

Neonode Inc.  
Form 10-K  
March 07, 2019

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

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

**For the fiscal year ended December 31, 2018**

**or**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

Commission File No. 1-35526

**NEONODE INC.**

*(Exact name of Registrant as specified in its charter)*

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

**Storgatan 23C, 114 55 Stockholm, Sweden**

*(Address of Principal Executive Office and Zip Code)*

**+46 (0) 8 667 17 17**

*(Registrant's Telephone Number, including Area Code)*

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

Title of Each Class	Name of Each Exchange on Which Registered
<b>Common Stock, par value \$0.001 per share</b>	<b>The Nasdaq Stock Market LLC</b>

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

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

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

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

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

Large accelerated filer Accelerated filer  
Non-accelerated filer Smaller reporting company  
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The approximate aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant, based on the closing price for the registrant's common stock on June 30, 2018 (the last business day of the registrant's most recently completed second fiscal quarter) as reported on the Nasdaq Stock Market, was \$20,230,934.

The number of shares of the registrant's common stock outstanding as of March 1, 2019 was 8,800,313.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement for the registrant's 2019 Annual Meeting of Stockholders are incorporated by reference as set forth in Part III of this Annual Report. The registrant intends to file such definitive proxy statement with the Securities and Exchange Commission within 120 days of the registrant's fiscal year ended December 31, 2018.



NEONODE INC.

**2018 ANNUAL REPORT ON FORM 10-K**

**TABLE OF CONTENTS**

<u>SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS</u>	ii
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**PART I**

<u>Item 1. BUSINESS</u>	1
<u>Item 1A. RISK FACTORS</u>	9
<u>Item 1B. UNRESOLVED STAFF COMMENTS</u>	15
<u>Item 2. PROPERTIES</u>	15
<u>Item 3. LEGAL PROCEEDINGS</u>	16
<u>Item 4. MINE SAFETY DISCLOSURES</u>	16

**PART II**

<u>Item 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	16
<u>Item 6. SELECTED FINANCIAL DATA</u>	17
<u>Item 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	17
<u>Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	34
<u>Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	F-1
<u>Item 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	35
<u>Item 9A. CONTROLS AND PROCEDURES</u>	35
<u>Item 9B. OTHER INFORMATION</u>	35

**PART III**

<u>Item 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	36
<u>Item 11. EXECUTIVE COMPENSATION</u>	36
<u>Item 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	36
<u>Item 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u>	36
<u>Item 14. PRINCIPAL ACCOUNTING FEES AND SERVICES</u>	36

**PART IV**

<u>Item 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES</u>	37
<u>Item 16. FORM 10-K SUMMARY</u>	38
<u>SIGNATURES</u>	39

## **SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS**

*This Annual Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, adopted pursuant to the Private Securities Litigation Reform Act of 1995. Statements that are not purely historical may be forward-looking. You can identify some forward-looking statements by the use of words such as “believe,” “anticipate,” “expect,” “intend,” “plan” and similar expressions. Forward-looking statements involve inherent risks and uncertainties regarding events, conditions and financial trends that may affect our future plans of operation, business strategy, results of operations and financial position. A number of important factors could cause actual results to differ materially from those included within or contemplated by such forward-looking statements, including, but not limited to risks relating to our limited experience manufacturing hardware devices, the uncertainty of growth in market acceptance for our technology, our history of losses since inception, our ability to remain competitive in response to new technologies, the costs to defend, as well as risks of losing, patents and intellectual property rights, our customer concentration and dependence on a limited number of customers, a reliance on our future customers’ ability to develop and sell products that incorporate our technology, the uncertainty of demand for our technology in certain markets, the length of a product development and release cycle, our ability to manage growth effectively, our dependence on key members of our management and development team, our ability to maintain the Nasdaq listing of our common stock, and our ability to obtain adequate capital to fund future operations. For a discussion of these and other factors that could cause actual results to differ from those contemplated in the forward-looking statements, please see “Item 1A. Risk Factors” and elsewhere in this Annual Report, and in our publicly available filings with the Securities and Exchange Commission. Forward-looking statements reflect our analysis only as of the date of this Annual Report. Because actual events or results may differ materially from those discussed in or implied by forward-looking statements made by us or on our behalf, you should not place undue reliance on any forward-looking statement. We do not undertake responsibility to update or revise any of these factors or to announce publicly any revision to forward-looking statements, whether as a result of new information, future events or otherwise.*

