

Neonode, Inc
Form 10-Q
August 08, 2013

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

FORM 10-Q

(Mark one)

Quarterly report pursuant to section 13 or 15(d)
of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2013

Transition report pursuant to section 13 or 15(d) of the
Securities and Exchange Act of 1934

For the transition period from _____ to _____

Commission file number 1-35526

NEONODE INC.

(Exact name of registrant as specified in its charter)

Delaware 94-1517641
(State or other (I.R.S.
jurisdiction of Employer
incorporation Identification
or No.)
organization)

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

(Address of principal executive offices and zip code)

(408) 496-6722

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during

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the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting
company

(do not check if a smaller
reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act. Yes

No

The number of shares of the registrant’s common stock outstanding as of August 3, 2013, was 34,615,474.

NEONODE INC.

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PART I. Financial Information

Item 1. Financial Statements

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

| | June 30, 2013 (Unaudited) | December 31, 2012 (Audited) |
|---|---------------------------------|-----------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 5,354 | \$ 9,097 |
| Accounts receivable | 690 | 2,123 |
| Prepaid expenses and other current assets | 907 | 550 |
| Total current assets | 6,951 | 11,770 |
| Deposit | 67 | 68 |
| Property and equipment, net | 295 | 330 |
| Total assets | \$ 7,313 | \$ 12,168 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 319 | \$ 539 |
| Accrued expenses | 1,012 | 804 |
| Deferred revenue | 2,813 | 2,725 |
| Total current liabilities | 4,144 | 4,068 |
| Total liabilities | 4,144 | 4,068 |
| Commitments and contingencies (Note 6) | | |
| Stockholders' equity: | | |
| Series A Preferred stock, 444,541 shares authorized with par value \$0.001 per share; 0 and 83 issued and outstanding at June 30, 2013 and December 31, 2012, respectively. (In the event of dissolution, each share of Series A Preferred stock has a liquidation preference equal to par value of \$0.001 over the shares of common stock) | -- | -- |
| Series B Preferred stock, 54,425 shares authorized with par value \$0.001 per share; 83 and 95 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively. (In the event of dissolution, each share of Series B Preferred stock has a liquidation preference equal to par value of \$0.001 over the shares of common stock) | -- | -- |
| Common stock, 70,000,000 shares authorized with par value \$0.001 per share; 34,237,513 and 33,331,182 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively | 34 | 33 |
| Additional paid-in capital | 148,381 | 146,677 |
| Accumulated other comprehensive income | 59 | 5 |

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| | | |
|--|------------|------------|
| Accumulated deficit | (145,305) | (138,615) |
| Total stockholders' equity | 3,169 | 8,100 |
| Total liabilities and stockholders' equity | \$ 7,313 | \$ 12,168 |

See accompanying notes to condensed consolidated financial statements.

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

| | Three months ended June 30, | | Six months ended June 30, | |
|--|--------------------------------|------------|------------------------------|------------|
| | 2013 | 2012 | 2013 | 2012 |
| Net revenues | \$1,084 | \$1,974 | \$1,632 | \$3,138 |
| Cost of revenues | 662 | 494 | 678 | 743 |
| Gross margin | 422 | 1,480 | 954 | 2,395 |
| Operating expenses: | | | | |
| Product research and development | 1,441 | 1,478 | 3,075 | 2,165 |
| Sales and marketing | 893 | 1,718 | 1,698 | 2,517 |
| General and administrative | 1,189 | 1,691 | 2,841 | 2,686 |
| Total operating expenses | 3,523 | 4,887 | 7,614 | 7,368 |
| Loss before provision for income taxes | (3,101) | (3,407) | (6,660) | (4,973) |
| Provision for income taxes | 19 | 20 | 30 | 42 |
| Net loss | \$(3,120) | \$(3,427) | \$(6,690) | \$(5,015) |
| Loss per common share: | | | | |
| Basic and diluted loss per share | \$(0.09) | \$(0.10) | \$(0.20) | \$(0.15) |
| Basic and diluted – weighted average number of common shares outstanding | 34,135 | 32,969 | 33,825 | 32,889 |

See accompanying notes to condensed consolidated financial statements.

NEONODE INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)
(Unaudited)

| | Three months ended June | | Six months ended June 30, | |
|--|-------------------------|-------------|---------------------------|------------|
| | 2013 | 30, 2012 | 2013 | 2012 |
| Net loss | \$(3,120) | \$(3,427) | \$(6,690) | \$(5,015) |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustments | 41 | (72) | 54 | (28) |
| Total comprehensive loss | \$(3,079) | \$(3,499) | \$(6,636) | \$(5,043) |

See accompanying notes to condensed consolidated financial statements.

