NEOMEDIA TECHNOLOGIES INC
Form 10-Q
May 10, 2007

U. S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10 - Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2007

OR

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

Commission File Number 0-21743

NEOMEDIA TECHNOLOGIES, INC.
(Exact Name of Issuer as Specified In Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**36-3680347** (I.R.S. Employer Identification No.)
2201 Second Street, Suite 600, Fort Myers, Florida (Address of Principal Executive Offices)	**33901** (Zip Code)

239-337-3434
Issuer's Telephone Number (Including Area Code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for 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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one): Large Accelerated Filer o Accelerated Filer x Non-accelerated Filer o

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

As of May 7, 2007, there were 891,400,239 shares of common stock and 21,622 shares of Series C Convertible Preferred Stock outstanding.

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PART I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NeoMedia Technologies, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(In Thousands, Except Share and Per Share Data)

	March 31, 2007 (unaudited)	December 31, 2006 *
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,295	$ 2,813
Trade accounts receivable, net of allowance for doubtful accounts of $13 and $68, respectively	152	187
Other accounts receivable	241	550
Inventories, net of allowance for obsolete & slow-moving inventory of $26 and $53 respectively	123	80
Investment in marketable securities	31	57
Prepaid expenses and other current assets	123	102
Assets held for sale	16,174	19,420
Total current assets	19,139	23,209
Leasehold improvements & property and equipment, net	168	191
Goodwill	3,418	3,418
Capitalized patents, net	2,764	2,839
Proprietary software, net	3,951	4,138
Other Intangible assets, net	47	42
Cash surrender value of life insurance policy	867	863
Other long-term assets	3,325	3,425
Total assets	$ 33,679	$ 38,125
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 2,710	$ 2,442
Liabilities held for sale	7,411	10,257
Taxes payable	41	5
Accrued expenses	3,267	4,016
Deferred revenues and other	741	575
Notes payable	15	15
Accrued purchase price guarantee	4,787	19,667
Derivative financial instruments	25,949	25,819
Deferred tax liability	677	706
Debentures payable	18,336	7,500
Preferred stock, $0.01 par value, 25,000,000 shares authorized, 22,000 issued, 21,622 shares outstanding, liquidation value of $21,657.	21,657	21,657
Total liabilities	85,591	92,659
Commitments and contingencies (Note 13)		
Shareholders' deficit:		

Common stock, $0.01 par value, 5,000,000,000 shares authorized, 898,836,158 and 639,233,173 shares issued and 897,194,732 and 637,591,747 outstanding, respectively		8,972		6,376
Additional paid-in capital		112,083		100,541
Accumulated deficit		(171,461)		(159,962)
Accumulated other comprehensive loss		(727)		(710)
Treasury stock, at cost, 201,230 shares of common stock		(779)		(779)
Total shareholders' deficit		(51,912)		(54,534)
Total liabilities and shareholders' deficit	$	33,679	$	38,125

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

* Amounts have been reclassified from the audited December 31, 2006 consolidated balance sheet to reflect assets and liabilities held for sale in relation to our discontinued operations.

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NeoMedia Technologies, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
and Comprehensive Income (Loss) (Unaudited)
(In Thousands, Except Share and per Share Data)

	Three Months Ended March 31,			
		2007		2006
Net sales	$	399	$	199
Cost of sales		313		131
Gross profit		86		68
Sales and marketing expenses		859		1,194
General and administrative expenses		2,440		1,347
Research and development costs		506		485
Loss from operations		(3,719)		(2,958)
Loss on extinguishment of debt		---		(1,964)
Interest income (expense), net		(1,698)		6
Gain/(loss) on derivative financial instruments		(3,508)		4,768
LOSS FROM CONTINUING OPERATIONS		**(8,925)**		**(148)**
DISCONTINUED OPERATIONS (Note 4)				
Loss from operations of discontinuing operations		(2,574)		(1,169)
NET LOSS		(11,499)		(1,317)
Accretion of dividends on convertible preferred stock		(433)		(137)
NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS		**(11,932)**		**(1,454)**
Comprehensive Loss:				
Net loss		(11,499)		(1,317)
Other comprehensive loss:				
Unrealized gain/(loss) on marketable securities		(26)		149
Foreign currency translation adjustment		9		(222)
COMPREHENSIVE LOSS	**$**	**(11,516)**	**$**	**(1,390)**
Loss per share from continuing operations--basic and diluted	**$**	**(0.02)**	**$**	**(0.00)**
Loss per share from discontinued operations--basic and diluted	**$**	**(0.00)**	**$**	**(0.00)**
Net loss per share--basic and diluted	**$**	**(0.02)**	**$**	**(0.00)**
Weighted average number of common shares--basic and diluted		**684,819,898**		**527,991,819**

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

NeoMedia Technologies, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)
(In Thousands)

	Three Months Ended March 31, 2007	2006
CASH FLOWS FROM OPERATING ACTIVITIES:		
Loss from continuing operations	($8,925)	($148)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	280	166
Loss on early extinguishment of debt	—	1,964
Change in fair value from revaluation of warrants and embedded conversion features	3,508	(4,768)
Stock-based compensation expense	891	895
Interest expense related to convertible debt	781	—
Increase in value of life insurance policies	(4)	(30)
Changes in operating assets and liabilities		
Trade and other accounts receivable	(6)	142
Inventories	(43)	—
Prepaid expenses and other current assets	(21)	(149)
Accounts payable and accrued liabilities	(232)	(641)
Deferred revenue and other current liabilities	137	612
Net cash used in operating activities	(3,634)	(1,957)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid to acquire Mobot, Inc., Sponge Ltd., Gavitec AG, and 12Snap AG, net of cash acquired	—	(13,867)
Acquisition of property and equipment	—	(23)
Acquisition of patents and other intangible assets	—	(8)
Advances to discontinued subsidiaries Micro Paint, 12Snap, Telecom Services, Mobot, and Sponge	(1,641)	(2,470)
Acquisition related costs	—	(59)
Payment of purchase price guarantee obligations	(2,372)	—
Amounts received (issued) under notes receivable	450	(500)
Net cash used in investing activities	(3,563)	(16,927)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowing under convertible debt instrument, net of fees of $781 in 2007	6,678	—
Repayments on notes payable and convertible debt instrument	—	(210)
Net proceeds from issuance of common stock, net of issuance costs of $24 in 2006	—	210
Net proceeds from issuance of Series C convertible preferred stock, net of issuance costs of $2,725 in 2006	—	14,066
Net proceeds from exercise of stock options and warrants	9	8,131
Net cash provided by financing activities	6,687	22,197
EFFECT OF EXCHANGE RATE CHANGES ON CASH FOR CONTINUING OPERATIONS	(8)	(192)

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS FROM CONTINUING OPERATIONS		(518)		3,121
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		2,813		1,704
CASH AND CASH EQUIVALENTS, END OF PERIOD	**$**	**2,295**	**$**	**4,825**

SUPPLEMENTAL CASH FLOW INFORMATION:		
Interest paid during the period	$ 401	$ 13
Supplemental disclosure of investing and financing activities:		
Unrealized gain (loss) on marketable securities	(26)	149
Fair value of 258,620,948 shares issued to satisfy purchase price guarantee obligations	12,721	—
Prepaid acquisition costs applied to purchase price	—	168
Fair value of shares and notes receivable from Pickups Plus, Inc. acquired in exchange for Series C Convertible Preferred Stock	—	594
Carrying value of promissory note and accrued interest paid in exchange for Series C Convertible Preferred Stock	—	(3,208)
Fair value of shares issued to acquire CSI International, Inc., Mobot, Inc., Sponge Ltd., Gavitec AG, 12Snap AG, and BSD Software, Inc.	—	46,964
Change in net assets resulting from acquisitions of CSI International, Inc., Mobot, Inc., Sponge Ltd., Gavitec AG, 12Snap AG, and BSD Software, Inc.	—	60,594
Accretion of dividends on Series C Convertible Preferred Stock	433	137
Fair value of outstanding warrants reclassified to liabilities	—	13,884
Portion of change in fair value of outstanding warrants converted to liabilities recorded to paid-in capital	—	3,790
Initial fair value of Series C Convertible Preferred Stock (host instrument only)	—	4,908
Deferred stock-based financing costs associated with Series C Convertible Preferred Stock	—	3,198
Difference between net proceeds and recorded fair value of Series C Convertible Preferred Stock	—	4,041
Advance receivable from Mobot, Inc. forgiven upon acquisition	—	1,500

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

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NEOMEDIA TECHNOLOGIES, INC. AND SUBSIDIARIES
UNAUDITED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND NATURE OF BUSINESS OPERATIONS

Basis of Presentation

The condensed consolidated financial statements include the financial statements of NeoMedia Technologies, Inc. and its wholly-owned subsidiaries ("NeoMedia" or the "Company"). The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete condensed consolidated financial statements. These condensed consolidated financial statements and related notes should be read in conjunction with the Company's Form 10-K for the fiscal year ended December 31, 2006. In the opinion of management, these condensed consolidated financial statements reflect all adjustments which are of a normal recurring nature and which are necessary to present fairly the condensed consolidated financial position of NeoMedia as of March 31, 2007, the results of operations for the three month periods ended March 31, 2007 and 2006, and cash flows for the three month periods ended March 31, 2007 and 2006. The results of operations for the three month period ended March 31, 2007 are not necessarily indicative of the results which may be expected for the entire fiscal year. All significant intercompany accounts and transactions have been eliminated in preparation of the condensed consolidated financial statements.

Going Concern

The accompanying condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. Net loss for the three months ended March 31, 2007 was $11,499,000. Net cash used in operations for the three months ended March 31, 2007 was $3,634,000, and net cash used for discontinued operations was $1,609,000 (including operating, investing, and financing activities, as well as effect of exchange rates on cash for discontinued subsidiaries). NeoMedia also has an accumulated deficit of $171,461,000 and a working capital deficit of $66,452,000 as of March 31, 2007, of which $25,949,000 relates to the fair value of derivative financial instruments.

During January 2007, the Company made a strategic decision to sell its 12Snap and Telecom Services businesses. During the year ended December 31, 2006, revenues from these businesses accounted for 91% of NeoMedia's consolidated revenues. In the event that the Company is successful in selling these businesses, revenue, gross margin, and operating expenses would decline materially relative to 2006.

