Neonode, Inc
Form 10-K
March 30, 2012

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

FORM 10-K
þ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2011

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	94-1517641
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

Sweden Linnegatan 89, SE-115 23 Stockholm, Sweden
USA 2700 Augustine Dr, Suite 100, Santa Clara, CA 95054
(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 Registered
Common Stock, par value $0.001 per share	NONE

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

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

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 ý

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 ý 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 (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

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. o

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company ý

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

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, 2011 (the last business day of the second quarter of the registrant's current fiscal year) as reported on the OTCBB, was $60,343,310.

The number of shares of the registrant's common stock outstanding as of March 22, 2012 was 32,956,300.
The number of shares of the registrant's Series A Preferred stock outstanding as of March 22, 2012 was 83.
The number of shares of the registrant's Series B Preferred stock outstanding as of March 22, 2012 was 95.

DOCUMENTS INCORPORATED BY REFERENCE

Part III (Items 10, 11, 12, 13 and 14) incorporates by reference portions of the Registrant's Proxy Statement for its Annual Meeting of Stockholders, which will be filed not later than 120 days after December 31, 2011. Exhibits incorporated by reference are referred to in Part IV.

NEONODE INC.

2011 ANNUAL REPORT ON FORM 10-K

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SPECIAL NOTE ON FORWARD LOOKING STATEMENTS

Certain statements set forth in or incorporated by reference in this Annual Report on Form 10-K 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.

PART I

ITEM 1.
BUSINESS

Neonode Inc., "we", "us", "our", the "Company", provide optical infrared touchscreen solutions for handheld and small to midsized 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. The cornerstone of our solution is our innovative optical infrared touchscreen technology zForce®, which can be applied on any flat surface such as Liquid Crystal Displays (LCD), Electronic Paper Displays (EPD) or as a Mouse Pad, and can be incorporated into all types of devices, enabling touch detection for any type of object (finger, pen, glove or brush). In addition the zForce touch solution has a low total weight and building height, thus enabling greater industrial design flexibility. Since nothing is layered on top of the display, the zForce solution provides 100% optical transparency, which improves image quality, reduces glare, and improves battery life.

We have recently developed our Multi-Sensing technology to help OEMs and device manufacturers differentiate themselves in a competitive market. Ready to be implemented into a wide range of commercial devices such as smart phones, tablets and automotive displays, our Multi-Sensing technology can be used for, but is not limited to, intuitive gaming, industrial design, and 3D modeling. This cutting-edge technology identifies any object and determines its size, pressure, depth, speed and the proximity of an object to a surface. It uses light with zero latency that can sense and determine objects like a pen, brush, bare/gloved finger or larger objects like a hand, at very high speed. The zForce multi-touch product, based on our Multi-Sensing technology, is our latest release and is currently being integrated into products such as mobile phones, e-Readers, household appliances, printers and office equipment, GPS devices, automobile consoles, games and toys and tablet PC's.

Our technology licensing model allows us to focus on the development of solutions for multi-touch enabled screens, and thus we do not have to contend with the financial and logistical burden of manufacturing products, which is handled by our ODM/OEM clients. We license the right to use zForce and software which, together with standard components from partners, create a complete optical touch solution. Our licensing model provides the added benefit of allowing us to grow sales without the need of increasing costs at anywhere near the same rate to support the sales growth.

Our website is www.neonode.com. Through our website, we make available free of charge all of our Securities and Exchange Commission ("SEC"), filings, including our annual reports on Form 10-K, our proxy statements, our quarterly reports on Form 10-Q, and our current reports on Form 8-K as well as Form 3, Form 4, and Form 5 Reports for our directors, officers, and principal stockholders, together with amendments to those reports filed or furnished pursuant to Sections 13(a), 15(d), or 16 under the Securities Exchange Act of 1934, as amended, or the Exchange Act. These reports are available immediately after their electronic filing with the SEC. Our website also includes corporate governance information, including our Code of Conduct, our Code of Ethics for the CEO and Senior Financial Officers, and our Board Committee Charters.

On March 25, 2011, we filed a Certificate of Amendment of our Amended and Restated Certificate of Incorporation affecting a reverse stock split of the Company's issued and outstanding shares of common stock and preferred stock at a ratio of twenty-five-to-one (the "Reverse Split"). The Certificate of Amendment provided that each twenty-five (25) outstanding shares of the Corporation's common stock, par value $0.001 per share, was exchanged and combined, automatically, without further action, into one (1) share of common stock, and each twenty-five (25) outstanding shares of the Corporation's preferred stock, par value $0.001 per share, was exchanged and combined, automatically, without further action, into one (1) share of preferred stock. The Reverse Split was declared effective on March 28, 2011 and has been reflected in this Annual Report on Form 10-K.

Our History

Neonode Inc, 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. (the "Merger"), and SBE, Inc.'s name was subsequently changed to "Neonode Inc." upon the completion of the Merger. Prior to the Merger, Neonode Inc. had been 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 is located in Stockholm, Sweden.

Through our previously 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 and subsequently discontinued the manufacturing of mobile phones and the operations of Neonode AB.

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 including the U.S. and has several patents-pending in the U.S. It uses infrared light that is projected over the screen. Infrared light pulses are sent out up to 1,000 times per second to capture a frame and detect touch activation. Up to 1000 coordinates are produced by using mathematical algorithms to calculate the exact position of a touch object 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 can be found 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 best 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 contrast 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 an extremely simple manufacturing process when compared to the expensive layered capacitive and resistive screens;

- 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 is one of the few viable touchscreen solutions that will operate as well on the new revolutionary reflective display panels that will offer paper-like reading experience in almost any ambient lighting condition while greatly reducing power consumption. Manufacturers of reflective display panels are targeting e-Reader, mobile phone and tablet PC markets because these devices require the clear viewing screen and low power consumption of the reflective display panels; and

- 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 thick gloves. In addition, zForce allows for waterproofing of the device.

Because of its uniqueness and flexibility, we believe that our zForce technology presents a very significant licensing opportunity for Neonode. The market is vast, given the current rapid increase in touchscreen-based devices such as e-Readers, automotive, mobile phones, Tablet PCs, media players, printers and GPS navigation devices.

Neonode NN1001 Single Chip Touch Controller

The NN1001 is the next generation touch technology solution that we have developed in collaboration with Texas Instruments. It is designed to simplify the integration to reduce bill of material (BOM) cost, as well as increase the performance where integrated. It also adds superior functionality, such as multi-touch and gestures for any object, and delivers a greater user experience on every level. The Single Chip Touch Controller outperforms capacitive touch solutions at a fraction of the cost.

- The NN1001 has a scanning speed of 1000 Hz (latency down to 1ms) and consumes less than 1mW at 100Hz.

- The NN1001 tracks any high-speed multi-touch gesture with any object (finger, gloved finger and passive pens) with high accuracy.

