-K filed on March 30, 2012)
3.2	Bylaws (incorporated by reference to Exhibit 3.2 of our Annual Report on Form 10-K filed on April 15, 2008)
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	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
101.INS	XBRL Instance Document *
101.SCH	XBRL Taxonomy Extension Schema Document *
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document *
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document *

* Furnished herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly this report to be signed on its behalf by the undersigned thereunto duly authorized, on November 7, 2013.

Neonode Inc.
Registrant

Date: November 7, 2013

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