In addition, as of March 31, 2007, NeoMedia owed $1,015,000 to the former shareholders of 12Snap AG relating to a purchase price guarantee obligation associated with NeoMedia's acquisitions of 12Snap in February 2006. This amount was paid from the proceeds of the Company's sale of 12Snap during April 2007 (see Note 3).

The items discussed above raise substantial doubts about the Company's ability to continue as a going concern. If the Company's financial resources are insufficient, the Company may require additional financing in order to execute its operating plan and continue as a going concern. The Company cannot predict whether this additional financing will be in the form of equity, debt, or another form. The Company may not be able to obtain the necessary additional capital on a timely basis, on acceptable terms, or at all. In any of these events, the Company may be unable to implement its current plans for expansion, repay its debt obligations as they become due or respond to competitive pressures, any of which circumstances would have a material adverse effect on its business, prospects, financial condition and results of operations. The financial statements do not include any adjustments relating to the recoverability and reclassification of recorded asset amounts or amounts and reclassification of liabilities that might be necessary, should the Company be unable to continue as a going concern.

Should financing sources fail to materialize, management would seek alternate funding sources such as the sale of common and/or preferred stock, the issuance of debt, or the sale of its marketable assets. Management's plan is to secure adequate funding to bridge the commercialization of its core code-reading business.

NeoMedia plans to attempt to address its working capital deficiency by completing the proposed sales of the Micro Paint Repair and NeoMedia Telecom business units, and continuing to reduce its workforce and overhead expenses in non-critical areas. In addition, NeoMedia will attempt to generate additional revenue and profit from the launch of its core code-reading products and the value optimization of its patent portfolio.

In the event that these financing sources do not materialize, or that NeoMedia is unsuccessful in increasing its revenues and profits, NeoMedia will be forced to further reduce its costs, may be unable to repay its debt obligations as they become due, or respond to competitive pressures, any of which circumstances would have a material adverse effect on its business, prospects, financial condition and results of operations. Additionally, if these funding sources or increased revenues and profits do not materialize, and NeoMedia is unable to secure additional financing, NeoMedia could be forced to reduce or curtail its business operations unless it is able to engage in a merger or other corporate finance transaction with a better capitalized entity.

Nature of Business Operations

Prior to 2006, NeoMedia was structured and evaluated by its Board of Directors and management as three distinct business units: NeoMedia Internet Switching Software (NISS), NeoMedia Micro Paint Repair (NMPR), and NeoMedia Consulting and Integration Services (NCIS).

During the first quarter of 2006, NeoMedia acquired new subsidiaries 12Snap AG (“12Snap”) of Munich, Sponge Ltd. (“Sponge”) of London, Gavitec AG of Aachen, Germany (“Gavitec”), Mobot, Inc. (“Mobot”) of Lexington, Massachusetts, and BSD Software, Inc. of Calgary, Canada (“BSD”), and wound down its NCIS business unit. As a result, during the year ended December 31, 2006, NeoMedia operated under the following three business units:

- NeoMedia Mobile (NMM) - encompassing NeoMedia's physical-world-to-internet and mobile marketing technologies and products;

- NeoMedia Telecom Services (NTS) - encompassing the billing, clearinghouse and information management services of Triton Global Business Services, the operating subsidiary of BSD, acquired in March 2006; and

- NeoMedia Micro Paint Repair (NMPR) - encompassing the micro paint and auto aftermarket accessories manufactured and distributed by NeoMedia.

During August 2006, NeoMedia announced that it intended to sell its NMPR business. During the fourth quarter of 2006, NeoMedia divested of its Mobot and Sponge subsidiaries. During January 2007, NeoMedia made the strategic decision with respect to its corporate structure in 2007 and beyond, deciding to shed its remaining non-core 12Snap and NTS business units to focus on the area that management believes will deliver the most value - the core code-reading business. During April 2007, NeoMedia sold the 12Snap business.

As a result of the divestitures of Mobot and Sponge, and the proposed divestitures of NMPR and 12 Snap and NeoMedia Telecom Services, beginning in the first quarter of 2007 NeoMedia evaluated its business as one consolidated business, focusing on its core code-reading business and related intellectual property.

For purposes of these financial statements, NeoMedia Micro Paint Repair, NeoMedia Telecom Services, 12Snap, Sponge, and Mobot are considered discontinued operations as of March 31, 2007 and for the three month periods ended March 31, 2007 and 2006. NeoMedia Micro Paint Repair, NeoMedia Telecom Services, 12Snap, Sponge, and Mobot qualified as separate operating business units because they (i) engaged in business activities that earned revenues and incurred expenses, (ii) had operating results that were regularly reviewed by decision makers for the purposes of allocating resources to the segment, and (iii) had separate discreet financial information.

NeoMedia is a pioneer in mobile enterprise and marketing technology, bridging the physical and electronic world with innovative direct-to-mobile-Web technology solutions. NeoMedia's flagship qode® service links users to the wireless, electronic world. NeoMedia is headquartered in Fort Myers, Florida, with an office in Aachen, Germany. The qode® suite of easy-to-use, market-driven products and applications is based on a strong foundation of patented technology, comprising the qode® (www.qode.com) platform, qode® reader and qode® window, all of which provide One Click to Content™ connectivity for products, print, packaging and other physical objects to link directly to specific desired content on the mobile Internet.

Reclassifications

Certain amounts in the 2006 condensed consolidated financial statements have been reclassified to conform to the 2007 presentation, most notably, net sales were formerly reported as separate line items "Technology license, service and products," and "Micro Paint Repair Products and Services." As a result of the winding down of the former NCIS business unit and the pending sale of the NMPR business unit, revenue from continuing operations now consists of license revenue and is being reported under the caption "Net sales."

In addition, due to the Company's decision to sell the Micro Paint Repair business unit, the completed divestitures of Mobot and Sponge during 2006, and the Company's decision to sell 12Snap and NeoMedia Telecom Services in January 2007, results of operations from each of these units have been reclassified under the caption "Discontinued Operations" for all periods shown on the accompanying condensed consolidated statement of operations, and assets and liabilities relating to these units are combined into the captions "Assets held for sale" and "Liabilities held for sale," respectively, on the accompanying condensed consolidated balance sheet. Additionally, the statements of cash flows for the three months ended March 31, 2006 have been restated to exclude the cash flows of the discontinued business units.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following significant accounting policies were not applicable as of the filing of its last annual report for the year ended December 31, 2006. For a complete discussion of the Company's significant accounting policies, please refer to the Company's annual report on Form 10-K for the fiscal year ended December 31, 2006.

Financial Accounting Standards Board Interpretation No. 48

The Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes-an interpretation of FASB Statement No. 109" ("FIN 48"), on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement 109, "Accounting for Income Taxes," and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

Based on its evaluation, the Company has concluded that there are no significant uncertain tax positions requiring recognition in its financial statements. The Company's evaluation was performed for the tax years ended December 31, 2003, 2004, 2005 and 2006, the tax years which remain subject to examination by major tax jurisdictions as of March 31, 2007.

The Company may from time to time be assessed interest or penalties by major tax jurisdictions, although any such assessments historically have been minimal and immaterial to the Company's financial results. In the event the Company has received an assessment for interest and/or penalties, it has been classified in the financial statements as interest expense.

Statement of Financial Accounting Standards No. 155

The company adopted Statement of Financial Accounting number 155 "Accounting for Certain Hybrid Financial Instruments" (FAS 155) in the first quarter of 2007. The Company has adopted FAS 155 on an individual instrument basis and is currently applying FAS 155 to certain of it's debt obligations. The Company will evaluate and determine on a case by case basis whether to apply FAS 155.

Revenue Recognition

NeoMedia derives revenues from the following sources: (1) license revenues relating to patents and internally-developed software, (2) hardware, software, and service revenues related to mobile marketing campaign design and implementation, and (3) sale of its proprietary Micro Paint Repair solution.

(1) Technology license fees, including Intellectual Property licenses, represent revenue from the licensing of NeoMedia's proprietary software tools and applications products. NeoMedia licenses its development tools and application products pursuant to non-exclusive and non-transferable license agreements. The basis for license fee revenue recognition is substantially governed by American Institute of Certified Public Accountants ("AICPA") Statement of Position 97-2 "Software Revenue Recognition" ("SOP 97-2"), as amended, and Statement of Position 98-9, Modification of SOP 97-2, "Software Revenue Recognition, With Respect to Certain Transactions.". License revenue is recognized if persuasive evidence of an agreement exists, delivery has occurred, pricing is fixed and determinable, and collectibility is probable. The Company defers revenue related to license fees for which amounts have been collected but for which revenue has not been recognized in accordance with the above, and recognizes the revenue over the appropriate period.

(2) Technology service and product revenue, which includes sales of software and technology equipment and service fee is recognized based on guidance provided in SEC Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition in Financial Statements," as amended (SAB 104). Software and technology equipment resale revenue is recognized when persuasive evidence of an arrangement exists, the price to the customer is fixed and determinable, delivery of the service has occurred and collectibility is reasonably assured. Service revenues including maintenance fees for providing system updates for software products, user documentation and technical support are recognized over the life of the contract. The Company's subsidiaries, Mobot (sold during 2006), and Gavitec follow this policy. The Company defers revenue related to technology service and product revenue for which amounts have been invoiced and or collected but for which the requisite service has not been provided. Revenue is then recognized over the matching service period.

(3) Technology service also includes mobile marketing services to its customers which mobile marketing projects are recognized after the completion of the project and accepted by the customer. All response and messaging based revenues are recognized at the time such responses are received and processed and the Company recognizes its premium messaging revenues on a net basis based on guidance provided in Emerging Issues Task Force Issues No. 99-19 (EITF 99-19), "Reporting Revenue Gross as Principal or Net as an Agent" and No. 01-09 (EITF 01-09), "Accounting for Consideration Given by a Vendor to a Customer." Consulting and management revenues and revenues for periodic services are recognized as services are performed. NeoMedia uses stand-alone pricing to determine an element's vendor specific objective evidence ("VSOE") in order to allocate an arrangement fee amongst various pieces of a multi-element contract. The Company's subsidiaries 12Snap and Sponge (sold during 2006) follow this policy. Telecom revenues from NeoMedia's subsidiary BSD are recognized at the time that calls are accepted by the clearinghouse for billing to customers on a net basis, based on guidance in EITF

99-19. The Company defers revenue related to mobile marketing service fees for which amounts have been invoiced and/or collected but for which revenue has not been recognized. Revenue is then recognized over the matching service period.