- The NN1001 connects to any microcontroller or application processor with a high speed SPI interface. The controller works in single or multiple configurations supporting screen sizes up to 20 inch.

- The NN1001 supports advanced power management and implements the Neonode AlwaysON™ technology where the touch is active even when the device is in sleep or off mode.

Markets

We currently provide touchscreen solutions for navigation for many of the world's premier e-Reader OEMs. We have aggressively expanded the markets for our touch technology beyond e-Readers and have also entered into technology license agreements with some of the world's leading OEMs operating in the mobile phone, automotive, office equipment (such as printers), GPS, and tablet markets. We are currently engaged in product development activities with these customers. In addition, we are in technology development and contract negotiations with OEMs operating in the automotive, household appliance, games and toys, and electronic gaming equipment markets.

In general, high-performance capacitive touchscreens cost a lot to manufacture, while low-performance resistive touchscreens are cheaper to make. Thanks to extensive experience and expertise, Neonode has solved this production-cost problem by developing zForce — the market's most innovative optical touch technology that may be customized for the various markets in which we have focused our marketing efforts.

zForce

- Operates on all screen types and provides a crystal-clear viewing experience in any lighting condition, even bright sunlight
- Runs on Electronic Paper Displays that creates a readable experience close to ink on paper because it reflects light like ordinary paper
- Operates on LCD (Liquid Crystal Displays)
- Supports high-resolution pen writing in combination with finger navigation that includes, e.g., gestures, multi-touch, and sweeps
- Provides a 100% clear viewing experience—unlike traditional resistive and capacitive touchscreens
- Can be applied to any flat surface.

In addition, zForce enables:

- Touch detection for any object
- A smooth touch experience with no necessary pressure for touch detection
- Greater industrial design flexibility for equipment and device manufacturers.
- Pressure sensing
- 3D scanning and proximity sensing

zForce includes features that benefit Neonode's customers by facilitating the creation of top-quality products at lower production costs, which enable faster time to market.

Tablets and e-Readers

As a result of these benefits and features, zForce is the world's most-used optical touch technology for e-Readers today with customers such as Amazon, Barnes & Noble, Sony and Kobo, all of whom have integrated our zForce technology into their e-Readers.

In addition, we have customers currently developing tablets.

Mobile Phones

Our innovative touch technology is suitable for mobile phones and virtually all other hand held devices.

Automotive

Touch interface displays in vehicles must operate in a wide range of ambient lighting and temperature conditions. A resistive screen may be operated with gloves on, but the membrane layer reduces transparency and can cause glare. The zForce solution is well-placed to make inroads in the automotive market since it provides a brighter, more readable display, with a full operating temperature range, that can easily be used while wearing gloves.

Printers and Office Equipment

Photo printers and combination printer/scanner/fax machines typically require feature-rich menus and settings, and OEMs have increasingly replaced mechanical buttons with resistive touchscreen displays. zForce offers an improved user experience, with brighter display, ultra light touch, and support for gestures (such as swipe to access menus and screens), all without increasing cost.

Home Electronics

Machines in the kitchen and laundry room are still mostly controlled by mechanical buttons, dials and membrane switches. New designs can use zForce with or without an underlying display. For example, touch sensitive buttons can be achieved by placing the light guide around a pre-printed array. A touch panel can include illumination without a display. A feature-rich device like a high-end dryer can be made much more streamlined and user friendly with a touch display.

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 been issued three United States (U.S.) patents including our inventions covering the activating function in response to a touch-and-glide operation on a touch sensitive surface and on a substrate formed or resting display arrangement. We have been issued patents in five countries outside the U.S. for our invention titled “On a substrate formed or resting display arrangement.” We have eight provisional patent applications, and fifteen non-provisional patent applications pending in the U.S. In addition, we have fourteen pending patent applications in countries outside the U.S. and one Patent Cooperation Treaty (PCT) application.

We have been granted trademark protection for the word NEONODE in the U.S., the European Union (EU), Sweden, Norway, and Australia. In addition we have filed an application for the word NEONODE in the U.S. to cover additional goods including touchscreen controller Application Specific Integrated Circuits (ASIC). We have been granted protection for the figurative mark NEONODE in the U.S., the EU and Sweden. Additional applications for the figurative trademark are still pending in Switzerland, China and Russia. We have been granted trademark protection for the word zForce in the U.S. and EU. In addition we have filed an application for the word zForce in the U.S. to cover additional goods including touchscreen controller ASICs. We filed applications for the trademarks ALWAYSON, ALWAYSON TOUCH and MULTI-SENSING in the U.S.

The Company’s user interface software described in some of the aforementioned patent applications may also be protected by copyright laws in most countries, including 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 sales offices located in Sweden, South Korea, the Netherlands and the U.S.

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 both fiscal years 2011 and 2010, we spent $1.9 million in each year 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.

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
Optical
Mechanical
Electrical
Industrial Design

Recent Developments

- On March 12, 2012, we signed a technology license agreement with IDT Technology Limited, a subsidiary of Oregon Scientific for the use of our touch technology in a children's tablet device.

- On February 29, 2012, we filed a Certificate of Correction with the Secretary of State of Delaware effectively reducing the amount of our 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 February 21, 2012, we announced the release of our newly developed Multi-Sensing technology that provides a new way for machines to communicate with the human senses, and enables a far more augmented and profound user experience than traditional touch. Multi-Sensing was developed to help OEMs and device manufacturers differentiate themselves in a competitive market. Ready to be implemented into a wide range of commercial devices such as smart phones, tablets and automotive touch displays, Neonode's Multi-Sensing technology can be used for, but is not limited to, intuitive gaming, industrial design, and 3D modeling. This cutting-edge technology identifies any object and determines its size, pressure, depth, speed and the proximity of an object to a surface. It uses light with zero latency that can sense and determine objects like a pen, brush, bare/gloved finger or larger objects like a hand, at very high speed.

- On January 30, 2012, our Board of Directors adopted an amendment to our 2006 Equity Incentive Plan (the “2006 Plan”) to increase the number of shares of common stock authorized by issuance under the 2006 Plan by an additional two million (2,000,000) shares.

- On January 19, 2012, we signed a technology license agreement with an OEM related to the use of our touchscreen technology for a universal color touch display for Tablet PCs. In conjunction with the signing of this technology license agreement, the OEM agreed to pay us $65,000 in non-recurring engineering development fees. We are deferring the engineering development fee revenue until such time as the engineering work has been completed. We expect to complete all services under this contract in 2012.

- On January 15, 2012, we signed a technology license agreement with a global top 5 printer OEM to use our touchscreen technology in a series of printers. In conjunction with the signing of this technology license agreement, the OEM agreed to pay us $50,000 in non-recurring engineering development fees. We are deferring the engineering development fee revenue until such time as the engineering work has been completed. We expect to complete all services under this contract in 2012.