NEONODE INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)
(Unaudited)

| | Six months ended June | |
|---|-----------------------|------------|
| | 30, | |
| | 2013 | 2012 |
| Cash flows from operating activities: | | |
| Net loss | \$ (6,690) | \$ (5,015) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Stock-based compensation expense | 1,339 | 2,351 |
| Depreciation and amortization | 64 | 40 |
| Loss on disposal of property and equipment | 1 | -- |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 1,431 | 1,623 |
| Other assets | (1) | -- |
| Prepaid expenses | (364) | (96) |
| Accounts payable and accrued expenses | 20 | 87 |
| Deferred revenue | 88 | (363) |
| Net cash used in operating activities | (4,112) | (1,373) |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (34) | (268) |
| Net cash used in investing activities | (34) | (268) |
| Cash flows from financing activities: | | |
| Proceeds from exercise of stock options | 166 | -- |
| Proceeds from exercise of warrants | 200 | 8 |
| Net cash provided by financing activities | 366 | 8 |
| Effect of exchange rate changes on cash | 37 | (32) |
| Net decrease in cash | (3,743) | (1,665) |
| Cash at beginning of period | 9,097 | 12,940 |
| Cash at end of period | \$ 5,354 | \$ 11,275 |
| Supplemental disclosure of cash flow information: | | |
| Interest paid | \$ -- | \$ -- |
| Income taxes paid | \$ 30 | \$ 42 |

See accompanying notes to condensed consolidated financial statements.

NEONODE INC.

Notes to the Condensed Consolidated Financial Statements

(Unaudited)

1. Interim Period Reporting

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

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

Operations

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

2. Summary of Significant Accounting Policies

Principles of Consolidation

The condensed consolidated balance sheet at December 31, 2012 and the condensed consolidated statements of operations, other comprehensive loss, and cash flows for the three and six months ended June 30, 2012 include our accounts and the accounts of our wholly owned Swedish subsidiary Neonode Technologies AB (“NTAB”). All significant intercompany accounts and transactions have been eliminated.

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

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires making estimates and assumptions that affect, at the date of the financial statements, the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. 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 and the fair value of options and warrants issued for stock-based compensation.

Concentration of Cash Balance Risks

Cash balances are maintained at various banks in the U.S., Japan and Sweden. At times, deposits held with financial institutions in the United States of America may exceed the amount of insurance provided by the Federal Deposit Insurance Corporation (“FDIC”), which provides basic deposit coverage with limits up to \$250,000 per owner. The Swedish government provides insurance coverage up to 100,000 euro per customer and covers deposits in all types of accounts. The Japanese government provides insurance coverage up to 10,000,000 Yen per customer. As of June 30, 2013, the Company has approximately \$5.0 million in excess of insurance limits.

Accounts Receivable and Allowance for Doubtful Accounts

Our accounts receivable are stated at net realizable value. Our policy is to maintain allowances for estimated losses resulting from the inability of our customers to make required payments. Credit limits are established through a process of reviewing the financial history and stability of each customer. Where appropriate, we obtain credit rating reports and financial statements of the customer when determining or modifying its credit limits. We regularly evaluate the 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 based on certain other factors including the length of time the receivables are past due and historical collection experience with customers. We determined that an allowance for doubtful accounts was not necessary at June 30, 2013 and December 31, 2012.

Property and Equipment

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

Estimated useful lives

| | |
|--------------------|---------|
| Computer equipment | 3 years |
| | 5 years |

Furniture and
fixtures

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Equipment purchased under capital leases is amortized on a straight-line basis over the estimated useful life of the asset or the term of the lease, whichever is shorter.

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

Long-lived Assets

We assess any impairment by estimating the future cash flow from the associated asset in accordance with relevant accounting guidance. If the estimated undiscounted future cash flow related to these assets decreases or the useful life is shorter than originally estimated, we may incur charges for impairment of these assets. At June 30, 2013, we believe there is no impairment of our long-lived assets.

Foreign Currency Translation and Transaction Gains and Losses

The functional currency of our foreign subsidiaries is the applicable local currency, the Swedish Krona and Japanese Yen. The translation from Swedish Krona and Japanese Yen to U.S. Dollars is performed for balance sheet accounts using current exchange rates in effect at the balance sheet date and for income statement accounts using a weighted-average exchange rate during the period. Foreign currency translation gains were \$41,000 and \$54,000 during the three and six months ended June 30, 2013, respectively, compared to translation losses of \$(72,000) and \$(28,000) during the same periods in 2012, respectively. Gains or losses resulting from translation are included as a separate component of accumulated other comprehensive income. Gains or losses resulting from foreign currency transactions are included in general and administrative expense in the accompanying condensed consolidated statements of operations and were \$87,000 and \$124,000 during the three and six months ended June 30, 2013, respectively, compared to \$73,000 and \$11,000 during the same periods in 2012, respectively.

Concentration of Credit and Business Risks

Our accounts receivable as of June 30, 2013 was due from twelve customers, three of which accounted for 54% of our accounts receivable as of June 30, 2013.