(4) Revenue for licensing and exclusivity on NeoMedia's Micro Paint Repair systems is recognized equally over the term of the contract, which is currently one year. A portion of the initial fee paid by the customer is allocated to licensing, training costs and initial products sold with the system. Revenue is recognized upon completion of training and shipment of the products, provided there is VSOE in a multiple element arrangement. Ongoing product and service revenue is recognized as products are shipped and services performed. The Company defers revenue related to micro paint repair licensing for which amounts have been invoiced and/or collected and revenue is then recognized over the estimated contract period, which is currently one year.

(5) Sales taxes represent amounts collected on behalf of specific regulatory agencies that require remittance on a specified date. These amounts are collected at the time of sales and are detailed on invoices provided to customers. In compliance with the Emerging Issues Task Force consensus on issue number 06-03 (EITF 06-03), NeoMedia accounts for sales taxes on a net basis.

3. ACQUISITIONS

During the three months ended March 31, 2006, NeoMedia completed acquisitions of Mobot, Sponge, Gavitec, 12Snap, and BSD. During November 2006, December 2006, and April 2007, NeoMedia divested of a substantial portion of its ownership in Sponge, Mobot, and 12Snap, respectively. NeoMedia is also in the process of attempting to sell its Micro Paint Repair business and Telecom Services business which is comprised of the operations acquired from BSD.

Acquisition and Sale of Mobot

On February 9, 2006, NeoMedia and Mobot (based in Lexington, Massachusetts) signed a definitive merger agreement, subject to closing conditions, under which NeoMedia acquired all of the outstanding shares of Mobot in exchange for $3,500,000 cash and $6,500,000 in stock, represented by 16,931,493 shares of NeoMedia common stock (2,604,845 of which were held in escrow for the purpose of securing the indemnification obligations outlined in the purchase agreement). On February 17, 2006, NeoMedia and Mobot completed the closing requirements and the acquisition became effective. In addition to cash and stock, at closing NeoMedia forgave notes payable totaling $1,500,000 due from Mobot. This amount is considered other additional consideration in the purchase price allocation. NeoMedia completed the acquisition of Mobot in an effort to gain entry into the rapidly evolving global mobile marketing industry.

Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock that were issued as stock consideration was calculated using a share price of $0.3839, which was the volume-weighted average closing price of NeoMedia common stock for the ten days up to and including February 8, 2006. The merger agreement between NeoMedia and Mobot also contained a provision that, in the event that NeoMedia's stock price at the time the consideration shares became saleable (either upon effectiveness of a registration statement containing the shares, or under Rule 144) were less than $0.3839, NeoMedia would be obligated to compensate Mobot shareholders in cash for the difference between the price at the time the shares became saleable and $0.3839.

The actual purchase price was based on cash paid, the fair value of NeoMedia stock around the date of the Mobot acquisition, and direct costs associated with the combination. The final purchase price was allocated as follows:

		(Dollars in Thousands)
Value of 16,931,493 shares issued at $0.395 per share [1]	$	6,688
Cash paid		3,500
Direct costs of acquisition		8
Advances to Mobot forgiven at acquisition		1,500
Total Fair Value of Purchase Price		11,696
Assets Purchased:		
Cash and cash equivalents	$	328
Accounts receivable		68
Other current assets		49
Property, plant & equipment		30
Intangible assets		13
Customer contracts and relationships		440
Capitalized software platform		4,200
Copyrighted materials		90
Goodwill		6,778
Total Assets Purchased		11,996
Less Liabilities Assumed:		
Accounts payable	$	51
Accrued liabilities		132
Deferred revenue		117
Total Liabilities Assumed		300

(1) - Shares were valued using the average stock price for two days before and two days after the measurement date, as defined in SFAS 141 and EITF 99-12

The combination was accounted for as a purchase business combination as defined by Statement of Financial Accounting Standards No. 141, Business Combinations. The allocation of the purchase price to the assets acquired and liabilities assumed was based on an independent valuation report obtained by the Company.

The values assigned to intangible assets are subject to amortization. The intangible assets were assigned the following lives for amortization purposes:

Intangible asset	Estimated useful life (in years)
Customer contracts and relationships	5
Copyrighted materials	5
Capitalized software platform	7

Goodwill consists of the excess of the purchase price paid over the identifiable net assets and liabilities acquired at fair value. Goodwill was determined using the residual method based on an independent appraisal of the assets and liabilities acquired in the transaction. Goodwill is tested for impairment as defined by Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

On December 6, 2006, NeoMedia and FMS Group, Inc. ("FMS"), a group consisting of former shareholders of Mobot, completed a transaction pursuant to which NeoMedia divested of its ownership interest in Mobot. The principal reasons for NeoMedia divesting of the Mobot business were: (i) a depressed NeoMedia stock price, which led to a large potential cash obligation stemming from the purchase price obligation clause in the original purchase agreement, (ii) the fact that the purchase price obligation would become due no later than February 17, 2007, and (iii) continued operating losses from the Mobot businesses putting strains on NeoMedia's working capital.

The material terms of the transaction with FMS were as follows:

- NeoMedia transferred 100% of its ownership interest in Mobot to FMS, and in return received 16,000 shares (18% ownership) of FMS, which will operate the Mobot business;
- All obligations under the original merger agreement, including the purchase price guarantee obligation, were terminated;
- NeoMedia contributed $67,000 cash to FMS at closing, and an additional $200,000 on December 27, 2006;
- NeoMedia received 16,931 preference shares in FMS that can be redeemed to reacquire the 16,931,493 original consideration shares originally issued to acquire Mobot. Each preference share can be redeemed for 1,000 shares of the NeoMedia common stock at NeoMedia's discretion within 15 months of the closing of this transaction, for cash in the amount of 40% of the then-current market value of the underlying NeoMedia shares. After 15 months, the preference shares can be redeemed upon a liquidation event of FMS, for either 1,000 shares of NeoMedia common stock each, or for the current cash equivalent of the shares, at FMS' discretion;
- NeoMedia entered into a license agreement with Mobot, pursuant to which NeoMedia received a license to use the Mobot image recognition service for barcode-related applications. The license is exclusive in the Americas, Europe and Australia, restricted in Japan, Korea, and Singapore, and non-exclusive in other areas of the world. The exclusivity is subject to NeoMedia meeting certain minimum transaction volume requirements or making minimum cash payments; and
- NeoMedia entered into a mutual release with each of the former Mobot shareholders in which the parties released each other from the terms of the original Mobot merger agreement, and the former Mobot shareholders consented to the release of the pending legal action against NeoMedia.

Due to NeoMedia's depressed stock price, the purchase price obligation clause became highly probable beyond a reasonable doubt. NeoMedia's inability to satisfy the pending obligation was the primary factor for the disposition of Mobot. The value of the purchase price obligation at the time of closing was $5,545,000. Concurrent with the disposition, NeoMedia reduced the fair value of the initial stock consideration by the amount of this contingency. At closing, NeoMedia recorded a loss on the sale of Mobot in the amount of $4,367,000, representing the difference between the fair value of the assets received in the transaction, and the carrying value of the assets at closing as follows:

		(Dollars in Thousands)
Carrying value of asset group at closing		
Tangible assets	$	518
Intangible assets		10,971
Liabilities		(324)
Purchase price guarantee liability		(5,545)
Net carrying value of asset group		5,620
Fair value of proceeds received		
Cash paid		(67)
Cash paid subsequent to closing but before December 31, 2006		(200)
Investment in Mobot common stock		1,926
Investment in Mobot special preference shares (put option)		(406)
Fair value of proceeds received		1,253
Loss on disposal of Mobot	**$**	**4,367**

The accompanying condensed consolidated statement of operations presented herein for the three months ended March 31, 2006, contains the results of operations for Mobot for the period from February 18, 2006, through March 31, 2006, under the caption "Loss from discontinued operations." No results are reflected on the condensed consolidated statement of operations presented herein for the three months ended March 31, 2007, since Mobot was sold prior to the beginning of this period.

Acquisition and Sale of Sponge

On February 20, 2006, NeoMedia and Sponge (a London-based company) signed a definitive share purchase agreement, subject to closing conditions, under which NeoMedia acquired all of the outstanding shares of Sponge in exchange for $6,141,000 cash and £6,550,000 (approximately $13.1 million at the time of the agreement), represented by 33,097,135 shares of NeoMedia common stock (3,400,490 of which were held in escrow for the purpose of securing the indemnification obligations outlined in the purchase agreement). The agreement also called for Sponge to earn an additional £2,500,000 (approximately $4.4 million) in the form of NeoMedia common stock if, during the two-year period beginning at closing, the Sponge business earned in excess of £1,300,000 (approximately $2.3 million) in net profits. On February 23, 2006, NeoMedia and Sponge completed the closing requirements and the acquisition became effective. Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock to be issued as consideration was calculated using a share price of $0.384, which was the volume-weighted average closing price of NeoMedia common stock for the ten days up to and including February 8, 2006. In the event that NeoMedia's stock price at the time the consideration shares became saleable (either upon effectiveness of a registration statement containing the shares, or under Rule 144) was less than $0.384, the purchase agreement called for NeoMedia to compensate Sponge shareholders in cash for the difference between the price at the time the shares became saleable and $0.384. NeoMedia completed the acquisition of Sponge in an effort to gain entry into the rapidly evolving global mobile marketing industry.

The actual purchase price was based on cash paid, the fair value of NeoMedia stock around the date of the Sponge acquisition, and direct costs associated with the combination. The final purchase price was allocated as follows:

		(Dollars in Thousands)
Value of 33,097,135 shares issued at $0.395 per share (1)	$	13,073
Cash paid		6,141
Direct costs of acquisition		194
Total Fair Value of Purchase Price		19,408
Assets Purchased:		
Cash and cash equivalents	$	177
Accounts receivable		617
Other current assets		35
Property, plant & equipment		53
Customer contracts and relationships		400
Capitalized software platform		1,300
Brand name		800
Copyrighted materials		50
Goodwill		16,692
Total Assets Purchased		20,124
Less Liabilities Assumed:		
Accounts payable	$	190
Accrued liabilities		322
Other current liabilities		204
Total Liabilities Assumed		716

(1) - Shares were valued using the average stock price for two days before and two days after the measurement date, as defined in SFAS 141 and EITF 99-12

The combination was accounted for as a purchase business combination as defined by Statement of Financial Accounting Standards No. 141, Business Combinations. The allocation of the purchase price to the assets acquired and liabilities assumed is based on an independent valuation report obtained by the Company.