- On January 10, 2012, the U.S. Patent and Trademark Office issued to us patent number 8,095,879 for sweep gesture user interfaces. The patent covers activating a function in response to a touch-and-glide operation on a touch sensitive surface. This patent complements Neonode’s U.S. patents 7,880,732 and 8,068,101 for small to midsize touchscreen devices. The patented technology is marketed and sold as Neonode’s offer to OEMs and ODMs.

- On January 4, 2012, we signed a technology license agreement with a global OEM to use our touchscreen technology in a series of GPS devices.

- On December 14, 2011, following the consummation of a financing in which the gross proceeds to the Company were in excess of $5 million, the remaining outstanding principal balance of Convertible Notes (approximately $3.7 million), plus accrued interest (approximately $130,000), was automatically converted into 1,513,228 shares of our common stock. In addition, we issued 99,461 shares of common stock related to the bonus interest feature associated with the mandatory conversion of the debt. As of December 31, 2011, all of the March and April 2011 Convertible Notes, plus accrued interest, was paid in cash or converted into shares of common stock.

- On December 13, 2011, we sold 3,000,000 shares of common stock of the Company, par value $0.001 per share, in a public offering pursuant to a Registration Statement on Form S-3. The shares were sold at a price of $4.00 per share. The net proceeds to the Company from this offering were $11.2 million, after deducting the underwriting discount but before deducting other estimated offering expenses of approximately $0.4 million payable by the Company. As part of the offering, the underwriter, Cowen and Company, LLC (the "Underwriter"), sold 1,000,000 shares held by Per Bystedt, our executive chairman, and Thomas Eriksson, our chief executive officer (together, the “Selling Stockholders”). In addition, the Underwriter exercised its over-allotment option and sold an additional 600,000 shares held by the Selling Shareholders. The Company did not receive any proceeds from the sale of any shares by the Selling Stockholders or upon the exercise by the Underwriter of its over-allotment option. The Company anticipates using the net proceeds from the offering primarily for general corporate purposes, including capital expenditures and working capital.

- In October and November 2011 note holders of $575,000 of the original approximately $4.2 million Convertible Notes exercised their right to convert their notes and accrued interest and were issued 232,125 shares of our common stock.

- In March 2011 we issued convertible notes (the “Convertible Notes”) to investors who loaned the Company an aggregate of approximately $4.2 million. The Convertible Notes were subject to automatic conversion into shares of our common stock, at a conversion price of $2.50 per share, in the event we consummated a financing in the amount of at least $5 million or our common stock was traded at a price of $6.25 or higher for five (5) consecutive trading days.

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, power consumption, 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 or conductive 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.

Touchscreen Technologies Competitors:

Company	Technology
3M	Capacitive, Dispersive Signal Touch
Synaptics	Capacitive sensors and IC controllers
ATMEL	Capacitive touch IC controllers
Cypress	Capacitive touch IC controllers
Maxim	Capacitive touch IC controllers
Nextwindow	Optical with camera sensor
Zytronic	Capacitive
Tyco Electronics	Capacitive, Resistive, Surface Wave,
Touch International	Resistive and Capacitive

Mass Multimedia Inc.	All touchscreen technologies
Young Fast	Capacitive sensor and module maker
TPK	Capacitive (provides the capacitive touch sensor for the Apple iPhone)

Today's market leading touch technologies, i.e., resistive and capacitive technologies make use of a "touch sensor/window" or an overlay in combination with a controller IC to function. In comparison zForce use a "lightguide" (to reflect and focus light) together with some standard IC components to operate.

Neonode licenses the complete solution to its customers thus there is no need for a 3rd party to assemble the touch sensor with the controller (called module maker), a step that adds costs to the complete solution.

Below is a comparison table for resistive, capacitive (2 types) and zForce touch technologies. Some of zForce's unique selling points include low power, low cost and low weight in combination with a 100 % transparent touch window.

Technology License Agreements

As of December 31, 2011, we have entered into twelve technology license agreements compared to four technology license agreements as of December 31, 2010. We have signed three additional technology license agreements with customers subsequent to December 31, 2011. The products related to these license agreements are e-Readers, Tablet PCs, mobile phones, commercial and consumer printers, automotive consoles and GPS devices.

We are dependent on a number of OEM customers and the loss of any one of these customers could have a material adverse effect on our future revenue stream. In the short term, we anticipate that we remain dependent on a limited number of customers for substantially all of our future revenues. 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.

Our accounts receivable as of December 31, 2011 was due from five customers. Our revenues for the year ended December 31, 2011 was earned from seven customers. Our customers are located in the U.S., Europe and Asia. Customers which accounted for 10% or more of our net revenues during the year ended December 31, 2011 are as follows:

- Amazon accounted for 40%
- Barnes & Noble accounted for 26%
- Sony Corporation accounted for 21%
- KOBO Inc. accounted for 11%

Our accounts receivable as of December 31, 2010 was due from six customers. Our net revenues for the year ended December 31, 2010 was earned from seven customers, of which two customers accounted for approximately 84% of our net revenues for the year.

Employees

On December 31, 2011, we had thirty full-time employees and one part-time employee. We augment our staff with consultants on an "as needed" basis. There were a total of twenty-two full-time and one part-time employee located in our corporate headquarters in Stockholm, Sweden. Six employees are located in a branch office in the United States, one employee is a resident of South Korea, and one employee is a resident of Israel. None of our employees are 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, stockholders or prospective investors should carefully consider the following risk factors:

Risks Related To Our Business

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

Although we recently raised over $11 million in a public offering, we may in the future 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 for at least the next twelve months. However, 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 when needed 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.

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 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. We may not be successful in growing our 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.

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 operating results may fluctuate significantly as a result of a variety of factors, many of which are outside of our control.

We are subject to the following factors, among others, that may negatively affect our operating results:

- the announcement or introduction of new products or technologies by our competitors;
- our ability to upgrade and develop our products and infrastructure to accommodate growth;
- our ability to attract and retain key personnel in a timely and cost effective manner;
- technical difficulties;
- the amount and timing of operating costs and capital expenditures relating to the expansion of our business, operations, and infrastructure; and
- general economic conditions as well as economic conditions specific to the hand-held device and/or touchscreen industry.

As a result of our limited operating history and the nature of the markets in which we compete, it is extremely difficult for us to forecast accurately. We have based our current and future expense levels largely on our investment plans and estimates of future events, although certain of our expense levels are, to a large extent, fixed. We may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall. Accordingly, any significant shortfall in revenues relative to our planned expenditures would have an immediate adverse effect on our business, results of operations and financial condition. Further, as a strategic response to changes in the competitive environment, we may from time to time make certain pricing, service, or marketing decisions that could have a material and adverse effect on our business, results of operations, and financial condition. Due to the foregoing factors, our revenues and operating results are and will remain difficult to forecast.

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, inability to deliver 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 efforts 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 efforts 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 will need to increase the size of our organization, and we may be unable to manage our growth effectively.