## **PART I**

*Neonode Inc., collectively with its subsidiaries, is referred to in this Annual Report as “Neonode”, “we”, “us”, “our”, “registrant”, or “Company”.*

*We use Neonode, our logo, zForce, AirBar and other marks as trademarks. This Annual Report contains references to our trademarks and service marks and to those belonging to other entities. Solely for convenience, trademarks and trade names referred to in this Annual Report, including logos, artwork and other visual displays, may appear without the ® or ™ symbols, but such references are not intended to indicate in any way that we will not assert, to the fullest extent under applicable law, our rights or the rights of the applicable licensor to these trademarks and trade names.*

### **ITEM 1. BUSINESS**

Our Company develops optical touch and gesture solutions for human interaction with devices. We offer our core technology under the brand name “zForce”.

We license our technology to Original Equipment Manufacturers (“OEMs”) and Tier 1 suppliers who embed our technology into products they develop, manufacture and sell. Our licensing customers have sold approximately 67 million devices that use our technology.

In addition to our licensing business, we design and manufacture sensor modules that incorporate our zForce AIR technology. We sell our embedded sensors components to OEMs, Original Design Manufacturers (“ODMs”) and Tier 1 suppliers for use in their products. We began shipping sensor modules in October 2017. We also sell our Neonode branded AirBar product that incorporates one of our sensor modules through distributors and directly to consumers.

#### **Our Organization**

Neonode Inc. was incorporated in the State of Delaware on September 4, 1997. Our principal executive office is located in Stockholm, Sweden. Our office in the United States is located in San Jose, California.



In 2008, we established a wholly owned subsidiary Neonode Technologies AB (Sweden) to develop and license touchscreen technology. In 2013, we established a wholly owned subsidiaries: Neonode Japan Inc., (Japan); Neno User Interface Solutions AB (Sweden) (sold in December 2018); NEON Technology Inc. (U.S.) (dissolved November 19, 2018); and Neonode Americas Inc. (U.S.) (dissolved November 19, 2018). In 2014, we established an additional wholly owned subsidiary: Neonode Korea Ltd. (South Korea). In 2015, we established an additional wholly owned subsidiary: Neonode Taiwan Ltd (Taiwan). In 2015, we established a 51% majority owned consolidated subsidiary: Pronode Technologies AB (Sweden). In 2016, we entered into a joint venture, Neoeye AB (Sweden).

## **Strategy and Focus Areas**

Our customers use touch, gesture and object sensing technology to grow their businesses, drive efficiencies, and seek competitive advantages. In this interactive world, cost effective and robust sensing technology is a strategic asset and is increasingly distributed across an expanding number of products. Our strategy is to deliver proven technology and support with the integration so our customers can bring products to market that provide an optimal user experience.

Our operations include a business unit to design, manufacture and sell embedded sensors to our business-to-business customers who integrate them into their products. We previously only offered licensed touch technology designs. An important piece of our strategy has been the development of an automated manufacturing and production system. Our ability to manufacture fully integrated sensor modules and provide support with hardware and software integration reduces our customers' time to market while providing us a path to further growth.

Our goal is to continue to be a leader in touch technology while transitioning current licensing customers into our embedded sensors and expanding to new markets where touch, gesture and object detecting features provide a competitive advantage. We intend to continue innovating through the introduction of next-generation products that offer better price and performance and architectural advantages compared to our competitors. We intend to execute on this strategy through portfolio transformation, internal innovation, and co-development of products with our customers and the building of strategic partnerships.

## **Business Model**

We derive revenues through technology licensing, selling embedded sensor modules and engineering consulting services. We mainly operate in the business-to-business (“B2B”) markets.

### *Licensing*

As of December 31, 2018, we have entered into forty-one technology license agreements with global OEMs, ODMs and Tier 1 suppliers.

Our licensing customer base is primarily in the automotive, printer, specialized tablet and e-reader markets. Seventeen of our licensing customers are currently shipping products that embed our touch and gesture technology. We anticipate current and new customers will initiate product shipments throughout 2019 and in future years as they complete final product development and release cycles. Customer product development and release cycles typically take between 6 months to 36 months. We earn our license fees on a per unit basis when our customers ship products using our technology.