The values assigned to intangible assets are subject to amortization. The intangible assets were assigned the following lives for amortization purposes:

Intangible asset	Estimated useful life (in years)
Customer contracts and relationships	5
Copyrighted materials	5
Capitalized software platform	7
Brand name	10

Goodwill consists of the excess of the purchase price paid over the identifiable net assets and liabilities acquired at fair value. Goodwill was determined using the residual method based on an independent appraisal of the assets and liabilities acquired in the transaction. Goodwill is tested for impairment as defined by Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

On November 14, 2006, NeoMedia and Sponge signed a definitive share purchase and settlement agreement, pursuant to which NeoMedia divested of a material portion of its ownership interest in Sponge. The principal reasons for NeoMedia divesting of the Sponge business were: (i) a depressed NeoMedia stock price, which led to a large potential cash obligation stemming from the purchase price obligation clause in the original purchase agreement, (ii) the fact that the purchase price obligation would become due no later than February 23, 2007, and (iii) the return of the original consideration shares for retirement.

- NeoMedia returned 92.5% of NeoMedia's ownership interest in Sponge, retaining 7.5% ownership of Sponge,
- NeoMedia relinquished its Board of Directors positions at Sponge,
- the 33,097,135 shares of NeoMedia common stock that were issued as consideration to acquire Sponge were returned to us and retired;
- all obligations under the original merger agreement, including the purchase price guarantee obligation, were terminated; and
- Sponge returned $100,000 cash (net of attorney fees) to NeoMedia at closing and $150,000 cash to NeoMedia on March 7, 2007.

Due to NeoMedia's depressed stock price, the purchase price obligation clause became highly probable beyond a reasonable doubt. NeoMedia's inability to satisfy the pending obligation was the primary factor for the disposition of Mobot. The value of the purchase price obligation at the time of closing was $10,088,000. Concurrent with the disposition, NeoMedia reduced the fair value of the initial stock consideration by the amount of this contingency. At closing, NeoMedia recorded a loss on the disposal of Sponge in the amount of $5,051,000, representing the difference between the fair value of the assets received in the transaction, and the carrying value of the assets at closing, as follows:

		(Dollars in Thousands)
Carrying value of asset group at closing		
Tangible assets	$	2,042
Intangible assets		19,091
Liabilities		(2,093)
Purchase price guarantee liability		(10,088)
Net carrying value of asset group		8,952
Fair value of proceeds received		
Cash received		35
Cash paid subsequent to December 31, 2006		150
Investment in Sponge common stock		1,399
Return of 33,097,135 shares of NeoMedia common stock		2,317
Fair value of proceeds received		3,901
Loss on disposal of Sponge	**$**	**5,051**

The accompanying condensed consolidated statement of operations presented herein for the three months ended March 31, 2006, contains the results of operations for Sponge for the period from February 24, 2006, through March 31, 2006 under the caption "Loss from discontinued operations." No results are reflected on the condensed consolidated statement of operations presented herein for the three months ended March 31, 2007, since Sponge was sold prior to the beginning of this period.

Acquisition of Gavitec

On February 17, 2006, NeoMedia and Gavitec (based in Aachen, Germany) signed a definitive sale and purchase agreement, subject to closing conditions, under which NeoMedia acquired all of the outstanding shares of Gavitec in exchange for $1,800,000 cash and $5,200,000 common stock, represented by 13,660,511 shares of NeoMedia common stock (1,366,051 of which were held in escrow until December 31, 2006 for the purpose of securing the indemnification obligations outlined in the purchase agreement, and were subsequently released). Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock to be issued as consideration was calculated using a share price of $0.389, which was the volume-weighted average closing price of NeoMedia common stock for the ten days up to and including February 16, 2006. On February 23, 2006, NeoMedia and Gavitec completed the closing requirements and the acquisition became effective.

Gavitec AG was founded in 1997 as a specialized provider and manufacturer of products and solutions for mobile marketing and mobile information technology. Using its software, Gavitec offers its clients standardized or individual solutions in the areas of mobile marketing, mobile ticketing, mobile couponing, and mobile payment systems. NeoMedia completed the acquisition of Gavitec in an effort to gain entry into the rapidly evolving global mobile marketing industry.

The actual purchase price was based on cash paid, the fair value of NeoMedia stock around the date of the Gavitec acquisition, and direct costs associated with the combination. The final purchase price has been allocated as follows:

		(Dollars in Thousands)
Value of 13,660,511 shares issued at $0.386 per share [(1)]	$	5,273
Cash paid		1,800
Direct costs of acquisition		114
Total Fair Value of Purchase Price		7,187
Assets Purchased:		
Cash and cash equivalents	$	74
Accounts receivable		173
Inventory		106
Other current assets		53
Property, plant & equipment		15
Intangible assets		3
Capitalized software platform		4,600
Copyrighted materials		50
Goodwill		3,418
Total Assets Purchased		8,492
Less Liabilities Assumed:		
Accounts payable	$	113
Accrued liabilities		24
Deferred revenue		117
Deferred tax liability		706
Other current liabilities		244
Total Liabilities Assumed		1,204

(1) - Shares were valued using the average stock price for two days before and two days after the measurement date, as defined in SFAS 141 and EITF 99-12

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The combination was accounted for as a purchase business combination as defined by Statement of Financial Accounting Standards No. 141, Business Combinations. The allocation of the purchase price to the assets acquired and liabilities assumed is based on an independent report obtained by the Company. The allocation was subject to change resulting from the purchase price guarantee contingency described above.

The values assigned to intangible assets are subject to amortization. The intangible assets were assigned the following lives for amortization purposes:

Intangible asset	Estimated useful life (in years)
Copyrighted materials	5
Capitalized software platform	7
Brand name	10

Goodwill consists of the excess of the purchase price paid over the identifiable net assets and liabilities acquired at fair value. Goodwill was determined using the residual method based on an independent appraisal of the assets and liabilities acquired in the transaction. Goodwill is tested for impairment as defined by Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets." An additional amount of $706,000 was allocated to goodwill of Gavitec related to the deferred tax liability associated with the intangible assets in excess of Gavitec's net operating loss carry forward deferred tax asset.

In the event that NeoMedia's stock price at the time the consideration shares became saleable (either upon effectiveness of a registration statement containing the shares, or under Rule 144) was less than $0.389, NeoMedia was obligated to compensate Gavitec shareholders in cash for the difference between the price at the time the shares became saleable and $0.389. On January 23, 2007, NeoMedia entered into an agreement with the former shareholders of Gavitec, whereby this purchase price obligation was to be satisfied through the payment by NeoMedia of (i) $1,800,000 in cash, payable no later than February 28, 2007 (subsequently extended to March 31, 2007), and (ii) 61,000,000 shares of NeoMedia common stock to be issued no later than February 28, 2007. NeoMedia also agreed to pay interest accrued on the purchase price in the amount of $481,000 and reimburse $100,000 of costs related to the acquisition to the primary former shareholder of Gavitec no later than February 28, 2007. NeoMedia issued the shares and made cash payments of $2,113,000 during March 2007. Accordingly, as of March 31, 2006, the balance on the accrual was $268,000, representing the remaining interest payments which are to be made during 2007.

The accompanying consolidated statement of operations presented herein for the three months ended March 31, 2007, contains the results of operations for Gavitec for the entire period. The accompanying consolidated statement of operations presented herein for the three months ended March 31, 2006, contains the results of operations for Gavitec for the period from February 24, 2006, through March 31, 2006. Pro-forma results of operations for the three months ended March 31, 2006 are presented at the end of this Note 3.

Acquisition of 12Snap

On February 10, 2006, NeoMedia and 12Snap signed a definitive sale and purchase agreement, subject to closing conditions, under which NeoMedia acquired all of the outstanding shares of 12Snap in exchange for $2,500,000 cash and $19,500,000 common stock, represented by 49,294,581 shares of NeoMedia common stock. On February 28, 2006, NeoMedia and 12Snap completed the closing requirements and the acquisition became effective. Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock to be issued as consideration was calculated using a share price of $0.3956, which was the volume-weighted average closing price of NeoMedia common stock for the ten days up to and including February 9, 2006.

12Snap AG is headquartered in Munich, Germany, with branches in Düsseldorf, New York, London, Milan, Stockholm and Vienna. 12Snap combines the know-how in mobile applications, mobile loyalty and mobile marketing. In the mobile marketing space, 12Snap creates and implements national and pan-European mobile marketing campaigns for international brands; its mobile loyalty business unit offers customer loyalty programs for companies and brands, and its mobile applications business unit is the center for development and software. NeoMedia completed the acquisition of 12Snap in an effort to gain entry into the rapidly evolving global mobile marketing industry.

The actual purchase price was based on cash paid, the fair value of NeoMedia stock around the date of the 12Snap acquisition, and direct costs associated with the combination. The final purchase price has been allocated as follows:

		(Dollars in Thousands)
Value of 49,294,581 shares issued at $0.394 per share (1)	$	19,422
Cash paid		2,500
Direct costs of acquisition		114
Total Fair Value of Purchase Price		22,036
Assets Purchased:		
Cash and cash equivalents	$	465
Investment in marketable securities		951
Accounts receivable		2,683
Other current assets		554
Property, plant & equipment		224
Intangible assets		93
Customer contracts and relationships		400
Capitalized software platform		4,400
Brand name		1,600
Copyrighted materials		50
Goodwill		18,390
Total Assets Purchased		29,810
Less Liabilities Assumed:		
Accounts payable	$	977
Accrued liabilities		989
Deferred revenue		1,434
Other current liabilities		225
Notes payable		4,149
Total Liabilities Assumed		7,774

(1) - Shares were valued using the average stock price for two days before and two days after the measurement date, as defined in SFAS 141 and EITF 99-12

The combination was accounted for as a purchase business combination as defined by Statement of Financial Accounting Standards No. 141, Business Combinations. The allocation of the purchase price to the assets acquired and liabilities assumed is based on an independent valuation report obtained by the Company. The allocation is subject to change resulting from the purchase price guarantee contingency described above.