Our failure to manage growth effectively could have a material and adverse effect on our business, results of operations and financial condition. We anticipate that expansion of our organization will be required to address internal growth to handle licensing and research activities. This expansion may place a significant strain on management, operational, and financial resources. To manage the expected growth of our operations and personnel, we must both improve our existing operational and financial systems, procedures, and controls, and implement new systems, procedures, and controls. We must also expand our finance, administrative, and operations staff. Our current personnel, systems, procedures, and controls may not adequately support future operations. Management may be unable to hire, train, retain, motivate, and manage the necessary personnel, or to identify, manage and exploit existing and potential strategic relationships and market opportunities.

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 future prospects.

We are dependent on a limited number of customers.

Our accounts receivable as of December 31, 2011 was due from five customers. Our net revenues for the year ended December 31, 2011 was earned from seven customers. Our customers are located in the U.S., Europe and Asia. Customers which accounted for 10% or more of our net revenues during the year ended December 31, 2011 are as follows:

- Amazon accounted for 40%
- Barnes & Noble accounted for 26%
- Sony Corporation accounted for 21%
- KOBO Inc. accounted for 11%

In the future, the loss of any of these customers, a reduction in net revenues to any of these customers for any reason, or a failure of any of these customers to fulfill their financial or other obligations due to us could have a material adverse affect on our business, financial condition, and future revenue stream.

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.

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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.

Further deterioration in the state of the global economy and financial market conditions could adversely affect our ability to conduct business and our results of operations.

Global economic and financial market conditions, including severe disruptions in the credit markets and the continuing impact of the recent global economic recession may materially impact our customers and other parties with whom we do business. Continued or further deterioration in general economic and financial market conditions could materially adversely affect our financial condition and results of operations. Specifically, the impact of these volatile and negative conditions may include decreased demand for our products and services, decreased ability to accurately forecast future product trends and demand, and a negative impact on our ability to timely collect receivables from our customers. The foregoing economic conditions may lead to increased levels of bankruptcies, restructurings, and liquidations for our customers, scaling back of research and development expenditures, delays in planned projects, and shifts in business strategies for many of our customers. Such events could, in turn, adversely affect our business through loss of revenues.

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 1,000,000 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 by our stockholders could negatively affect our stock price.

Sales of a substantial number of shares of our common stock in the public market by our stockholders, or the perception that these sales might occur, could depress the market price of our common stock and could impair our ability to raise capital through the sale of additional equity securities. All of the shares of common stock sold in our recent public offering are freely tradable without restrictions or further registration under the Securities Act of 1933, as amended, or the Securities Act, and thus the price of our common stock may decline.

Future sales of our common stock by us 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.

We will have broad discretion in using the net proceeds from our recent public offering, and the benefits from our use of the proceeds may not meet investors' expectations.

Our management will have broad discretion over the allocation of our net proceeds from our recent public offering as well as over the timing of their use without stockholder approval. We have not yet determined how the net proceeds from our recent public offering will be used, other than for working capital and other general corporate purposes. As a result, investors will be relying upon management's judgment with only limited information about our specific intentions for the use of our net proceeds from this offering. Our failure to apply these proceeds effectively could cause our business to suffer.

If securities analysts do not publish research or if securities analysts or other third parties publish inaccurate or unfavorable research about us, the price of our common stock could decline.

The trading market for our common stock will rely in part on the research and reports that securities analysts and other third parties choose to publish about us. We do not control these analysts or other third parties. The price of our common stock could decline if one or more securities analysts downgrade our common stock or if one or more securities analysts or other third parties publish inaccurate or unfavorable research about us or cease publishing reports about us.

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

Neonode Technologies AB has a lease with Vasakronan Fastigheter AB for 2,207 square feet of office space located at Linnegatan 89, Stockholm, Sweden for approximately $6,000 per month including property tax (excluding VAT). The annual payment for this space equates to approximately $66,000 per year including property tax (excluding VAT). This lease has a notice period of 3 months.

Neonode Technologies AB 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 9 month notice period. The contract will be extended for an additional 3 years if it is not terminated according to the terms in the contract.

On March 18, 2011, we entered into a twelve month lease with CA-Santa Clara Office Center Limited Partnership for approximately 1,718 square feet of office space located at 2700 Augustine Drive, Suite 100, Santa Clara, California, USA for approximately $2,647 per month. The lease expires on April 30, 2012.

On March 22, 2012, we entered into a 39 month lease with 2350 Mission Investors LLC for approximately 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 approximately $7,000 per month, increasing to $7,700 per month over the term of the lease. The annual payment for this space equates to approximately $84,000 per year.

ITEM 3.
LEGAL
PROCEEDINGS

None

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable

PART II

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

Our common stock has been quoted on the Over the Counter Bulletin Board Market (OTCBB) under the symbol NEON.OB. As of December 31, 2011, there were approximately 2,611 shareholders of record of our common stock.

	Fiscal Quarter Ended			
	March 31	June 30	September 30	December 31
Fiscal 2011				
High	$3.35	$4.40	$4.70	$5.97
Low	$1.25	$2.95	3.40	$4.00
Fiscal 2010				
High	$1.00	$1.25	$2.00	$2.00
Low	$0.50	$0. 50	0.75	$1.50

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.

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, 2011 and 2010 and the related notes included therein.

Overview

Neonode Inc provides optical infrared touchscreen solutions for handheld and small to midsized 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. The cornerstone of our solution is our innovative optical infrared touchscreen technology zForce®. zForce can be applied on any flat surface such as Liquid Crystal Displays (LCD), Electronic Paper Displays (EPD) or as a Mouse Pad and can be incorporated into all types of devices, enabling touch detection for any type of object (finger, pen, glove or brush). In addition the zForce touch solution has a low total weight and building height, thus enabling greater industrial design flexibility. Since nothing is layered on top of the display, the zForce solution provides 100% optical transparency, which improves image quality, reduces glare, and improves battery life.

We have recently developed our Multi-Sensing technology to help OEMs and device manufacturers differentiate themselves in a competitive market. Ready to be implemented into a wide range of commercial devices such as smart phones, tablets and automotive displays, our Multi-Sensing technology can be used for, but is not limited to, intuitive gaming, industrial design, and 3D modeling.

Our technology licensing model allows us to focus on the development of solutions for multi-touch enabled screens and thus we do not have to contend with the financial and logistical burden of manufacturing products, which is handled by our ODM/OEM clients. We license the right to use zForce and software which, together with standard components from partners, create a complete optical touchscreen solution. zForce is currently being integrated into products such as mobile phones, automotive products, e-Readers, printers, GPS devices and Tablet PC's. It should be noted that our licensing model provides the added benefit of allowing us to grow revenues exponentially without the need of increasing costs at anywhere near the same rate to support the revenue growth.