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

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

Kobo Inc. - 18%

Netronix Inc. - 16%

Sony Corporation – 13%

BYD Precision Manufacture Company Limited – 11%

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

Kobo Inc. - 27%

Netronix Inc. -18%
Sony Corporation – 15%

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

Amazon - 53%
Kobo Inc. - 11%
Sony Corporation - 11%

Our net revenues for the six months ended June 30, 2012 were earned from sixteen customers. Customers who accounted for 10% or more of our net revenues during the six months ended June 30, 2012 are as follows:

Amazon - 53%
Sony Corporation - 13%

Revenue Recognition

Licensing Revenues:

We derive revenue from the licensing of internally developed intellectual property (“IP”). We enter into IP licensing agreements that generally provide licensees the right to incorporate our IP components in their products with terms and conditions that vary by licensee. The IP licensing agreements generally include a nonexclusive license for the underlying IP. Fees under these agreements may include license fees relating to our IP and royalties payable following the distribution by our licensees of products incorporating the licensed technology. The license for our IP has standalone value and can be used by the licensee without maintenance and support. Neonode meets all the accounting requirements for revenue recognition as per unit royalty products are distributed or licensed by the Company’s customers. For technology license arrangements that do not require significant modification or customization of the underlying technology, we recognize technology license revenue when: (1) we enter into a legally binding arrangement with a customer for the license of technology; (2) the customer distributes or licenses the products; (3) the customer payment is deemed fixed or determinable and free of contingencies or significant uncertainties; and (4) collection is reasonably assured. Our customers report to us the quantities of products distributed or licensed by them after the end of the reporting period stipulated in the contract, generally 30 to 45 days after the end of the month or quarter.

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

Engineering Services:

We may sell engineering consulting services to our customers on a flat rate or hourly rate basis. We recognize revenue from these services when all of the following conditions are met: (1) evidence existed of an arrangement with the customer, typically consisting of a purchase order or contract; (2) our services were performed and risk of loss passed to the customer; (3) we completed all of the necessary terms of the contract; (4) the amount of revenue to which we were entitled was fixed or determinable; and (5) we believed it was probable that we would be able to collect the amount due from the customer. To the extent that one or more of these conditions has not been satisfied, we defer recognition of revenue. Generally, we recognize revenue as the engineering services stipulated under the contract are completed and accepted by our customers.

Deferred Revenue

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

Advertising

Advertising costs are expensed as incurred. Advertising costs for the three and six months ended June 30, 2013 and 2012 amounted to approximately \$5,000 and \$85,000 and \$129,000 and \$282,000, respectively.

Product Research and Development

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

Stock-Based Compensation Expense

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

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

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

Income Taxes

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

Based on the uncertainty of future pre-tax income, we fully reserved our net deferred tax assets as of June 30, 2013 and December 31, 2012. In the event we were to determine that we would be able to realize our deferred tax assets in the future, an adjustment to the deferred tax asset would increase income in the period such determination was made. The provision for income taxes represents the net change in deferred tax amounts, plus income taxes paid or payable for the current period.

We follow the relevant accounting guidance related to uncertain tax positions, which provisions include a two-step approach to recognizing, de-recognizing and measuring uncertain tax positions. As a result, we did not recognize a liability for unrecognized tax benefits. As of June 30, 2013 and December 31, 2012, we had no unrecognized tax benefits.

Net Loss Per Share

Net loss per share amounts have been computed based on the weighted-average number of shares of common stock outstanding during the period. Net loss per share, assuming dilution amounts from common stock equivalents, is computed based on the weighted-average number of shares of common stock and potential common stock equivalents outstanding during the period. The weighted-average number of shares of common stock and potential common stock equivalents used in computing the net loss per share for three and six months ended June 30, 2013 and 2012 exclude the potential common stock equivalents, as the effect would be anti-dilutive (See Note 8).

Comprehensive Income (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 of stockholder' equity in the condensed consolidated balance sheets as accumulated other comprehensive income.

Cash Flow Information

Cash flows in foreign currencies have been converted to U.S. dollars at an approximate weighted-average exchange rate for the respective reporting periods. The weighted-average exchange rate for the consolidated statements of operations and comprehensive loss was 6.56 and 6.95 Swedish Krona to one U.S. Dollar for the three months ended June 30, 2013 and 2012, respectively. The weighted-average exchange rate for the consolidated statements of operations and comprehensive loss was 6.50 and 6.85 Swedish Krona to one U.S. Dollar for the six months ended June 30, 2013 and 2012, respectively. The exchange rate for the consolidated balance sheets was 6.70 and 6.52 Swedish Krona to one U.S. Dollar as of June 30, 2013 and December 31, 2012, respectively. The weighted-average exchange rate for the consolidated statement of operations and comprehensive loss was 98.75 and 95.49 Japanese Yen to one U.S. Dollar for the three and six months ended June 30, 2013. The exchange rate for the consolidated balance sheet was 99.1 Japanese Yen to one U.S. Dollar as of June 30, 2013.

3. Stockholders' Equity

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

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

Common Stock

During the six months ended June 30, 2013, warrant holders (excluding our CFO) exercised warrants to purchase 578,066 shares of common stock using the cashless exercise provision allowed in the warrant and received 412,254 shares of our common stock. In addition, warrant holders exercised warrants to purchase 148,145 shares of common stock and paid a cash exercise price ranging between \$1.00 and \$3.13 per share for a total cash exercise price of \$200,000.

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

Preferred Stock

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

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

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

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

Dividends and Distributions.