The values assigned to intangible assets are subject to amortization. The intangible assets were assigned the following lives for amortization purposes:

Intangible asset	Estimated useful life (in years)
Customer contracts and relationships	5
Copyrighted materials	5
Capitalized software platform	7
Brand name	10

Goodwill consists of the excess of the purchase price paid over the identifiable net assets and liabilities acquired at fair value. Goodwill was determined using the residual method based on an independent appraisal of the assets and liabilities acquired in the transaction. Goodwill is tested for impairment as defined by Statement of Financial Accounting Standards No. 142, ”Goodwill and Other Intangible Assets.”

During the first quarter of 2007, NeoMedia initiated an action plan to sell its 12Snap business. During the three months ended March 31, 2007, and the year ended December 31, 2006, NeoMedia recorded impairment charges of $2,467,000 and $18,327,000, respectively, to adjust the carrying value of the 12Snap asset group to the expected net proceeds from the sale of the assets. Prior to the impairment charge, the asset group consisted primarily of goodwill and other intangible assets recorded upon purchase of 12Snap by NeoMedia during the first quarter of 2006. In connection with its decision to sell the 12Snap business in the first quarter of 2007, NeoMedia revised its expected cashflow to reflect the estimated net cash proceeds that the Company anticipates receiving in a sale transaction. The operations of 12Snap are classified as discontinued operations during the three months ended March 31, 2007 and 2006. The criteria for discontinued operations classification were met during the three months ended March 31, 2007. (See Note 4)

Pursuant to the terms of the original purchase agreement, in the event that NeoMedia’s stock price at the time the consideration shares became saleable (either upon effectiveness of a registration statement containing the shares, or under Rule 144) was less than $0.3956, NeoMedia was obligated to compensate 12Snap shareholders in cash for the difference between the price at the time the shares became saleable and $0.3956. On February 22, 2007, the shares became eligible for resale under Rule 144. The actual calculated purchase price obligation to NeoMedia based on the volume weighted average closing price of NeoMedia stock for the ten days up to and including February 22, 2007 was $16,233,000. Because the amount of the purchase price guarantee became measurable and highly probable of occurrence beyond a reasonable doubt, as of December 31, 2006, NeoMedia reduced the fair value of the initial stock consideration by the amount of the contingency. During the three months ended March 31, 2007, NeoMedia issued 197,620,948 shares of its common stock in satisfaction of a portion of the purchase price obligation totaling $9,427,000, and made cash payments against the liability totaling $259,000. The balance on the purchase price obligation as of March 31, 2007 was $6,547,000, of which $1,760,000 is presented as liabilities held for sale. During April 2007, NeoMedia made additional cash payments of $75,000 and further reduced the balance through the forgiveness of $1,758,000 of obligation in connection with the sale of 12Snap. The Company is currently negotiating payment terms for the balance of the obligation.

On April 4, 2007, NeoMedia reached an agreement with Bernd Michael (the “Buyer”), a private investor and former shareholder of 12Snap prior to NeoMedia’s acquisition of 12Snap, pursuant to which the Buyer acquired from NeoMedia 90% of the shares of 12Snap, subject to the following material terms and conditions:

- $1,100,000 was paid in cash at closing, of which $1,015,000 was applied toward amounts owed to silent partners of 12Snap
- $500,000 was placed into an escrow account for 90 days to secure warranty claims;
- The Buyer waived his portion of the purchase price guarantee obligation in the amount of $880,000;

- The Buyer returned to NeoMedia 2,525,818 NeoMedia shares previously issued to Buyer;
- 12Snap management waived their portion of the purchase price guarantee obligation in the amount of $880,000;
- 12Snap management returned to NeoMedia 5,225,039 shares of NeoMedia common stock previously issued to 12Snap management;
- NeoMedia will retain a 10% ownership in 12Snap, subject to an option agreement pursuant to which NeoMedia has the right to sell and Buyer has the right to acquire the remaining 10% stake held by NeoMedia for a purchase price of $750,000 after December 31, 2007; and
- 12Snap and NeoMedia will execute a cooperation agreement pursuant to which 12snap will remain NeoMedia preferred partner and enjoy most favored prices, and 12snap will perform certain research and development functions for NeoMedia.

The accompanying condensed consolidated statement of operations presented herein for the three months ended March 31, 2007 reflects the results of operations for 12Snap for the entire period under the caption "Loss from discontinued operations." The accompanying condensed consolidated statement of operations presented herein for the three months ended March 31, 2006 reflects the results of operations for 12Snap for the period from February 24, 2006, through March 31, 2006 under the caption "Loss from discontinued operations."

Acquisition of BSD

On March 21, 2006, NeoMedia completed its acquisition of BSD Software, Inc. of Calgary, Alberta, Canada, for 7,123,698 shares of NeoMedia common stock. Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock to be issued as consideration was calculated using a share price of $0.3467, which was the volume-weighted average closing price of NeoMedia common stock for the five days preceding March 21, 2006. BSD owns 90% of the outstanding shares of Triton Global Business Services, Inc., a provider of live and automated operator calling services and e-business support, including billing, clearinghouse and information management services, to companies in the telecommunications industry.

NeoMedia completed the acquisition of BSD for the purpose of increasing its revenue and profit through establishment of a Telecom Services business unit, as well as gaining access to the Canadian telecom industry in order to penetrate that market with the products of the NeoMedia Mobile division.

The actual purchase price was based on cash paid, the fair value of NeoMedia stock around the date of the BSD acquisition, and direct costs associated with the combination. The purchase price has been allocated as follows:

		(Dollars in Thousands)
Value of 7,123,698 shares issued at $0.352 per share [1]	$	2,508
Direct costs of acquisition		7
Total Fair Value of Purchase Price		2,515
Assets Purchased:		
Cash and cash equivalents	$	55
Accounts receivable		1,733
Other current assets		13
Property, plant & equipment		61
Customer contracts and relationships		1,300
Copyrighted materials		130
Goodwill		4,402
Total Assets Purchased		7,694
Less Liabilities Assumed:		
Accounts payable	$	2,424
Accrued liabilities		1,224
Notes payable		1,531
Total Liabilities Assumed		5,179

(1)- Shares were valued using the average stock price for two days before and two days after the measurement date, as defined in SFAS 141 and EITF 99-12

The combination was accounted for as a purchase business combination as defined by Statement of Financial Accounting Standards No. 141, Business Combinations. The allocation of the purchase price to the assets acquired and liabilities assumed is based on an independent valuation report obtained by the Company.

The values assigned to intangible assets are subject to amortization. The intangible assets were assigned the following lives for amortization purposes:

Intangible asset	Estimated useful life (in years)
Customer contracts and relationships	5
Copyrighted materials	5

Goodwill consists of the excess of the purchase price paid over the identifiable net assets and liabilities acquired at fair value. Goodwill was determined using the residual method based on an independent appraisal of the assets and liabilities acquired in the transaction. Goodwill is tested for impairment as defined by Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

During the first quarter of 2007, NeoMedia initiated an action plan to sell this business. The operations of this business are classified as discontinued operations during the three months ended March 31, 2007 and 2006. The criteria for discontinued operations classification were met during the three months ended March 31, 2007. (See Note 4)

The accompanying condensed consolidated statement of operations presented herein for the three months ended March 31, 2007 reflects the results of operations for BSD for the entire period under the caption “Loss from discontinued operations.” The accompanying condensed consolidated statement of operations presented herein for the three months ended March 31, 2006 reflects the results of operations for BSD for the period from March 22, 2006, through March 31, 2006 under the caption “Loss from discontinued operations.”

Pro Forma Financial Information (Unaudited)

Pro-forma results of operations as if NeoMedia was combined with Gavitec as of January 1, 2006 are as follows:

	Total Net Sales	Loss from Continuing Operations	Loss per Share from Continuing Operations	Weighted Average Common Shares Outstanding
NeoMedia	$404	($263)	$0.00	527,991,819
Gavitec	122	(239)		
Pro forma adjustments	(33)(A)	110(A)	$0.00(A)(B)	67,200,319(B)
Pro forma combined	$493	($392)	$0.00	595,192,138

__Basis of Presentation__: NeoMedia acquired Mobot, Sponge, Gavitec, 12Snap, and BSD during the three months ended March 31, 2006. During November and December 2006, NeoMedia divested of Mobot and Sponge. During April 2007, NeoMedia divested of 12Snap. During the first quarter of 2007, NeoMedia decided to sell its Telecom Services business, comprised of the operations of BSD. Because the results of BSD, 12Snap, Mobot, and Sponge have already been removed from NeoMedia's continuing operations and classified as discontinued operations for the three months ended March 31, 2006, these entities have not been included in the pro forma results shown above. However, the pro forma shares issued as consideration for the acquisitions of Gavitec, 12Snap, and BSD are reflected in the pro forma loss per share and weighted average common shares outstanding. The pro forma shares issued as consideration for the acquisitions of Mobot and Sponge, and NeoMedia shares returned in the sale of Sponge, are not reflected in the pro forma weighted average common shares outstanding, since for pro forma purposes the acquisition and disposal transactions are assumed to have occurred on January 1, 2006. Since the results of Gavitec were included in NeoMedia’s consolidated financial results for the entire three month period ended March 31, 2007, separate pro forma results are not shown above for this period.

(A) - Adjustment is to reflect operations of Gavitec from February 23, 2006 (closing date of acquisition) through March 31, 2006, and to reflect amortization of Gavitec intangible assets for the period January 1, 2006 through February 23, 2006. Results of operations for Gavitec from February 23, 2006 through March 31, 2006 are included in NeoMedia's operations for the three months ended March 31, 2006.