We have incurred net operating losses and negative operating cash flows since inception. As of December 31, 2011, we had an accumulated deficit of $129.3 million. During the years ended December 31, 2011 and 2010, we raised approximately $15.5 million and $4.0 million, respectively, of net cash proceeds though the sale of our securities and convertible debt. We may incur additional losses on a quarterly basis during 2012, but do expect to generate net income and positive operating cash flows for the year ended December 31, 2012. We believe we have sufficient cash to operate for the remainder of 2012, and thereafter, expect to receive sufficient cash from customer license agreements currently in place to operate for at least the next twelve months.

Our success is dependent on our obtaining sufficient capital or operating cash flows to fund our operations and to develop our technology and bringing such technology to the worldwide market. To achieve our 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, 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 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 consolidated financial statements are in conformity with generally accepted accounting principles in the United States ("GAAP") and include the accounts of Neonode Inc. and its wholly-owned subsidiary based in Sweden, Neonode Technologies AB.

All inter-company accounts and transactions have been eliminated in consolidation. The 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.

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 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, collectibility of accounts receivable, recoverability of long-lived assets, the valuation allowance related to our deferred tax assets, the fair value of derivative instruments, and the fair value of securities such as options and warrants issued for stock-based compensation and in certain financing transactions.

Concentration of Cash Balance Risks

Cash balances are maintained at various banks in the U.S. 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. In addition to the basic insurance deposit coverage, the FDIC is providing temporary unlimited coverage for non-interest bearing transaction accounts through December 31, 2012. The Swedish government provides insurance coverage up to 100,000 euro per customer and covers deposits in all types of accounts. As of December 31, 2011, the Company has approximately $1.2 million in excess of this limit.

Revenue Recognition

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 contact are completed and accepted by our customers.

Licensing Revenues:

We also 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 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. As of December 31, 2011, 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) customer distributes or license the products; (3) customer payment is deemed fixed or determinable and free of contingencies or significant uncertainties; and (4) collection is reasonably assured.

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Prior to September 30, 2011, we deferred the technology license fee revenue until such time as the warranty period stipulated in the applicable license agreement expired because we did not have sufficient historical experience in estimating potential warranty costs. From June 2010 to December 31, 2011, we entered into 12 technology license contracts with customers. During that time there were no warranty related costs incurred for any customer products after they have been released to market. During the quarter ended September 30, 2011, the Company performed an analysis and determined that it had sufficient historical evidence regarding estimated warranty costs and therefore began recognizing technology license fee revenues, net of warranty costs, if any, as the products incorporating the Neonode technology are distributed or licensed by our customers, assuming all other revenue recognition criteria have been met. Our customers report to us the quantities of products distributed 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 December 31, 2011.

Hardware Products:

We may from time-to-time develop custom hardware products for our customers that incorporate our touch 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 will 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. To date, we have not sold any hardware products.

Software Products:

We may derive revenues from software licensing sales. We will 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.

For software license arrangements that do not require significant modification or customization of the underlying software, we will 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.

On January 1, 2011, we adopted new authoritative guidance on a prospective basis for revenue arrangements containing multiple deliverables. This guidance requires us to allocate revenues to all deliverables based on their relative selling price using a specific hierarchy. The hierarchy is as follows: vendor-specific objective evidence (“VSOE”), third-party evidence of selling price (“TPE”) or best estimate of selling price (“BESP”).

When a sale involves multiple elements, we will allocate the entire fee from the arrangement to each respective element based on VSOE of fair value and recognize revenue when each element’s revenue recognition criteria are met. VSOE of fair value for each element is established based on the price charged when the same element is sold separately. We have established VSOE for our software licenses based on historical stand-alone sales to third parties or from the stated renewal rates contained in the customer contracts. Maintenance service revenue is recognized on a straight-line basis over the support period.

We have not yet demonstrated VSOE for the professional services that are rendered in conjunction with our software license sales. In accordance with the hierarchy we would attempt to establish the selling price of professional services using TPE. Our product contains significant differentiation such that the comparable pricing of products with similar functionality cannot be obtained. We are typically not able to obtain TPE for professional services.

When we are unable to establish selling prices using VSOE or TPE, we use BESP. The objective of BESP is to determine the price at which we would transact a sale if professional services were sold on a stand-alone basis. BESP is generally used for offerings that are not typically sold on a stand-alone basis or for highly customized offerings.

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.

The adoption of this guidance did not have a material effect on our consolidated financial statements.

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 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.

Debt Issuance Costs

Debt issuance costs represent costs incurred in connection with the issuance of the convertible notes payable. Debt issuance costs are amortized over the term of the financing instrument on a straight-line basis, which approximates the effective interest method.

Advertising

Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2011 and 2010 were approximately $241,000 and $28,000, respectively.

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

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 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 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 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 in accordance with accounting guidance, which requires that such equity instruments be recorded at their fair value and the unvested portion be re-measured each reporting period. 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.

Foreign Currency Translation and Transaction Gains and Losses

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 income (loss). Gains or losses resulting from foreign currency transactions are included in general and administrative expenses in the accompanying consolidated statements of operations and were $44,000 and $23,000 during the years ended December 31, 2011 and 2010, respectively. For the years ended December 31, 2011 and 2010, our foreign currency translation gains totaled $76,000 and $33,000, respectively.

Liabilities 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 that contain anti-dilution rights. Such embedded derivatives are assessed at inception of the contract and every reporting period, depending on their characteristics, and 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 statements of operations as an increase or decrease to non-cash charges.

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 statements of operations as an increase or decrease to non-cash charges.

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 is recorded as a debt discount and amortized to expense over the life of the related debt using the straight line method, which approximates 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 straight-line method, which approximates the effective interest method.

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 the year ended December 31, 2011 and 2010, respectively, 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. The cumulative amount of translation gains and losses are reflected as a separate component in stockholders' equity (deficit) and comprehensive income (loss).

Income taxes

We account for income taxes in accordance with accounting guidance. Accounting guidance requires recognition of 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 "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, 2011 and 2010. 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 provisions of the accounting, which provisions included a two-step approach to recognizing, de-recognizing and measuring uncertain tax positions accounted for in accordance with the accounting guidance.

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 6.50 and 7.21 Swedish Krona to one U.S. Dollar for the years ended December 31, 2011 and 2010, respectively. The exchange rate for the consolidated balance sheets was 6.92 and 6.78 Swedish Krona to one U.S.

Dollar as of December 31, 2011 and 2010, 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, accounts receivable, payables and derivatives are deemed to approximate fair value due to their short maturities. The carrying amounts of convertible debt cannot be reasonably determined since no quoted market prices exist for these instruments and quoted prices for similar instruments cannot be located.

Deferred Revenue

Engineering development fees are recorded as deferred revenue until such time as the engineering services have been provided.

As of December 31, 2011, we have $––––––1.5 million of deferred license fee revenue related to a prepayment for future license fee from one customer and a total of $0.4 million of deferred engineering development fees from four customers. We are deferring the engineering development fee revenue until such time as the engineering work has been completed. We expect to complete all services under these contracts by the fourth quarter of 2012.