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

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

Liquidation Preference.

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

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

Voting.

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

Conversion.

Initially, each share of Series A Preferred stock and each share of Series B Preferred stock was convertible into one share of our common stock. Any modification to the conversion rate requires shareholder approval. On March 31, 2009, our shareholders approved a resolution to increase the authorized share capital, and to increase the conversion ratio to 480.63 shares of common stock for each share of Series A Preferred stock and to 132.07 shares of our common stock for each shares of Series B Preferred stock, thus completing the restructuring begun in December 2008.

On April 24, 2009, we initiated the process of allowing the shareholders of our preferred stock to convert the Series A and B Preferred stock to shares of our common stock. In order to convert the preferred stock to common stock each preferred stock shareholder is required to submit the preferred stock certificate to our transfer agent and request conversion to common stock. The conversion to common stock is not mandatory and shareholders who own preferred stock may choose not to convert their preferred stock to shares of our common stock. The following table summarizes the Preferred stock not yet converted as of June 30, 2013.

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

4. Deferred Revenue

As of June 30, 2013 and December 31, 2012, we have \$2.0 million and \$2.1 million, respectively, of deferred license fee revenue related to prepayments for future license fees from three customers and a total of \$0.8 million and \$0.6 million, respectively, of deferred engineering development fees from seventeen and thirteen customers, respectively. We defer the license fees until we have met all accounting requirements for revenue recognition as per unit royalty products are distributed or licensed by the Company's customers and the engineering development fee revenue until such time as the engineering work has been completed and accepted by our customers.

5. Stock-Based Compensation

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

Stock Options

As of June 30, 2013, we had two equity incentive plans:

The 1998 Non-Officer Stock Option Plan (the 1998 Plan), which expired in June 2008 ;
The 2006 Equity Incentive Plan (the 2006 Plan).

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

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

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

| Number of Options | Weighted Average |
|----------------------|---------------------|
|----------------------|---------------------|

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| | Outstanding | Exercise Price |
|--------------------------------|-------------|-------------------|
| Outstanding at January 1, 2013 | 1,715,200 | \$ 5.04 |
| Granted | 15,000 | 5.97 |
| Cancelled or expired | (18,256) | 6.04 |
| Exercised | (38,456) | 4.33 |
| Outstanding at June 30, 2013 | 1,673,488 | \$ 5.05 |

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

The aggregate intrinsic value of the 1,673,488 stock options that are outstanding, vested and expected to vest at June 30, 2013 is \$2.6 million.

On March 19, 2013, the Company received an aggregate of \$166,000 from two employees in connection with the exercise of stock options into 38,456 shares of common stock. The intrinsic value related to the options exercised was \$58,000 on the date of exercise.

We granted an option to purchase 15,000 shares of our common stock to an employee during the six months ended June 30, 2013 with a grant date fair value of \$80,000 computed using the Black-Scholes option pricing model.

For the three and six months ended June 30, 2013, the Company recorded \$577,000 and \$1.2 million, respectively, of compensation expense related to the vesting of stock options. For the three and six months ended June 30, 2012, the Company recorded \$2.3 million, respectively, of compensation expense related to the vesting of stock options. The fair value of the stock-based compensation was calculated using the Black-Scholes option pricing model as of the date of grant of the stock option.

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

| | For the Six Months Ended June 30, 2013 |
|-------------------------|--|
| Annual dividend yield | -- |
| Expected life (years) | 4.3 |
| Risk-free interest rate | 0.65% |
| Expected volatility | 154% |
| | For the Six Months Ended June 30, 2012 |
| Annual dividend yield | -- |
| Expected life (years) | 3.8 |
| Risk-free interest rate | 0.55% - 0.57% |
| Expected volatility | 186% - 187% |

The 1998 Plan terminated effective June 15, 2008 and the Director Plan terminated effective March 2011. Although we can no longer issue stock options out of the plans, the outstanding options at the date of termination will remain outstanding and vest in accordance with their terms. Options granted under the Director Plan vested over a one to four-year period, expire five to seven years after the date of grant and have exercise prices reflecting market value of the shares of our common stock on the date of grant. Stock options granted under the 1998 and 2006 Plans are exercisable over a maximum term of ten years from the date of grant, vest in various installments over a one to four-year period and have exercise prices reflecting the market value of the shares of common stock on the date of grant.

Warrants

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

On December 3, 2010, we issued 120,000 warrants at an exercise price of \$1.63 per share to an employee. The fair value of the warrants was \$198,000 on the date of grant, using the Black-Scholes option pricing model, which has been amortized to expense over 24 months. During the three and six months ended June 30, 2012, we recorded \$25,000 and \$50,000, respectively, of stock based compensation expense related to vesting of such warrants.

On September 12, 2011, we issued 20,000 three-year stock purchase warrants to an employee at an exercise price of \$3.90 per share with a vesting period over 24 months. The warrant granted to an employee had a fair value on the date of grant of \$75,000. This amount is expensed over the vesting period of which \$10,000 and \$19,000 and \$9,000 and \$18,000 of expense related to this warrant is included in product research and development expense for the three and six months ended June 30, 2013 and 2012, respectively. The fair value of stock-based compensation related to the issuance of warrants is calculated using the Black-Scholes option pricing model as of the grant date of the underlying warrant.