(B) - Adjustment for shares that would have been issued in connection with the acquisitions of Gavitec, 12Snap, and BSD if they had occurred on January 1, 2006. The adjustment between the reported and the pro forma number of weighted average shares outstanding is caused by (i) the weighting of the pro forma shares for the three months ended March 31, 2006, whereas in the reported number the shares were only outstanding from the closing date of each acquisition through March 31, 2006, and (ii) the number of pro forma shares being higher than the actual shares issued due to a lower stock price on the pro forma date of issuance than the actual date of issuance. Using the stock price around January 1, 2006, the pro forma number of shares that would have been issued was:

	Gavitec	12Snap	BSD	Total
Total stock consideration	$ 5,400,000	$ 19,500,000	$ 2,279,263	$ 27,179,263

Stock price on pro forma acquisition date	$ 0.290	$ 0.290	$ 0.290	
Pro forma number of consideration shares	18,620,690	67,241,379	7,859,527	93,721,596

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Tax Implications of Acquisitions

For income tax purposes, amounts assigned to particular assets acquired and liabilities assumed in the business combinations are different than amounts used for financial reporting. The differences in assigned values for financial reporting and tax purposes result in temporary differences. In applying SFAS 109, “Accounting for Income Taxes”, the Company is required to recognize the tax effect of these temporary differences and, accordingly, a deferred tax liability has been recognized. The Company determined that its pre-existing and acquired deferred tax assets, and those acquired, including those subject to limitations, were more likely than not to be realized to offset the deferred tax liability. The reduction in the valuation allowance resulting in an asset was used to offset the deferred tax liability arising from the business combinations, pursuant to SFAS 109.

In addition, the acquisitions of Sponge, Gavitec, 12Snap, and BSD involve a change of control of foreign entities, and as a result any net operating loss carryforward in existence prior to the acquisition may have limited or no use for NeoMedia.

Intangible Assets

As of March 31, 2007, NeoMedia had intangible assets used in its continuing operations with original historical cost as follows:

	(US dollars in thousands)		
	Gavitec	**Other**	**Total**
Proprietary Software	$ 4,600	$ 763	$ 5,363
Copyrighted Materials	58	---	58
Patents	---	4,888	4,888
Total	**$ 4,658**	**$ 5,651**	**$ 10,309**

As of March 31, 2007, accumulated amortization on NeoMedia's intangible assets used in its continuing operations was:

	(US dollars in thousands)		
	Gavitec	**Other**	**Total**
Proprietary Software	$ 722	$ 690	$ 1,412
Copyrighted Materials	11	---	11
Patents	---	2,124	2,124
Total	**$ 733**	**$ 2,814**	**$ 3,547**

As of March 31, 2007, the carrying value of NeoMedia's intangible assets used in its continuing operations was:

	(US dollars in thousands)		
	Gavitec	**Other**	**Total**
Proprietary Software	$ 3,878	$ 73	$ 3,951
Copyrighted Materials	47	---	47
Patents	---	2,764	2,764
Total	**$ 3,925**	**$ 2,837**	**$ 6,762**

Estimated future amortization expense on NeoMedia's intangible assets is expected to be:

	(US dollars in thousands)			
	Proprietary Software	**Copyrighted Materials**	**Patents**	**Total**
2007 (remaining 9 months)	$ 510	$ 7	$ 224	$ 741
2008	662	10	295	967
2009	631	10	284	925
2010	629	10	264	903
2011	629	2	170	801
Thereafter	890	8	1,527	2,425
Total	**$ 3,951**	**$ 47**	**$ 2,764**	**$ 6,762**

It is important to note that actual amortization expense could differ materially from the table due to subjective factors such as changes in assumptions of useful lives or impairment charges. The weighted average remaining life for the intangible assets was approximately 9.6 years as of March 31, 2007.

As of March 31, 2007, the following intangible assets relating to discontinued operations were included in "Assets held for sale" on the accompanying consolidated balance sheet:

	(US dollars in thousands)			
	12snap	**BSD**	**Micro Paint**	**Total**
Customer Contracts, net	$ 193	$ 1,083	$ 54	$ 1,330
Proprietary Software, net	2,332	---	7	2,339
Brand Name, net	850	---	---	850
Copyrighted Materials, net	24	108	23	155
Patents, net	---	---	1,318	1,318
Goodwill, net	---	4,402	1,068	5,470
Total	**$ 3,399**	**$ 5,593**	**$ 2,470**	**$ 11,462**

Goodwill

As of March 31, 2007, goodwill consisted of $3,418,000 associated with NeoMedia's acquisition of Gavitec. As of March 31, 2007, NeoMedia also had recorded goodwill in the amount of $1,068,000 and $4,402,000 relating to its Micro Paint Repair and Telecom Services businesses, respectively, that are held for sale. These amounts are included in "Assets held for sale" on the accompanying consolidated balance sheet.

4. DISCONTINUED OPERATIONS AND ASSETS AND LIABILITIES HELD FOR SALE

Micro Paint Repair Business Unit

During August 2006, NeoMedia decided to sell its Micro Paint Repair business unit. The Company is currently in the process of negotiating with potential buyers with respect to the sale.

NeoMedia has analyzed the pertinent facts of the proposed transaction with respect to the criteria outlined in SFAS 144, and has determined that all of the criteria have been met and continue to be met. Accordingly, NeoMedia is reporting the operating results of the MPR business unit as Discontinued Operations, and the assets and liabilities as Held for Sale for all periods presented in this filing. Assets Held for Sale are not depreciated or amortized.

Sponge and Mobot Businesses

In the fourth quarter of 2006, NeoMedia disposed of two subsidiaries, Sponge and Mobot. All assets and liabilities associated with these two subsidiaries were disposed in the sale and removed from NeoMedia’s consolidated balance sheet. In accordance with SFAS 144, NeoMedia is reporting the operating results of these two subsidiaries as Discontinued Operations for all periods presented in this filing. NeoMedia has analyzed the applicable accounting literature found in the SEC Staff Accounting Bulletin (SAB) Topic 5E, Accounting Principles Board (APB) Opinion 29, APB 18, Statement of Financial Accounting Standards (SFAS) 141, SFAS 144, and Emerging Issues Task Force (EITF) issue 01-2, and determined that the criteria for reporting the disposal of a business and reporting of discontinued operations have been met.

12Snap Business

In January 2007, NeoMedia management determined that it would focus on its core code-reading business in North America, the UK, mainland Europe, and China. In conjunction with this direction, the Company decided to sell its 12Snap business unit. On April 4, 2007, NeoMedia completed the sale of 12Snap. NeoMedia has analyzed the pertinent facts of the proposed transaction with respect to the criteria outlined in SFAS 144, and has determined that all of the criteria were met as of March 31, 2007 and continue to be met. Accordingly, NeoMedia is reporting the operating results of the 12Snap business unit as Discontinued Operations, and the assets and liabilities as Held for Sale for all periods presented in this filing. Assets Held for Sale are not depreciated or amortized. The disposal transaction will be reflected in NeoMedia’s financial statements for its fiscal quarter ended June 30, 2007.

Telecom Services Business

In connection with its January 2007 decision to focus on its core code-reading business, the Company also decided to sell the NeoMedia Telecom Services business unit. NeoMedia has analyzed the pertinent facts of the proposed transaction with respect to the criteria outlined in SFAS 144, and has determined that all of the criteria were met as of March 31, 2007 and continue to be met. Accordingly, NeoMedia is reporting the operating results of the NeoMedia Telecom Services business unit as Discontinued Operations, and the assets and liabilities as Held for Sale for all periods presented in this filing. Assets Held for Sale are not depreciated or amortized.

The operating results of the Micro Paint Repair, Sponge, Mobot, 12Snap, and Telecom Services businesses classified as discontinued operations are shown in the following table. These results include a gain on extinguishment of debt realized by Telecom Services in the amount of $257,000, and an impairment charge to reduce 12Snap assets to their fair market value in the amount of $2,467,000 in the three months ended March 31, 2007. There is not any tax expense or benefit to report due to NeoMedia's net operating loss carry forward tax position.

	Three months ended March 31, 2007					
	Micro Paint Repair	**Telecom Services**	**12Snap**	**Mobot**	**Sponge**	**Total**
Net Sales	$ 326	$ 302	$ 2,621	$ ----	$ ---	$ 3,249
Loss from discontinued operations	$ (591)	$ (3)	$ (1,954)	$ (11)	$ (15)	$ (2,574)

	Three months ended March 31, 2006					
	Micro Paint Repair	**Telecom Services**	**12Snap**	**Mobot**	**Sponge**	**Total**
Net Sales	$ 377	$ 27	$ 896	$ 57	$ 291	$ 1,648
Loss from discontinued operations	$ (451)	$ (429)	$ (56)	$ (282)	$ 49	$ (1,169)

The assets and liabilities of the Micro Paint Repair, 12Snap, and Telecom Services businesses classified as held for sale are shown in the following table. There are no assets or liabilities associated with the Sponge or Mobot subsidiaries as of the balance sheet dates of March 31, 2007 or 2006.

	As of March 31, 2007			
	Micro Paint Repair	**Telecom Services**	**12Snap**	**Total**
ASSETS				
Current assets:				
Cash & Cash Equivalents	$ 68	$ 14	$ 824	$ 906
Trade Accounts Receivable, net	223	1,727	820	2,770
Inventory	236	---	---	236
Prepaid expenses and other current assets	49	12	380	441
Total Current Assets	576	1,753	2,024	4,353
Leasehold improvements and property and equipment, net	139	40	180	359
Goodwill and other intangible assets, net	2,470	5,593	3,399	11,462
Total Assets Held for Sale	**$ 3,185**	**$ 7,386**	**$ 5,603**	**$ 16,174**
LIABILITIES				
Current Liabilities:				
Accounts Payable	$ 88	$ 1,656	$ 525	$ 2,269
Accrued expenses	24	4	2,099	2,127
Taxes Payable	10	1,023	---	1,033
Deferred revenue & Other	329	69	1,584	1,982
Total Liabilities Held for Sale	**$ 451**	**$ 2,752**	**$ 4,208**	**$ 7,411**

	As of December 31, 2006			
	Micro Paint Repair	**Telecom Services**	**12Snap**	**Total**
ASSETS				
Current assets:				
Cash & cash equivalents	$ 81	$ 72	$ 721	$ 874
Trade accounts receivable, net	196	1,577	1,842	3,615
Inventory	154	---	---	154
Investment in marketable securities	---	---	---	---
Prepaid expenses and other current assets	36	12	407	455
Total Current Assets	467	1,661	2,970	5,098
Leasehold improvements and property and equipment, net	135	48	200	383
Goodwill and other intangible assets, net	2,470	5,593	5,876	13,939
Other long term assets	---	---	---	---
Total Assets Held for Sale	**$ 3,072**	**$ 7,302**	**$ 9,046**	**$ 19,420**
LIABILITIES				
Current Liabilities:				
Accounts payable	$ 25	$ 1,854	$ 640	$ 2,519
Accrued expenses	22	6	2,144	2,172
Taxes payable	8	1,037	---	1,045
Deferred revenue & other	352	73	4,096	4,521
Total Liabilities Held for Sale	**$ 407**	**$ 2,970**	**$ 6,880**	**$ 10,257**

Inventory included in assets held for sale is as follows:

	March 31, 2007	December 31, 2006
Raw materials	$ 130	$ 90
Work-in-process	---	---
Finished goods	106	64
Total	**$ 236**	**$ 154**

Results of operations for all discontinued business units are included in the line item entitled “Loss from discontinued operations” on the accompanying consolidated statement of operations for all periods presented. Balance sheet items for all discontinued business units are included in the line items entitled “Assets held for sale” and “Liabilities held for sale” on the accompanying consolidated balance sheet for all periods presented. As a result, pro forma results of operations as if the sale of each entity had occurred at the beginning of the period reported, and pro forma balance sheets as if the sale of each entity had occurred at the balance sheet dates presented, are not shown separately in this footnote.