New Accounting Pronouncements

In September 2009, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU 2009-13”), Multiple-Deliverable Revenue Arrangements, which amends the revenue guidance under ASC Topic 605, Revenue Recognition , which describes the accounting for multiple-element arrangements. ASU 2009-13 addresses how to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting and how arrangement consideration shall be measured and allocated to the separate units of accounting in the arrangement. ASU 2009-13 is effective on a prospective basis for the Company’s fiscal year 2011, with earlier adoption permitted. The Company adopted ASU 2009-13 on January 1, 2011 and determined that the adoption of this guidance did not have a material effect on the consolidated financial statements.

In September 2009, the FASB issued ASU 2009-14, Certain Revenue Arrangements That Include Software Elements (“ASU 2009-14”), which excludes tangible products containing software components and non-software components that function together to deliver product’s essential functionality from scope of ASC Topic 985, Software, which describes the accounting for software revenue recognition. ASU 2009-14 is effective on a prospective basis for the Company’s fiscal year 2011, with earlier adoption permitted. The Company adopted ASU 2009-14 on January 1, 2011 and determined that the adoption of this guidance did not have a material effect on the consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-4, Fair Value Measurement ("ASU 2011-04"). ASU 2011-04 amends existing guidance to achieve convergence in measurement and disclosure between U.S. GAAP and International Financial Reporting Standards ("IFRS"). ASU 2011-04 is effective for fiscal year 2012. The Company is currently evaluating the impact that ASU 2011-04 will have on its consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income (“ASU 2011-05”). The provisions of ASU 2011-05 allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both choices, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The statement(s) are required to be presented with equal prominence as the other primary financial statements. ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders’ equity but does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. Certain provisions of ASU No. 2011-05 are effective for the Company's interim reporting period beginning on or after December 15, 2011, with retrospective application required. The adoption of ASU No. 2011-05 is expected to result in presentation changes to the Company's consolidated statements of operations and the addition of a consolidated statement of comprehensive income (loss). The adoption of ASU No. 2011-05 will have no impact on the Company's consolidated balance sheet.

Results of Operations

Net Revenue

Net revenue for the year ended December 31, 2011 was $6.1 million, compared to $440,000 for the year ended December 31, 2010. Our net revenue for the year ended December 31, 2011 included $5.8 million from technology license fees and $287,000 in non-recurring engineering services related to our touchscreen solution for various customers. Under the terms of one of our contracts entered into in 2010, the customer prepaid $3.0 million of technology licenses prior to shipment of its first product. The $3.0 million pre-payment was included in deferred revenue as of December 31, 2010 and will be amortized to revenue as units are sold. For the year ended December 31, 2011, $1.5 million in license fees related to products shipped in 2011 have been recognized as revenue, and as of December 31, 2011, $1.5 million remains in deferred revenue. Our net revenue for the year ended December 31, 2010 was $440,000 and includes $387,000 in fees for engineering design services, $50,000 for the sale of components, and $3,000 from technology license fees related to our touchscreen solution for our customers.

As of December 31, 2011, we had twelve signed technology license agreements with global OEMs. Six 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 2012. Sony Corporation is currently shipping the "Sony Reader Wi-Fi PRS-T1" model. Koobe Inc. began shipping the "Jin Yong e-Reader" in limited quantities to the Chinese market in December 2010 but ceased shipments in the first quarter of 2011. Kobo Inc. is currently shipping the "Kobo eReader Touch"; Barnes & Noble Inc. is currently shipping "The Simple Touch Reader" Nook e-Reader; Amazon is currently shipping the Kindle Touch and Kindle Touch 3G e-Readers; and Onyx began shipping e-Reader products in December 2011. All of these products incorporate Neonode's zForce touch technology.

In the first quarter of 2012, we signed technology license agreements with four new customers in the GPS, Tablet PC, printing and office equipment, and imaging markets. 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 printer products, GPS devices, e-Readers, Tablet PCs, touch panels for automobiles, household appliances, mobile phones and games and toys. The development and product release cycle for these products typically takes six to eighteen months.

Current and future drivers of the touchscreen market include mobile phones, printers, automotive, household appliances, tablet PCs, e-Readers, navigation screens, etc. The proliferation and mass market acceptance of touchscreens have prompted new applications and uses for existing and new offerings, thus making the production and utilization of these modules one of the fastest growing tech segments. The typical sales cycle is nine to eighteen months with new customers while existing customer lead times are typically six to nine months. During the initial cycle, there are three phases: evaluation, design, and commercialization. In the evaluation phase, prospects validate the Neonode technology using a Neonode evaluation kit and may produce short runs of prototype products. During the design phase, true product development and solution definition begins. This phase tends to be the longest and delays typically occur which may extend the term of the overall cycle. In the final phase, commercialization, the customer enters into full production mode, ships products to the market and Neonode earns its license revenue.

Gross Margin

Gross margin was $5.2 million and $172,000 for the years ended December 31, 2011 and 2010, respectively. Our cost of revenues includes the direct cost of production of the components plus the costs of Company employed engineering personnel plus engineering consultants to complete the engineering design contract.

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Product Research and Development

Product research and development (R&D) expenses for each of the years ended December 31, 2011 and 2010 were $1.9 million. R&D costs mainly consist of personnel related costs in addition to some external consultancy costs such as testing, certifying and measurements.

We continue to pursue and expand 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, 2011, our R&D department had eighteen full-time employees compared to eight full-time employees and one part-time consultant at December 31, 2010.

Sales and Marketing

Sales and marketing expenses for the year ended December 31, 2011 were $1.8 million, compared to $566,000 for the year ended December 31, 2010. This increase in 2011 as compared to 2010 is primarily related to an increase in sales personnel, marketing, trade shows and travel expenses. As of December 31, 2011, our sales and marketing department has nine full-time employees, compared to three employees at December 31, 2010.

Our sales activities focus primarily on OEM customers who will integrate our touchscreen technology into their products. Our OEM customers will then sell and market their products incorporating our technology to their customers.

General and Administrative

General and administrative (G&A) expenses for the year ended December 31, 2011 were $3.5 million, compared to $3.6 million for the year ended December 31, 2010. This slight decrease in 2011 as compared to 2010 is primarily related to a decrease in non-cash fair value of warrants issued to employees that was partially offset by an increase in patent related legal fees and financial consultant costs.

As of December 31, 2011 and 2010, we had three employees and one part-time 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, 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 19,800 shares of the Company's 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 were related parties.

The fair value of the conversion feature of the 19,800 shares of Series A Preferred shares issued to the related parties to acquire Neonode Technologies AB that were converted into a total of 9,516,447 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 was 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 has been amortized to compensation expense at the rate of $1.6 million per quarter for six quarters beginning January 1, 2009. The amortization of the $9.5 million in compensation expense related the value of the stock issued to the related parties to acquire Neonode

Technologies AB was completed on June 30, 2010. For the year ended December 31, 2010, $3.2 million has been recorded as compensation expense in our consolidated statement of operations.