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

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

| | Three months ended June 30, | | Six months ended June 30, | |
|----------------------------------|--------------------------------|--|------------------------------|----------|
| | 2013 | 2012 | 2013 | 2012 |
| Product research and development | \$ 58 | \$ 178 | \$ 118 | \$ 187 |
| Sales and marketing | \$ 194 | 918 | 385 | 943 |
| General and administrative | \$ 501 | 1,221 | 836 | 1,221 |
| Stock compensation expense | \$ 753 | \$ 2,317 | \$ 1,339 | \$ 2,351 |
| | | Remaining unamortized expense at June 30, 2013 | | |
| Stock-based compensation | \$ | 2,401 | | |

The remaining unamortized expense related to stock options and warrants will be recognized on a straight line basis monthly as compensation expense over the remaining vesting period which approximates 2.7 years.

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

A summary of all warrant activity is set forth below:

| | | June 30, 2013 | |
|--|-------------|--|---|
| | | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life |
| Outstanding and exercisable | Warrants | | |
| January 1, 2013 | 4,704,636 | \$ 1.61 | 1.41 |
| Issued | -- | -- | -- |
| Expired/forfeited | -- | -- | -- |
| Exercised | (1,046,211) | 1.35 | -- |
| Outstanding and exercisable, June 30, 2013 | 3,658,425 | \$ 1.69 | 0.92 |

During the six months ended June 30, 2013, warrant holders (excluding our CFO) exercised warrants to purchase 578,066 shares of common stock using the cashless exercise provision allowed in the warrant and received 412,254 shares of our common stock. In addition, warrant holders exercised warrants to purchase 148,145 shares of common stock and paid a cash exercise price ranging between \$1.00 and \$3.13 per share for a total cash exercise price of \$200,000.

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

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

| Description | Issue Date | Exercise Price | Shares | Expiration Date |
|----------------------------------|---------------|-------------------|-----------|--------------------|
| August 2009 Employee Warrants | 8/25/2009 | \$ 0.50 | 80,000 | 8/25/2016 |
| 2007 Debt Extension Warrants | 9/22/2010 | \$ 1.00 | 16,000 | 9/22/2015 |
| September 2010 Repricing Warrant | 9/28/2010 | \$ 1.38 | 4,000 | 9/28/2013 |
| October 2010 Repricing Warrants | 10/18/2010 | \$ 1.38 | 1,845,461 | 10/18/2013 |

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| | | | | |
|-------------------------------------|------------|---------|-----------|------------|
| October 2010 Employee Warrants | 10/15/2010 | \$ 1.38 | 800,000 | 10/15/2013 |
| December 2010 Employee Warrants | 12/3/2010 | \$ 1.63 | 200,000 | 12/3/2015 |
| January 2011 Employee Warrant | 1/21/2011 | \$ 2.00 | 20,000 | 1/21/2014 |
| February 2011 Legal Advisor Warrant | 2/22/2011 | \$ 2.50 | 80,000 | 2/22/2016 |
| March 2011 Investor Warrants | 3/9/2011 | \$ 3.13 | 538,864 | 3/9/2016 |
| March 2011 Investor Warrants | 4/7/2011 | \$ 3.13 | 34,100 | 4/7/2016 |
| May 2011 Consultant Warrant | 5/17/2011 | \$ 4.05 | 20,000 | 5/17/2014 |
| September 2011 Employee Warrant | 9/12/2011 | \$ 3.90 | 20,000 | 9/12/2014 |
| Total Warrants Outstanding | | | 3,658,425 | |

6. Commitments and Contingencies

Non-Recurring Engineering Development Costs

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

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

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

In the three and six months ended June 30, 2013, \$52,000 and \$270,000, respectively, of NRE expense related to this agreement is included in product research and development on the condensed consolidated statement of operations. No amounts were recorded in the three and six months ended June 30, 2012 as no shipments of NN1001 took place.

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

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

Operating Leases

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 nine month notice period. The contract will be extended for an additional three years if it is not terminated according to the terms in the contract.

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

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

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

For the six months ended June 30, 2013 and 2012, the Company recorded approximately \$228,000 and \$193,000, respectively, for rent expense.