We also offer engineering consulting services to our licensing customers on a flat rate or hourly rate basis. Typically, our customers require engineering support during the development and initial manufacturing phase for their products using our technology.

Our plan is to continue with the licensing business along with selling embedded sensor modules. For some customers, the licensing business model is preferable to transitioning to purchase agreements using our sensor modules.

### *Sensor modules*

In 2015, we developed our zForce AIR. This optical sensing technology that enables touch interaction, gesture control and object detection led to the development of a series of sensor modules that provide our customers with various solutions in a sensor hardware component.

We utilize a robotic manufacturing process designed specifically for zForce AIR components. Industry specific sensor modules with a common technology platform provides hardware touch, gesture and object sensing solutions that, paired with our technology licensing platform, gives us a full range of options to enter and compete in key markets.

Our offerings include a consumer product, AirBar. As a plug and play accessory, AirBar enables touch and gesture functionality for notebook computers. AirBar is powered by our sensor modules. In 2016 and 2017, we began shipping 15.6 inch, 13.3 inch and 14 inch AirBar to distributors and customers in the United States and Europe. We have no current plans to develop new Neonode branded products for the consumer markets.

In October 2017, we began selling embedded sensor modules to business customers in the industrial and consumer electronics markets. Over time, we expect a significant portion of our revenues will be derived from sensor modules.

## **Markets**

### *Automotive*

Sensors are a key enabler to developing automobiles that become more interactive in every generation. Our sensor offering address challenges when automobiles interact with the driver, passengers, its environment and other vehicles. The need for new sensors is growing rapidly as new concepts develop into automobiles ready for mass production.

The automotive market is comprised of OEM and a series of Tier 1 suppliers who design and manufacture systems and components for the OEMs. We have license agreements with many of the major Tier 1 suppliers who deliver center console infotainment systems to the automotive OEMs. We are also in active design and product development co-operations for our sensor modules with the leading Tier 1 suppliers of automotive entry in addition to our interactive self and assisted driving steering wheel.

In 2016, fourteen automotive OEMs had a total of thirty-six automobile models using our touch technology in their infotainment systems. The majority of these automobiles are sold in China and include SUVs (Baojun 560 and Haval H6) and two top-selling sedans (Chevrolet Cruze and Buick Excelle). In the fourth quarter of 2014, Volvo launched their XC90 incorporating a 9.7 inch display using our touch technology. Our touch technology was also deployed in Volvo models launched in 2016, 2017 and 2018, the S90, V90, V90 Cross Country, XC60 and XC40. The Volvo XC90 and S90 infotainment systems have received awards citing properties such as responsiveness and gloved operation. During 2018, our customers shipped approximately 1.1 million products compared to approximately 1.1 million in 2017.

We are currently actively engaged with automotive OEM and Tier 1 suppliers to the automotive market in the development of the following:

Our zForce AIR sensor modules are being developed for use in entry systems such as tailgates, trunks and other exterior parts of the automobile to enable handsfree entry and automation of door functions. The Air sensors also support a wide array of touch and gesture input in the cars passenger compartment.

Our zForce DRIVE sensor technology enables high fidelity detection of hands and fingers positions on the steering wheel. This helps create a safer and more natural interaction with the automobile's systems and the driver's smart phone to decrease driver distraction. In 2015, we entered into an agreement with Autoliv Development AB, a leading supplier of safety products for the automotive industry, to explore and industrialize our zForce technology for the steering wheel. Self and assisted driving cars with zForce DRIVE sensors have been publicly displayed at CES 2016, 2017 and 2018. The technology was shown in the latest version of Veoneers LIV car at CES.

### ***Consumer Electronics***

### ***Printers and Office Equipment***

Multi-function printers typically require feature-rich menus and settings to deliver an optimal user experience and printer OEMs are increasingly replacing mechanical buttons and old style resistive touch displays with higher performance touch interactive displays. We have license agreements with five of the leading global printers and office equipment OEMs. World's largest printer manufacturer started shipping the first consumer printer with our touch technology integrated in early 2014 and today many of their printer models with interactive displays are using our technology. Other major customers started shipping printers with our technology in late 2016 and in the first quarter 2017. During 2018 our customers shipped approximately 8 million printers and cumulatively they shipped approximately 32 million printers using our touch technology since mid-2014.