Interest and Other Expense

Interest expense for the year ended December 31, 2011 was $288,000, compared to $179,000 for the year ended December 31, 2010. The increase is primarily due to an increase in the debt outstanding from $2.8 million at December 31, 2010 to $4.2 million for the majority of the year ended December 31, 2011.

Foreign Currency Translation and Transaction Gains and Losses

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 general and administrative expenses in the accompanying consolidated statements of operations and were $44,000 and $23,000 during the years ended December 31, 2011 and 2010, respectively. Foreign currency translation gains were $76,000 and $33,000 during the years ended December 31, 2011 and 2010, respectively.

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 for the year ended December 31, 2011 was $14.7 million, compared to $20.0 million for the year ended December 31, 2010. The amount in the current year includes $8.6 million in net change in derivative liabilities, $4.3 million of debt discount and debt issuance cost amortization, $1.5 million in excess amount of debt discount recognized as interest expense associated with derivatives, and $0.4 million associated with the fair value of shares issued for bonus interest related to the automatic conversion of the Senior Convertible Secured Notes - 2011. The amount in the prior year includes $16.3 million in net change in derivative liabilities, $2.7 million of debt discount and debt issuance cost amortization, and $1.0 million in excess amount of debt discount recognized as interest expense associated with derivatives.

Loss on extinguishment of debt

Loss on extinguishment of debt for the year ended December 31, 2010 of $2.4 million was primarily the result of the warrant repricing and debt extension financing transaction that was consummated in the prior year. During September and October 2010, all of the holders of the convertible notes and the holders of the stock purchase warrants issued in the 2009 and 2010 Senior Secured Convertible Debt Financing Transactions agreed to extend the maturity date of their convertible debt from December 31, 2010 to June 30, 2011. In addition, holders of 2,766,857 stock purchase warrants also agreed to exercise their previously granted three-year warrants for a discounted exercise price. In accordance with relevant accounting guidance, the transaction qualified for debt extinguishment accounting.

Income Taxes

Our effective tax rate was 0% in the year ended December 31, 2011 and 2010, respectively. We recorded valuation allowances in 2011 and 2010 for deferred tax assets related to net operating losses due to the uncertainty of realization.

Net Loss

As a result of the factors discussed above, we recorded a net loss of $17.1 million for the year ended December 31, 2011, compared to a net loss of $31.6 million in the comparable period in 2010.

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 above. 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 financial statements.

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.

We have six current active customers for our touchscreen technology and an additional nine 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.

Our cash is subject to interest rate risk. We invest primarily on a short-term basis. Our financial instrument holdings at December 31, 2011 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, 2011, we had cash of $12.9 million, as compared to $911,000 at December 31, 2010. In the year ended December 31, 2011, $3.5 million of cash was used in operating activities, primarily as a result of our net loss increased by the following non-cash items (in thousands):

Depreciation and amortization	$	26
Stock-based compensation expense		550
Debt discounts and deferred financing fees and the valuation of conversion features and warrants		14,735
Total adjustments to reconcile net loss to net cash used in operating activities	$	15,311

Working capital (current assets less current liabilities) was $13.6 million at December 31, 2011, compared to an adjusted working capital (current assets less current liabilities not including non-cash liabilities related to warrants and embedded derivatives) deficit of $3.2 million at December 31, 2010.

In the years ended December 31, 2011 and 2010, we purchased $114,000 and $14,000, respectively of fixed assets, consisting primarily of computers and engineering equipment.

During the year ended December 31, 2010, we received proceeds from a private placement of convertible notes totaling $1.6 million and converted $163,000 of accounts payable to convertible debt that were converted, at the holder's option, into 3,521,423 shares of our common stock at a conversion price of $0.50 per share. The convertible note holders had the right to have the conversion price adjusted to equal the lower stock price if we issued common stock or convertible notes at a lower conversion price than $0.50 during the period that the notes were outstanding. These convertible notes that were due on December 31, 2010 were extended until June 30, 2011and bore an annual interest rate of 7%, payable on June 30 and December 31 of each year that the convertible notes were outstanding. In addition, we issued 1,760,711 three year warrants to the convertible note holders with an exercise price of $1.00 per share (see below).

During March and April 2011, we received an aggregate of $4.2 million in cash proceeds related to a private placement of convertible notes, bearing interest at a rate of seven percent (7%) per annum, that was scheduled to mature on March 1, 2014, and that was convertible at the holder's option into 1,691,320 shares of our common stock at a conversion price of $2.50 per share. The loan would automatically convert into shares of our common stock in the event that on or before the loan due date either (a) the Company's common stock traded at a price per share of $6.25 or higher for five (5) consecutive trading days, or (b) the Company consummated a financing in the amount of at least $5 million. In the event that the loan principal and accrued interest was not repaid by the Company by the due date, and the Investor had not previously converted the loan, the investor's sole remedy for such non-payment was the payment of additional annual interest at a rate of 10% per year. The accrued interest was payable in stock, using the $2.50 conversion price, or cash, at the holder's option, on September 30 and December 31 of each year.

In March 2011, the Company entered into a warrant agreement with investors who participated in the Company's 2009 and 2010 financing transactions and who had been issued common stock purchase warrants with exercise prices of $0.50 per share, $1.00 per share, and $1.38 per share (the "2009 and 2010 Warrants"). Pursuant to the warrant agreement, each warrant holder who exercised some or all of its outstanding 2009 and 2010 Warrants at the applicable exercise price ($0.50 per share, $1.00 per share, and/or $1.38 per share), received a number of March 2011 Warrants equal to fifty percent (50%) of the number of 2009 and 2010 Warrants exercised by such warrant holder. The warrant holders exercised an aggregate of 493,426 outstanding 2009 and 2010 Warrants, for an aggregate investment of $515,000 and received 493,426 shares of common stock and 246,713 new five-year common stock purchase warrants, with an exercise price of $3.13 per share. The March 2011 Warrants may be exercised by cash payment or through cashless exercise by the surrender of warrant shares having a value equal to the exercise price of the portion of the warrants being exercised.

On December 13, 2011, the Company sold 3,000,000 shares of common stock of the Company, par value $0.001 per share, in a public offering pursuant to a Registration Statement on Form S-3. The net proceeds to the Company from this offering was $11.2 million, after deducting the underwriting discount but before deducting other estimated offering expenses of approximately $0.4 million payable by the Company.

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.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable

FINANCIAL STATEMENTS

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Report of Independent Registered Public Accounting Firm

Board of Directors and Stockholders
Neonode Inc.

We have audited the accompanying consolidated balance sheets of Neonode Inc. (a Delaware corporation) and subsidiary (the "Company") as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity (deficit) and comprehensive loss, and cash flows for each of the years in the two-year period ended December 31, 2011. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Neonode Inc. and subsidiary at December 31, 2011 and 2010, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2011, in conformity with accounting principles generally accepted in the United States of America.