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

| Year ending December 31, | Total |
|-----------------------------|--------|
| 2013 (remaining six months) | \$ 192 |
| 2014 | 261 |
| 2015 | 23 |
| | \$ 476 |

7. Segment Information

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

The following tables present net revenues by geographic region for the three and six months ended June 30, 2013 and 2012 (dollars in thousands):

| | Three months ended June 30, 2013 | | Three months ended June 30, 2012 | |
|--|-------------------------------------|------------|-------------------------------------|------------|
| | Amount | Percentage | Amount | Percentage |
| Net revenues from customers in North America | \$ 457 | 42% | \$ 1,218 | 62% |
| Net revenues from customers in Asia | 535 | 49% | 756 | 38% |
| Net revenues from customers in Europe | 92 | 9% | -- | -- |
| | \$ 1,084 | 100% | \$ 1,974 | 100% |

| | Six months ended June 30, 2013 | | | Six months ended June 30, 2012 | | |
|--|-----------------------------------|------------|---|-----------------------------------|------------|---|
| | Amount | Percentage | | Amount | Percentage | |
| Net revenues from customers in the North America | \$748 | 46 | % | \$2,000 | 64 | % |
| Net revenues from customers in Asia | 774 | 47 | % | 1,138 | 36 | % |
| Net revenues from customers in Europe | 110 | 7 | % | -- | -- | |
| | \$1,632 | 100 | % | \$3,138 | 100 | % |

8. Net Loss Per Share

Basic net loss per common share for the three and six months ended June 30, 2013 and 2012 was computed by dividing the net loss for the relevant period by the weighted average number of shares of common stock outstanding. Diluted loss per common share is computed by dividing net loss by the weighted average number of shares of common stock and common stock equivalents outstanding.

Potential common stock equivalents of approximately 332,000 and 103,000 outstanding stock options, 2.5 million and 3.4 million outstanding stock warrants under the treasury stock method and 11,000 and 52,000 shares issuable upon conversion of preferred stock are excluded from the diluted earnings per share calculation for the six months ended June 30, 2013 and 2012, respectively, due to their anti-dilutive effect.

| (in thousands, except per share amounts) | Three months ended June 30, | |
|--|--------------------------------|-------------|
| | 2013 | 2012 |
| BASIC AND DILUTED | | |
| Weighted average number of common shares outstanding | 34,135 | 32,969 |
| Number of shares for computation of net loss per share | 34,135 | 32,969 |
| Net loss | \$ (3,120) | \$ (3,427) |
| Net loss per share - basic and diluted | \$ (0.09) | \$ (0.10) |

| (in thousands, except per share amounts) | Six months ended June 30, | |
|--|------------------------------|------------|
| | 2013 | 2012 |
| BASIC AND DILUTED | | |
| Weighted average number of common shares outstanding | 33,825 | 32,889 |
| Number of shares for computation of net loss per share | 33,825 | 32,889 |
| Net loss | \$(6,690) | \$(5,015) |
| Net loss per share - basic and diluted | \$(0.20) | \$(0.15) |

9. Subsequent Events

Subsequent to June 30, 2013, warrant holders exercised warrants to purchase 471,729 shares of common stock using the cashless exercise provision allowed in the warrant and received 377,163 shares of our common stock. In addition, warrant holders exercised warrants to purchase 5,572 shares of common stock at an exercise price of \$3.13 per share for cash proceeds to the Company of \$17,420.

On July 15, 2013, an employee exercised stock options with an exercise price of \$4.25 per share and was issued 5,555 shares of our common stock for cash proceeds of \$23,609. The intrinsic value of the option exercised was approximately \$22,000.

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

Forward Looking Statements

This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, adopted pursuant to the Private Securities Litigation Reform Act of 1995. Statements that are not purely historical may be forward-looking. You can identify some forward-looking statements by the use of words such as "believes," "anticipates," "expects," "intends" and similar expressions. Forward looking statements involve inherent risks and uncertainties regarding events, conditions and financial trends that may affect our future plans of operation, business strategy, results of operations and financial position. A number of important factors could cause actual results to differ materially from those included within or contemplated by such forward-looking statements, including, but not limited to risks relating to the uncertainty of growth in market acceptance for our technology, a history of losses since inception, our ability to remain competitive in response to new technologies, the costs to defend, as well as risks of losing, patents and intellectual property rights, a reliance on our future customers' ability to develop and sell products that incorporate our technology, our customer concentration and dependence on a limited number of customers, the uncertainty of demand for our technology in certain markets, our ability to manage growth effectively, our dependence on key members of our management and development team, our limited experience in conducting operations internationally, and our ability to obtain adequate capital to fund future operations, For a discussion of these and other factors that could cause actual results to differ from those contemplated in the forward-looking statements, please see the discussion under "Risk Factors" contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 and in our publicly available filings with the Securities and Exchange Commission. Forward-looking statements reflect our analysis only as of the date hereof. Actual events or results may differ materially from the results discussed in or implied by the forward-looking statements. We do not undertake any responsibility to update or revise any of these factors or to announce publicly any revisions to forward-looking statements, whether as a result of new information, future events or otherwise.

The following Management's Discussion and Analysis should be read in conjunction with the condensed consolidated financial statements and the notes thereto included in Item 1 of this Quarterly Report on Form 10-Q and consolidated financial statements for the year ended December 31, 2012 included in our Annual Report on Form 10-K.

Overview

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

During the three and six months ended June 30, 2013, we had six and nine customers, respectively, using our touchscreen technology in products that were shipping to customers. We had an additional seventeen customers with signed license agreements currently in the product development stage. In most circumstances, our target customers will have to successfully integrate our technology into their products and then sell those products to their customers before we will receive any cash from our technology license agreements.