### ***E-Readers and Tablets***

Our touch technology is widely used in e-readers. Since 2011, over 31 million e-readers and tablets have been shipped containing our touch technology. During 2018, our customers shipped more than 2.0 million e-readers and tablets.

### **Product Backlog**

Our sensor module product backlog at March 1, 2019 was approximately \$22,000. The product backlog includes orders confirmed for products planned to be shipped within 60 days to one customer. Our AirBar backlog at March 1, 2019 was approximately \$131,000. The product backlog includes orders confirmed for products planned to be shipped within 60 days to three customers. Our cycle time between order and shipment is generally short and customers occasionally change delivery schedules. Additionally, orders can be canceled without significant penalties. As a result of these factors, we do not believe that our product backlog, as of any particular date, is necessarily indicative of actual product revenue for any future period.

## **Distribution, Sales and Marketing**

### ***Licensing***

In our licensing business, we consider OEMs, ODMs and Tier 1 suppliers to be our primary customers. OEMs, ODMs and Tier 1 suppliers determine the design requirements and make the overall decision regarding the use of our user interface and touch technology in their products. The use and pricing of our user interface and touch technology are governed by a technology licensing agreement, which typically have an initial term of three years with automatic one-year renewal periods.

Our licensing agreements historically resulted from sales efforts by our senior management, design engineers, and sales personnel interacting with our potential customers' decision-makers throughout the product development and order process.

### ***Sensor modules***

In our sensor module business, we consider OEMs, ODMs and Tier 1 suppliers to be our primary customers. Our customers purchase sensor modules that come in different sizes with different interfaces and we offer engineering consulting to customize hardware and/or firmware to meet specific requirements. We produce the sensor modules in Sweden by our majority-owned subsidiary Pronode, in an automated manufacturing process. The sales of our sensors are governed by a product purchase agreement. In addition, our customers may request engineering services which will generate NRE fee revenues.

Our sales force and marketing operations are managed out of our office in Stockholm, Sweden. Our current sales force is comprised of sales offices located in the United States, Sweden, South Korea, Japan and Taiwan.

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

### **Customers**

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As of December 31, 2018, we have entered into forty-one technology license agreements compared to forty-one license agreements as of December 31, 2017. One license agreement was terminated during 2017. Seventeen of our licensing customers are currently shipping products that embed our touch and gesture technology. The products related to these license agreements include e-readers, tablets, commercial and consumer printers, automotive consoles and GPS devices.

In October 2017, we began selling our new embedded sensor modules to new customers while starting the process to convert our existing license customer to sensor modules.

Our customers are primarily located in the United States, Europe and Asia.

As of December 31, 2018, four customers represented approximately 67% of our consolidated accounts receivable.

As of December 31, 2017, two customers represented approximately 69% of our consolidated accounts receivable.

Customers who accounted for 10% or more of our revenues during the year ended December 31, 2018 are as follows.

Hewlett-Packard Company – 35%

Epson – 14%

Canon – 12%

Customers who accounted for 10% or more of our revenues during the year ended December 31, 2017 are as follows.

Hewlett-Packard Company – 28%

Canon – 17%

Bosch – 10%

### Customers by Market

The following table presents our revenues by market as a percentage of total revenues for the years ended December 31:

	2018	2017
Automotive	19 %	21 %
Consumer Electronics	74 %	64 %
Sensor modules	3 %	8 %
NRE	4 %	7 %
Total	100 %	100 %

### Geographical Data

The following table presents our revenues by geographic region as a percentage of total revenues for the years ended December 31:

	2018	2017
U.S.	50 %	41 %
Sweden	- %	5 %
Japan	34 %	27 %
China	3 %	7 %
Germany	9 %	12 %
Taiwan	2 %	3 %
South Korea	1 %	2 %
Canada	- %	1 %
Singapore	- %	1 %



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Other	1	%	1	%
Total	100	%	100	%

The following table presents our total assets by geographic region for the years ended December 31 (in thousands):

	2018	2017
U.S.	\$2,828	\$3,694
Sweden	10,308	9,312
Asia	106	121
Total	\$13,242	\$13,127

## **Touch Technologies**

### ***Background***

There are various technologies for touch and gesture sensing technology available in the market with differing profiles such as performance, power consumption, level of maturity, and cost:

Optical sensing technology uses structured light beams that when blocked or reflected by objects enables the detection of the objects position.