/s/ KMJ Corbin & Company LLP

Costa Mesa, California
March 30, 2012

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

	As of December 31, 2011	As of December 31, 2010
ASSETS		
Current assets:		
Cash	$ 12,940	$ 911
Accounts receivable	3,345	151
Debt issuance costs, net	--	4
Prepaid expenses and other current assets	234	161
Total current assets	16,519	1,227
Property and equipment, net	108	24
Total assets	$ 16,627	$ 1,251
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$ 447	$ 442
Accrued expenses	601	643
Deferred revenue	1,906	540
Convertible debt, net of discounts	--	2,772
Embedded derivatives of convertible debt and warrants	--	6,718
Total current liabilities	2,954	11,115
Total liabilities	2,954	11,115
Commitments and contingencies (Note 11)		
Stockholders' equity (deficit):		
Series A Preferred stock, 444,541 shares authorized with par value of $0.001 per share; 83 and 166 shares issued and outstanding at December 31, 2011 and 2010, 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 of $0.001; 114 and 141 shares issued and outstanding at December 31, 2011 and 2010, 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 and 848,000,000 shares authorized at December 31, 2011 and 2010, respectively, with par value of $0.001; 32,778,993 and 21,816,602 shares issued and outstanding at December 31, 2011 and 2010, respectively	33	22

Additional paid-in capital		142,955		102,360
Accumulated other comprehensive income (loss)		13		(63)
Accumulated deficit		(129,328)		(112,183)
Total stockholders' equity (deficit)		13,673		(9,864)
Total liabilities and stockholders' equity (deficit)	$	16,627	$	1,251

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 December 31, 2011	2010
Net revenues	$6,067	$440
Cost of revenues	908	268
Gross margin	5,159	172
Operating expenses:		
Product research and development	1,858	1,873
Sales and marketing	1,812	566
General and administrative	3,533	3,588
Amortization of fair value of stock issued to related parties for purchase of Neonode Technologies AB (formerly AB Cypressen)	--	3,168
Total operating expenses	7,203	9,195
Operating loss	(2,044)	(9,023)
Other expense:		
Interest and other expense	(288)	(179)
Loss on extinguishment of debt	--	(2,416)
Non-cash items related to debt discounts and deferred financing fees and the valuation of conversion features and warrants	(14,735)	(19,963)
Total other expense	(15,023)	(22,558)
Loss before provision for income taxes	(17,067)	(31,581)
Provision for income taxes	78	45
Net loss	$(17,145)	$(31,626)
Loss per common share:		
Basic and diluted loss per share	$(0.64)	$(1.73)
Basic and diluted – weighted average shares used in per share computations	26,784	18,293

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

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NEONODE INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT) AND COMPREHENSIVE LOSS
(Amounts in thousands)

	Common stock shares issued	Common stock amount	Additional paid-in-capital	Series A Preferred stock shares issued	Series A Preferred stock amount	Series B Preferred stock shares issued	Series B Preferred stock amount	Accumulated other comprehensive income (loss)	Accumulated deficit	Total Stockholders' equity (deficit)	Other comprehensive loss
Balances, January 1, 2010	16,659	$ 17	$ 74,288	3	$ -	1	$ -	$ (96)	$ (80,557)	$ (6,348)	
Employee stock option and warrant compensation expense	-	-	2,262	-	-	-	-	-	-	2,262	
Amortization of fair value of stock issued to related parties for purchase of Neonode Technologies AB (formerly AB Cypressen)	-	-	3,168	-	-	-	-	-	-	3,168	
Reclassification of derivative liabilities to additional paid-in capital	-	-	19,286	-	-	-	-	-	-	19,286	
Common stock issued to settle lawsuit	498	-	647	-	-	-	-	-	-	647	
Exchange of Series A Preferred Stock for common stock	1,577	2	(2)	(3)	-	-	-	-	-	-	
Exchange of Series B Preferred Stock for common	73	-	-	-	-	(1)	-	-	-	-	

stock											
Proceeds for issuance of warrants	-	-	49	-	-	-	-	-	-	49	
Common stock issued upon conversion of debt including beneficial conversion feature amounts	186	-	179	-	-	-	-	-	-	179	
Common stock issued to brokers	57	-	65	-	-	-	-	-	-	65	
Common stock issued to investors in the 2010 warrant repricing financing transaction	2,767	3	2,418	-	-	-	-	-	-	2,421	
Foreign currency translation adjustment	-	-	-	-	-	-	-	33	-	33	33
Net loss	-	-	-	-	-	-	-	-	(31,626)	(31,626)	$ (31,626)
Comprehensive loss											(31,593)
Balances, December 31, 2010	21,817	22	102,360	-	-	-	-	(63)	(112,183)	(9,864)	
Stock option and warrant compensation expense to employees and vendors	-	-	550	-	-	-	-	-	-	550	
Common stock issued upon exercise of	543	1	514	-	-	-	-	-	-	515	

warrants											
Proceeds from sale of common stock, net of offering costs	3,000	3	10,784	-	-	-	-	-	-	10,787	
Reclassification of derivative liabilities to additional paid-in capital	-	-	20,075	-	-	-	-	-	-	20,075	
Fair value of warrants issued in connection with issuance of 2011 Senior Secured Convertible Debt	-	-	937	-	-	-	-	-	-	937	
Exchange of Series A Preferred Stock for common stock	40	-	-	-	-	-	-	-	-	-	
Exchange of Series B Preferred Stock for common stock	6	-	-	-	-	-	-	-	-	-	
Common stock issued upon conversion of outstanding convertible debt and accrued and bonus interest	7,313	7	7,615	-	-	-	-	-	-	7,622	
Common stock issued for settlement of accrued expenses	60	-	120	-	-	-	-	-	-	120	
Foreign currency	-	-	-	-	-	-	-	76	-	76	76

translation adjustment											
Net loss	-	-	-	-	-	-	-	-	(17,145)	(17,145)	$ (17,145)
Comprehensive loss	-	-	-	-	-	-	-	-	-	-	$ (17,069)
Balances, December 31, 2011	32,779	$ 33	$ 142,955	-	$ -	-	$ -	$ 13	$ (129,328)	$ 13,673	

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

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NEONODE INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	Years ended December 31,	
	2011	2010
Cash flows from operating activities:		
Net loss	$(17,145)	$(31,626)
Adjustments to reconcile net loss to net cash		
used in operating activities:		
Stock-based compensation expense to employees and vendors	550	5,430
Fair value of common stock issued in settlements	--	647
Depreciation and amortization	26	11
Loss on extinguishment of debt	--	2,416
Debt discounts and deferred financing fees and the valuation		
of conversion features and warrants	14,735	19,963
Changes in operating assets and liabilities:		
Accounts receivable	(3,228	