As of June 30, 2013, we have signed twenty-nine technology license agreements with global OEMs. Subsequent to June 30, 2013, we signed one new license agreement with a global OEM located in South Korea to develop a multi-sensing touch solution for a series of consumer products. Seven 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 2013 and 2014. In addition, we are currently developing prototype products and are engaged in product engineering design discussions with numerous global OEMs who are in the process of qualifying our touchscreen technology for incorporation in various products such as laptop computers, printer products, GPS devices, e-Readers, tablets, touch panels for automobiles, household appliances, mobile phones, wearable electronics and games and toys. The development and product release cycle for these products typically takes six to eighteen months.

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

Results of Operations

Net Revenues

Net revenues for the three and six months ended June 30, 2013 were \$1.1 million and \$1.6 million, respectively, compared to net revenues for the three and six months ended June 30, 2012 of \$2.0 million and \$3.1 million, respectively. Our net revenues for the three and six months ended June 30, 2013 included \$0.6 million and \$1.2 million from license fees plus \$0.45 million and \$0.46 million, respectively, of fees for engineering design services related to our touch screen solution for customers. Our net revenues for the three and six months ended June 30, 2012 included \$1.6 million and \$2.5 million, respectively, from license fees plus \$0.4 million and \$0.6 million, respectively, of fees for engineering design services related to our touch screen solution for numerous customers.

The decrease in overall net revenues in the three and six months ended June 30, 2013 compared to the same periods in 2012 is primarily due to a decrease in license fees primarily from Amazon. Amazon contributed approximately fifty-three percent of our total net revenues during the six months ended June 30, 2012 compared to less than 1% in the six months ended June 30, 2013. The decrease in net revenues earned from Amazon was partially offset by an increase in net revenues earned from Kobo Inc. and Netronix.

Gross Margin

Gross margin was \$0.4 million and \$1.0 million for the three and six months ended June 30, 2013, respectively, compared to \$1.5 million and \$2.4 million for the same periods in 2012, respectively. Our cost of revenues includes the direct cost of production of certain customer prototypes, costs of Company employed engineering personnel and engineering consultants to complete the engineering design contract. Our gross margin has decreased due to the decrease in our total revenues particularly our license fee revenue. The gross margin related to our license fees is 100% and when license fees as a percentage of our total revenues decrease our gross margin will decrease.

Product Research and Development

Product research and development (R&D) expenses for the three and six months ended June 30, 2013 were \$1.4 million and \$3.1 million, respectively, compared to \$1.5 million and \$2.2 million for the same periods in 2012. R&D costs mainly consist of personnel related costs in addition to some external consultancy costs such as testing, certifying and measurements along with costs related to developing and building new product prototypes. Included in R&D expenses is \$58,000 and \$118,000 of non-cash stock-based compensation expense for the three and six months ended June 30, 2013, respectively, compared to \$178,000 and \$187,000 for the same periods in 2012. Other costs related to customer specific activities are included in our cost of revenue.

Sales and Marketing

Sales and marketing (S&M) expenses for the three and six months ended June 30, 2013 were \$0.9 million and \$1.7 million, respectively, compared to \$1.7 million and \$2.5 million for the same periods in 2012, respectively. This decrease in 2013 as compared to 2012 is primarily related to a decrease in marketing activities, travel related and stock based compensation related costs. Marketing related expense decreased to \$5,000 and \$129,000 for the three and six months ended June 30, 2013, respectively, compared to \$85,000 and \$282,000 for the same periods in 2012. Included in S&M expenses is \$194,000 and \$385,000 of non-cash stock-based compensation expense for the three and six months ended June 30, 2013, respectively, compared to \$918,000 and \$943,000 for the same periods in 2012.

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 three and six months ended June 30, 2013 were \$1.2 million and \$2.8 million, respectively, compared to \$1.7 million and \$2.7 million for the same periods in 2012, respectively. This overall increase in 2013 as compared to 2012 is primarily related to salary expense, legal expenses related to patent filings, corporate and SEC compliance and customer contracts. Included in G&A expenses is \$501,000 and \$836,000 of non-cash stock-based compensation expense for the three and six months ended June 30, 2013, respectively, compared to \$1.2 million for the same periods in 2012.

Income Taxes

Our effective tax rate was 0% in the three and six months ended June 30, 2013 and 2012, respectively. We recorded valuation allowances for the three and six month periods ended June 30, 2013 and 2012 for deferred tax assets related to net operating losses due to the uncertainty of realization. In the event of future taxable income, our effective income tax rate in future periods could be lower than the statutory rate as such tax assets are realized.

Net Loss

As a result of the factors discussed above, we recorded a net loss of \$3.1 million and \$6.7 million for the three and six months ended June 30, 2013, respectively, compared to a net loss of \$3.4 million and \$5.0 million, respectively, in the comparable periods in 2012.

Off-Balance Sheet Arrangements

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

Contractual Obligations and Commercial Commitments

Non-Recurring Engineering Development Costs

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

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

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

In the three and six months ended June 30, 2013, \$52,000 and \$270,000, respectively, of NRE expense related to this agreement is included in product research and development on the condensed consolidated statement of operations. No amounts were recorded in the three and six months ended June 30, 2012 as no shipments of NN1001 took place.