Capacitive touch sensors typically use one or several layers of transparent conductive material applied to the inner structure of the LCD or on a glass or plastic layer in front on the LCD to sense activation.

Resistive touch sensors use conductive and resistive layers separated by thin space to sense activation.

Acoustic pulse recognition sensors use piezoelectric transducers located at positions of a surface to alter the mechanical energy of a touch vibration into an electronic signal.

Surface acoustic wave touch sensors use ultrasonic waves that pass over the screen for activation.

### ***Capacitive and Resistive Technology***

The two dominant types of touch technologies available are capacitive and resistive. A capacitive sensor reacts to a conductive object by sensing the difference in capacitance between two areas on the sensor surface or between the finger and the ground. Capacitive touch sensors are suitable if the user has unimpeded contact between the finger and the screen. A resistive touch sensor is pressure-sensitive. Resistive touch sensors are suitable for detailed work and for selection of particular spot on a screen. Resistive technology is not suitable for sweeping gestures or motion, such as zooming in and out.

### ***Optical Sensing Technology***

Our optical technology works by projecting Infrared beams across a surface, through the air or any other detection area without any need for an extra physical layer to be added. It can be activated by using any object such as fingers, passive pens or thick gloves. Our optical sensing technology can also be designed to work through transparent

materials, enabling 100% water/dust proof applications and can provide sensing functionality when fully submerged.

We believe our optical sensing technology has a number of key advantages over other touch sensing technologies:

It does not require additional layers that may dilute the image quality of the display or cause unwanted reflections and glare making reading the display difficult.

It is faster than capacitive sensing technology.

It requires no downward pressure on the activation surface in order to select or move items.

It is cost-efficient due to the lower cost of materials and its high yield manufacturing process.

It enables multiple methods of input, such as continuous tracking of multiple fingers, taps to hit keys, sweeps to zoom in or out, and gestures to write text or symbols directly on the touch surface.

It works in all environments and does not require any special properties from the object used.

## **Competition**

The market for touch technology is intensely competitive and characterized by rapidly changing technology, evolving standards and new product releases by our competitors.

We believe that implementation of resistive touch technologies in consumer devices is declining because of limitations in sweep gestures, limitations on industrial design, and the negative impact on screen clarity due to film overlays.

Neonode is one of few companies that offer optical sensing technology in high volume. Our major competition are companies offering projected capacitive (“PCAP”) technologies. PCAP is a prevalent standard in mobiles and tablets offering finger-based touch and industrial design flexibility. PCAP has many suppliers competing to offer the same solution with price being a major differentiation point. OEMs regularly change PCAP suppliers in order to maintain the best pricing.

Our competitors, and the interface technology we believe they offer, include the following:

Company	Technology
Synaptics	Capacitive; In-cell
Cypress	Capacitive; In-cell
Touch International	Resistive; Capacitive
Continental	Capacitive / hands-free entry systems
Brose	Capacitive / hands-free entry systems

### **Controller Chips**

Our licensing customers must use our Application Specific Integrated Circuit (“ASIC”) controllers designed specifically for our optical sensing technology. Our sensor modules also utilize ASIC controller chips.

The NN1001, the first-generation controller ASIC, was developed pursuant to an Analog Device Development Agreement between Neonode and Texas Instruments entered into on February 4, 2011 and effective as of January 24, 2010. The NN1001 began shipping to our licensing customers in 2012.

The NN1002, the second-generation controller ASIC, was developed pursuant to an Analog Device Development Agreement between Neonode and Texas Instruments entered into on April 25, 2013 effective December 6, 2012. The NN1002 began shipping to our licensing customers in 2015.

The NN1003 is the third-generation controller ASIC and was developed by ST Microelectronics. The NN1003 is designed for high speed sensing applications. The NN1003 began shipping in 2016 and is powering our sensor modules.