As of March 31, 2007, NeoMedia also had recorded goodwill in the amount of $1,068,000 and $4,402,000 relating to its Micro Paint Repair and Telecom Services businesses, respectively, that are held for sale. These amounts are included in “Assets held for sale” on the accompanying consolidated balance sheet.

5. FINANCING

Series C Convertible Preferred Stock

The Company entered into a Securities Purchase Agreement, dated February 17, 2006 (the “Agreement”) with Cornell Capital Partners LP, an accredited investor (the “Purchaser”). Pursuant to the Agreement, the Purchaser agreed to purchase 8% cumulative Series C convertible preferred stock to be fully converted three (3) years from the date of issuance in the aggregate amount of $22,000,000. Net consideration from this arrangement amounted to $17,854,000, comprised of cash of $14,066,000, marketable securities with a calculated fair value of $579,000 and a purchase value of $2,000,000, and the extinguishment of $3,209,000 of preexisting indebtedness. In addition, the Purchaser withheld $2,725,000 commitment and structuring fees from the gross proceeds. The Agreement also provided for the issuance to the Purchaser, at no additional cost to the Purchaser, warrants to purchase shares of the Company's common stock. The Agreement also called for the Purchaser to acquire an additional $5,000,000 of Series C convertible preferred stock on the date a registration statement filed by the Company was declared effective by the U.S. Securities and Exchange Commission. In connection with the Agreement, the Company also entered into a registration rights agreement with the Purchaser that required the Company to (i) file a registration statement with the SEC registering the resale of the shares of common stock issuable upon conversion of the preferred stock and the exercise of the warrants, (ii) achieve effectiveness by December 1, 2006, and (iii) maintain effectiveness of the registration statement. NeoMedia failed to meet these requirements, accordingly the Company is subject to liquidated damages amounting to 1% of the outstanding amount of Series C preferred stock per month, not to exceed $1,200,000.

At any time from the closing date until February 17, 2009, the Purchaser has the right to convert the preferred stock, in whole or in part, into common stock of the Company at the then effective conversion price, which varies relative to the Company’s trading stock price, as follows: The lower of $0.50 per share, or 97% of the lowest closing bid price (as reported by Bloomberg) of the common stock for the 30 trading days immediately preceding the conversion date. The conversions are limited such that the holder cannot exceed 4.99% ownership, unless the holders waive their right to such limitation. The limitation will terminate under any event of default.

On November 29, 2006, the Purchaser exercised the conversion of 378 shares of the Series C convertible preferred stock for 6,631,579 shares of NeoMedia’s common stock, leaving a balance of 21,622 shares of Series C convertible preferred stock outstanding.

The Series C convertible preferred stock, at the option of the holder, affords the Purchaser anti-dilution protection should, at any time while the Series C preferred stock instruments are outstanding, the Company offer, sell or grant any option to purchase or offer, sell or grant any right to re-price its securities, or otherwise dispose of or issue any common stock or common stock equivalents, entitle any person to acquire shares of common stock at an effective price per share less than the then effective conversion price (excluding employee stock options), as calculated by the formula described above; then, in such instance, the conversion price for the convertible preferred stock shares shall be reduced to the lower price. In case of any such adjustment in the effective conversion price for the convertible preferred shares, this could significantly dilute existing investors.

Under the Series C Agreement, the Purchaser also received “A” warrants, “B” warrants and “C” warrants to purchase 20,000,000, 25,000,000, and 30,000,000 shares of NeoMedia’s common stock, respectively, exercisable in three separate traunches at a price of $0.50, $0.40 and $0.35, respectively, per share, subject to adjustment, included under anti-dilution protection similar to that described above. As an inducement to enter into subsequent financing arrangements related to Cornell Debentures, the warrants were repriced on December 29, 2006 to $0.04 per share, subject to all the original terms and conditions of the respective warrant agreements. The Company recorded an additional warrant liability of $250,000 related to the repricing. The warrants have a five-year contractual life. NeoMedia can force exercise of the warrants if the closing bid price of NeoMedia stock is more than $0.10 greater than the exercise price of any of the warrants for 15 consecutive trading days. It is important to note that the warrants held by Cornell Capital Partners contain a provision that, if at the time of exercise, NeoMedia is in default of the warrant agreement, the holder can perform a "cashless" exercise of the warrants and in lieu of making payment of the exercise price in cash, elect instead to withhold shares as consideration for the exercise price. In the event of such a "cashless" exercise, NeoMedia would not receive any cash proceeds upon the exercise of such warrants. NeoMedia is currently in default of the Investor Registration Rights Agreement entered into on February 17, 2006, in connection with the Series C convertible preferred stock, which called for a registration statement containing the shares underlying the Series C convertible preferred stock to be filed by June 1, 2006 and declared effective by December 1, 2006. Such a default of the Investor Registration Rights Agreement constitutes an event of default under the warrant agreements issued in connection with the Series C convertible preferred stock. As a result, Cornell Capital Partners currently has the right to exercise on a cashless basis 75,000,000 of the warrants they hold that were issued in connection with the Series C convertible preferred stock.

The 8% cumulative Series C convertible preferred stock contains consequences in case of default. Events of default which could subject the Company to penalties, damages, and liabilities as specified in the Agreement include:

- Any case or action of bankruptcy or insolvency commenced by the Company or any subsidiary, against the Company or adjudicated by a court against the Company for the benefit of creditors;
- Any default in its obligations under a mortgage or debt in excess of $100,000;
- Any cessation in the eligibility of the Company's stock to be quoted on a trading market;
- Failure to timely file the registration statement covering the shares related to the conversion option, or failure to make the registration statement effective timely (NeoMedia is in default of this provision);
- Any lapse in the effectiveness of the registration statement covering the shares related to the conversion option, the warrants as described and transacted in the securities purchase agreement and accompanying documents;
- Any failure to deliver certificates within the specified time; and
- Any failure, by the Company, to pay in full the amount of cash due pursuant to a buy-in or failure to pay any amounts owed on account on account of an event of default within 10 days of the date due.

Other provisions included in the Agreement include the following:

- The 8% cumulative Series C convertible preferred stock is convertible into common stock, at the option of the Purchaser, at any time after the effective date;
- Conversions can be made in increments and from time to time;
- The 8% cumulative Series C convertible preferred stock has voting rights on an "as converted" basis, meaning the Purchaser is entitled to vote the number of shares of common stock into which the 8% cumulative Series C convertible preferred stock was convertible as of the record date for a meeting of shareholders;
- As promptly as practicable after any conversion date and subject to an effective registration statement or an exemption from registration, the Company shall cause its transfer agent to deliver a certificate representing the converted shares, free of any legends and trading restrictions for the number of shares converted;

- The Company will reserve and keep available authorized and unissued registered shares available to be issued upon conversion;

- Purchaser will not be responsible for any transfer taxes relative to issuance of shares;

- If the Company offers, sells or grants stock at an effective per share price less than the then Conversion Price, then the Conversion Price shall be reduced to equal the effective conversion, exchange or purchase price for such common stock or common stock equivalents;

Due to the current default status, the Purchaser has certain material additional rights in this financing arrangement that did not exist prior to default. Specifically,

- The full fair value of the Series C convertible preferred stock is now callable in the amount of $21,657,000;

- The warrants can be exercised on a cashless basis as described above;

- The requirement for the Purchaser to maintain an ownership interest in NeoMedia of less than 4.99% is waived;

- NeoMedia is responsible for liquidated damages as described above.

In addition, the accounting for the Series C convertible preferred stock reflects certain specific accounting rules and regulations that are applicable under the default provision:

- Prior to the default, NeoMedia was accreting dividends on the Series C convertible preferred stock, using the effective interest method, through periodic charges to additional paid in capital. Due to the default status, NeoMedia accreted dividends to the full fair value of the Series C convertible preferred stock during the fourth quarter of 2006.

- The Series C convertible preferred stock is now reported as demand debt in the current liabilities section of the balance sheet, pursuant to the guidance outlined in SFAS 150.

At the inception date of February 17, 2006, a summary of the allocation of the components of the transaction was as follows:

Instrument:		
Convertible preferred stock (1)	$	1,711,000
Common stock warrants (2)		16,172,000
Embedded conversion feature		1,935,000
Debt extinguishment loss (3)		(1,964,000)
Total gross proceeds	$	17,854,000

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(1) The discount to the face value of the 8% cumulative Series C convertible preferred stock that resulted from the allocation along with deferred costs was being accreted through periodic charges to additional paid-in capital using the effective interest method, prior to the accretion to full fair value due to NeoMedia's being in default of the registration rights agreement

(2) The Company issued additional warrants to purchase aggregate 75,000,000 shares of common stock in connection with the 8% cumulative Series C convertible preferred stock. The Company also issued 2,000,000 warrants (valued at $447,000) as financing fees.

(3) The financing arrangement settled face value $3,209,000 of preexisting indebtedness. The debt extinguishment loss was calculated as the amount that the fair value of securities issued (using a relative fair value basis) exceeded the Company's carrying value.

In accordance with Statement of Financial Accounting Standards No. 133, ‘Accounting for Derivative Instruments and Hedging Activities’, (“FASB 133”), the Company determined that the conversion feature of the Series C convertible preferred stock met the criteria of an embedded derivative and therefore the conversion feature of the Series C convertible preferred stock needed to be bifurcated and accounted for as a derivative. The Series C convertible preferred stock does not meet the definition of “conventional convertible debt” because the number of shares which may be issued upon the conversion of the Series C convertible preferred stock is not fixed. Furthermore, there is no cap on the number of shares that could be issued upon conversion. Therefore, the conversion feature fails to qualify for equity classification under EITF 00-19, and must be accounted for as a derivative liability.