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

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

Operating Leases

We lease office space in one U.S. location. Outside the U.S., we lease office space in Stockholm, Sweden and Tokyo, Japan. The future minimum lease payments under all of our non-cancelable operating leases with an initial term in excess of one year as of June 30, 2013 were \$476,000. There have been no material changes in those obligations during the first three months of fiscal 2013.

On April 16, 2013, Neonode Technologies AB renewed a lease with No Picnic for 2,853 square feet of office space located at Storgatan 23C, Stockholm, Sweden for approximately \$14,000 per month including property tax (excluding VAT). The annual payment for this space equates to approximately \$174,000 per year including property tax (excluding VAT). This lease is valid through April 15, 2014.

Liquidity and Capital Resources

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

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

At June 30, 2013, we had cash of \$5.4 million, as compared to \$9.1 million at December 31, 2012.

Working capital (current assets less current liabilities) was \$2.8 million at June 30, 2013, compared to working capital of \$7.7 million at December 31, 2012.

Net cash used in operating activities for the six months ended June 30, 2013 was \$4.1 million and was primarily the result of (i) a net loss of approximately \$6.7 million and (ii) approximately \$1.2 million in net cash provided by changes in operating assets and liabilities, primarily accounts receivable. Cash used to fund net losses is reduced by approximately \$1.4 million in non-cash operating expenses, comprised of depreciation and amortization and stock-based compensation.

Accounts receivable decreased approximately \$1.4 million at June 30, 2013 compared with December 31, 2012, primarily as a result of a decrease in net revenues from approximately \$2.3 million in the fourth quarter of 2012 compared to approximately \$1.6 million in the first six months of 2013. During the six months ended June 30, 2013, we were successful in collecting cash from net revenues to our customers in accordance with our standard payment terms.

Deferred revenue increased approximately \$0.1 million during the six months ended June 30, 2013 compared with December 31, 2012, primarily as a result of additional license technology agreements and engineering projects entered into during the six months ended June 30, 2013.

In the six months ended June 30, 2013, we purchased \$34,000 of property and equipment, primarily computers and test equipment.

Net cash provided by financing activities was the result of net proceeds of \$366,000 received in connection with the exercise of stock options and warrants for shares of our common stock during the six months ended June 30, 2013.

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.

We may from time to time raise capital under our current shelf registration in amounts, at prices, and on terms to be announced when and if the securities are offered. The specifics of any future offerings, along with the use of proceeds of any securities offered, will be described in detail in a prospectus supplement, or other offering materials, at the time of the offering. At June 30, 2013, there were 1,000,000 shares that remained registered and available for issuance under our shelf registration.

The functional currency of our foreign subsidiaries in Sweden is the Swedish Krona and in Japan is the Japanese Yen. They are subject to foreign currency exchange rate risk. Any increase or decrease in the exchange rate of the U.S. Dollar compared to the Swedish Krona or Japanese Yen will impact Neonode's future operating results.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are exposed to risks associated with changes in currency exchange rates. All of our revenue and approximately 55% of our consolidated costs are denominated in U.S. dollars. We do not believe changes in foreign currency exchange rates will be material to our financial position or results of operation. We do not currently enter into forward-exchange contracts to hedge exposure denominated in foreign currencies or any other derivative financial instruments for trading or speculative purposes. In the future, if our operations change and we determine that our foreign exchange exposure has increased, we may consider entering into hedging transactions to mitigate such risk.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

Under the supervision of and with the participation of our management, including the Company's Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2012. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Changes in internal control over financial reporting

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

PART II. Other Information

ITEM 1. Legal Proceedings

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

ITEM 1A. Risk Factors

There have been no material changes from the risk factors as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012.

ITEM 6. Exhibits

Exhibits

Exhibit #Description

- | | |
|-------|--|
| 3.1 | Amended and Restated Certificate of Incorporation of Neonode Inc., dated April 17, 2009 (incorporated by reference to Exhibit 10.22 of our Quarterly Report on Form 10-Q filed on August 4, 2009). |
| 3.1.1 | Certificate of Amendment, dated December 13, 2010 (incorporated by reference to Exhibit 3.1.1 of our Annual Report on Form 10-K filed on March 31, 2011) |
| 3.1.2 | Certificate of Amendment, dated March 18, 2011 (incorporated by reference to Exhibit 3.1 of our Current Report on Form 8-K filed on March 28, 2011) |

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- 3.1.3 Certificate of Correction, dated February 29, 2011 (incorporated by reference to Exhibit 3.1.3 of our Annual Report on Form 10-K filed on March 30, 2012)
- 3.2 Bylaws (incorporated by reference to Exhibit 3.2 of our Annual Report on Form 10-K filed on April 15, 2008)
- 31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act Of 2002
- 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act Of 2002
- 32 Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
- 101.INS XBRL Instance Document *
- 101.SCH XBRL Taxonomy Extension Schema Document *
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document *
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document *
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document *
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document *

* Furnished herewith

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized, on August 8, 2013.

Neonode Inc.
Registrant

Date: August 8, 2013

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