The carrying value of the 8% cumulative Series C convertible preferred stock amounted to $21,657,000 at March 31, 2007. The face value of Series C convertible preferred stock at March 31, 2007 was also $21,657,000 as the instrument was written up to full fair value during the fourth quarter of 2006 due to NeoMedia’s current default position. Derivative financial instruments arising from the issuance of Series C convertible preferred stock are initially recorded and continuously carried at fair value. Upon conversion of any derivative financial instrument, the change in fair value from the previous reporting date to the date of conversion is recorded to income (loss), and then the carrying value is recorded to paid-in capital, provided all other criteria for equity classification are met. The following tabular presentation reflects the components of derivative financial instruments related to the Series C convertible preferred stock on the Company’s balance sheet at March 31, 2007:

(Assets) Liabilities:		**March 31, 2007**
Common stock warrants	$	2,700,000
Embedded conversion feature		2,908,000
Other warrants (1)		782,000
	$	6,390,000

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(1) The fair values of certain other derivative financial instruments (warrants) that existed at the time of the issuance of Series C convertible preferred stock were reclassified from stockholders’ equity to liabilities when, in connection with the issuance of Series C convertible preferred stock, the Company no longer controlled its ability to share-settle these instruments. These derivative financial instruments had fair values of $14,331,000, $977,000 and $782,000 on February 17, 2006, December 31, 2006, and March 31, 2007, respectively. The decrease in fair value of these other derivative financial instruments resulted from a decrease in NeoMedia’s share price between February 17, 2006, December 31, 2006, and March 31, 2007. The change in fair value is reported as “Gain on derivative financial instruments” on the condensed consolidated statement of operations during each period. These warrants will be reclassified to stockholders’ equity when the Company reacquires the ability to share-settle the instruments.

The following tabular presentation reflects the number of common shares into which the aforementioned derivative financial instruments are convertible or exercisable into at March 31, 2007:

	Shares of common stock
Common stock warrants	75,000,000
Embedded conversion feature (1)	607,422,165
Other warrants	33,325,000
	715,747,165

(1) The terms of the embedded conversion features in the Series C convertible preferred stock provide for variable conversion rates that are indexed to the Company's trading common stock price. As a result, the number of indexed shares is subject to continuous fluctuation. For presentation purposes, the number of shares of common stock into which the embedded conversion feature was convertible as of March 31, 2007 was calculated as the face value of $21,622,000 plus assumed dividends of $1,946,000 if declared, divided by 97% of the lowest closing bid price for the 30 trading days preceding March 31, 2007, which was $0.04 per share.

As of March 31, 2007 cumulative dividends earned but not declared in excess of the carrying value are $1,946,000.

Derivative income associated with adjustments recorded to reflect the aforementioned derivatives at fair value amounted to $2,828,000 and $4,768,000 during the three months ended March 31, 2007 and 2006, respectively. These amounts are reported as "Gain on derivative financial instruments" in the accompanying condensed consolidated statement of operations.

Fair value considerations for derivative financial instruments:

Freestanding derivative instruments, consisting of warrants that arose from the financing and those reclassified as described above are valued using the Black-Scholes-Merton valuation methodology because that model embodies all of the relevant assumptions that address the features underlying these instruments. Significant assumptions included in this model as of March 31, 2007 are as follows:

	Three months ended March 31, 2007		**Three months ended March 31, 2006**	
Holder	**Cornell Capital Partners**	**Other**	**Cornell Capital Partners**	**Other**
Instrument	Warrants	Warrants	Warrants	Warrants
Exercise price	$0.04	$0.01 - $3.45	$0.35 - $0.50	$0.01 - $3.45
Term (years)	3.88	0.2 - 3.88	4.88	1.0 - 4.88
Volatility	107.81%-131.04%	115.73%-131.04%	70.80%	52.56% -70.80%
Risk-free rate	4.54%	4.54%	3.65%	3.65%

Embedded derivative financial instruments, arising from the Series C convertible preferred stock, consist of multiple individual features that were embedded in the instrument. The Company evaluated all significant features of the instruments as required under current accounting standards and aggregated such instruments into one compound derivative financial instrument for financial reporting purposes. The compound embedded derivative instruments are valued using the Flexible Monte Carlo methodology because that model embodies certain relevant assumptions (including, but not limited to, interest rate risk, credit risk, and conversion/redemption privileges) that are necessary to value these complex derivatives.

Assumptions included exercise estimates/behaviors and the following other significant estimates:

	Three months ended March 31,	
Instrument	**2007**	**2006**
Conversion prices	$0.04	$0.95 - $1.29
Remaining terms (years)	1.88	2.88
Equivalent volatility	117.69%-119.64%	52.56% - 56.47%
Equivalent interest-risk adjusted rate	4.54% - 14.26%	8.17% - 8.58%
Equivalent credit-risk adjusted yield rate	62.50%	14.50%

Equivalent amounts reflect the net results of multiple modeling simulations that the Monte Carlo Simulation methodology applies to underlying assumptions. The assumptions included in the Monte Carlo Simulation calculation are highly subjective and subject to interpretation.

$5 Million Secured Convertible Debenture - August 2006

The Company entered into a Securities Purchase Agreement, dated August 24, 2006, (the “Agreement”) with Cornell Capital Partners LP, an accredited investor (the “Purchaser”). Pursuant to the Agreement, the Purchaser agreed to purchase 10% secured convertible debentures maturing two years from the date of issuance in the aggregate amount of $5,000,000. The Agreement also provided for the issuance to the Purchaser, at no additional cost to the Purchaser, warrants to purchase shares of the Company's common stock. In connection with the Agreement, the Company also entered into a registration rights agreement with the Purchaser that required the Company to (i) file a registration statement with the SEC registering the resale of the shares of common stock issuable upon conversion of the convertible debenture and the exercise of the warrants, (ii) achieve effectiveness within a stated period and (iii) maintain effectiveness of the registration statement. Failure to meet these requirements will require the Company to incur liquidated damages amounting to 2% of the principal per month, but in no event shall consideration paid as liquidated damages exceed $1,000,000. The debentures are secured by substantially all of the Company’s assets.

At any time from the closing date until August 24, 2008, the Purchaser has the right to convert the convertible debenture into common stock of the Company at the then effective conversion price, which varies relative to the Company’s trading stock price, as follows: $0.15 per share, or 90% of the lowest closing bid price (as reported by Bloomberg) of the common stock for the 30 trading days immediately preceding the conversion date. The conversion was limited such that the holder cannot exceed 4.99% ownership, unless the holders waive their right to such limitation. The limitation will terminate under any event of default.

The convertible debenture, at the option of the holder, affords the Purchaser anti-dilution protection should, at any time while the convertible debenture is outstanding, the Company offer, sell or grant any option to purchase or offer, sell or grant any right to re-price its securities, or otherwise dispose of or issue any common stock or common stock equivalents, entitle any person to acquire shares of common stock at an effective price per share less than the then effective conversion price (excluding employee stock options), as calculated by the formula described above; then, in such instance, the conversion price for the convertible debenture shall be reduced to the lower price. In case of any such adjustment in the effective conversion price for the convertible debenture, this could significantly dilute existing investors.

Under the Agreement, the Purchaser also received "A" warrants, "B" warrants, "C" warrants and "D" warrants to purchase an aggregate of up to 175,000,000 shares of common stock, exercisable in four separate traunches at a price of $0.15, $0.25, $0.20 and $0.05 respectively per share, subject to adjustment, included under anti-dilution protection similar to that described above. As an inducement to enter into a subsequent financing arrangement with the Purchaser, the warrants were repriced on December 29, 2006 to $0.04 per share, subject to all the original terms and conditions of the respective warrant agreements. The Company recorded an additional warrant liability of $452,000 related to this repricing. The warrants have a five-year contractual life. NeoMedia can force exercise of the warrants if the closing bid price of NeoMedia stock is more than $0.10 greater than the exercise price of any of the warrants for 15 consecutive trading days. It is important to note that the warrants held by Cornell Capital Partners contain a provision that, if at the time of exercise, NeoMedia is in default of the warrant agreement, the holder can perform a "cashless" exercise of the warrants and in lieu of making payment of the exercise price in cash, elect instead to withhold shares as consideration for the exercise price. In the event of such a "cashless" exercise, NeoMedia would not receive any cash proceeds upon the exercise of such warrants. NeoMedia is currently in default of the Investor Registration Rights Agreement entered into on August 24, 2006, in connection with the secured convertible debenture, which called for a registration statement containing the shares underlying the secured convertible debenture to be declared effective by November 22, 2006. Such a default of the Investor Registration Rights Agreement constitutes an event of default under the warrant agreements issued in connection with the secured convertible debenture. As a result, Cornell Capital Partners currently has the right to exercise on a cashless basis 175,000,000 of the warrants they hold that were issued in connection with the secured convertible debenture.

The convertible debenture contains consequences in case of default. Events of default which could subject the Company to penalties, liabilities, and foreclosure upon the assets of the Company as specified in the Agreement include:

· Any case or action of bankruptcy or insolvency commenced by the Company or any subsidiary, against the Company or adjudicated by a court against the Company for the benefit of creditors;

· Any default in its obligations under a mortgage or debt in excess of $100,000;

· Any cessation in the eligibility of the Company's stock to be quoted on a trading market;

· Failure to timely file the registration statement covering the shares related to the conversion option, or failure to make the registration statement effective timely. NeoMedia is currently in default of this provision;

· Any lapse in the effectiveness of the registration statement covering the shares related to the conversion option, the warrants as described and transacted in the securities purchase agreement and accompanying documents;

· Any failure to deliver certificates within the specified time; and

· Any failure, by the Company, to pay in full the amount of cash due pursuant to a buy-in or failure to pay any amounts owed on account on account of an event of default within 3 days of the date due.

Other provisions included in the Agreement include the following:

· The convertible debenture is convertible into common stock, at the option of the Purchaser, at any time after the effective date;

· As promptly as practicable after any conversion date, and subject to an effective registration statement or an exemption from registration the Company shall cause its transfer agent to deliver a certificate representing the converted shares, free of any legends and trading restrictions for the number of shares converted;