### **Intellectual Property**

We rely on a combination of intellectual property laws and contractual provisions to establish and protect the proprietary rights in our technology. The number of our issued and pending patents and patents filed in each jurisdiction as of December 31, 2018 is set forth in the following table:

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Jurisdiction	No. of Issued Patents	No. of Patents Pending
United States	67	13
Europe	12	5
Japan	16	1
China	10	1
South Korea	12	1
Canada	11	0
Australia	16	0
Singapore	16	0
Patent Convention Treaty	Not Applicable	2
Total:	160	23

Our patents cover six main categories: user interfaces, optics, controller integrated circuits, drivers, mechanics and applications.

Our user interface software may also be protected by copyright laws in most countries, including Sweden and the European Union, which do not grant patent protection for the software itself, if the software is deemed new and original. Protection can be claimed from the date of creation.

In 2018 we filed ten new patent applications, while abandoning certain pending patent applications that were no longer in our product plans.

The duration of our patent protection for utility patents is generally 20 years. The duration of our patent protection for design patents varies throughout the world between 10 and 25 years, depending on the jurisdiction. We believe the duration of our intellectual property rights is adequate relative to the expected lives of our products.

We also protect and promote our brand by registering trademarks in key markets around the world. These markets include: Neonode (21 registrations), the Neonode logo (14 registrations), zForce (9 registrations), zForce AIR (1 registration), AlwaysON (5 registrations), Multisensing (5 registrations), Touch In Everything (1 registration), AirBar (43 registrations) and the AirBar logo (1 registration) as well as pending trademark applications for the marks zForce DRIVE, and zForce PLUS.

## **Research and Development**

In fiscal years 2018 and 2017, we spent \$5.3 million and \$6.1 million, respectively, on research and development activities. Our research and development is predominantly in-house, but may also be performed in collaboration with external partners and specialists.

## **Employees**

On December 31, 2018, we had forty-five employees and seven full-time consultants. There were a total of ten employees in our general and administrative group, six in our sales and marketing group, twenty-four in our engineering group, and five in our production group. We have employees or consultants located in the United States, Sweden, Japan, South Korea and Taiwan. None of our employees is represented by a labor union. We have experienced no work stoppages. We believe our employee relations are positive.

## **Additional Information**

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) and we file or furnish reports, proxy statements, and other information with the Securities and Exchange

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Commission (“SEC”). The reports and other information filed by us with the SEC are available free of charge on the SEC’s website at [www.sec.gov](http://www.sec.gov).

Our website is [www.neonode.com](http://www.neonode.com). Through our website, we make available free of charge all of our filings with the SEC, including our annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K as well as Form 3, Form 4, and Form 5 reports for our directors, officers, and principal stockholders, together with amendments to those reports filed or furnished pursuant to Sections 13(a), 15(d), or 16 under the Exchange Act. These reports are available as soon as reasonably practicable after their electronic filing or furnishing with the SEC. Our website also includes corporate governance information, such as our Code of Business Conduct (including a Code of Ethics for the Chief Executive Officer and Senior Financial Officers) and our Board of Directors’ Committee Charters. We are not including the information contained on our website as part of, nor incorporating it by reference into, this Annual Report.

## ITEM 1A. RISK FACTORS

*An investment in our common stock involves a high degree of risk. Before deciding to purchase, hold, or sell our common stock, you should consider carefully the risks described below in addition to the cautionary statements and risks described elsewhere and the other information contained in this Annual Report and in our other filings with the SEC, including subsequent reports on Forms 10-Q and 8-K. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations. If any of these known or unknown risks or uncertainties actually occurs, our business, financial condition, results of operations or cash flows could be seriously harmed. This could cause the trading price of our common stock to decline, resulting in a loss of all or part of your investment.*

### **Risks Related To Our Business**

*We have limited experience in manufacturing products and our entry into the hardware market may not be successful.*

Our business model has focused on licensing touch technology. In recent years, we began to manufacture and sell sensor touch components. There is no assurance that our hardware manufacturing and sales will result in market acceptance or meaningful revenues. The success of our sensor modules will depend on customer response and our management execution. The success of our sensor modules is subject to numerous risks, including:

the quality and reliability of product components that we source from third-party suppliers;

our ability to secure product components in a timely manner, in sufficient quantities or on commercially reasonable terms;

our ability to increase production capacity or volumes to meet demand;

our ability to identify and qualify alternative suppliers for components in a timely manner; and

our ability to establish and maintain effective sales channels.

In addition, if demand for our products increases, we will have to invest additional resources to purchase components, hire and train employees and enhance our manufacturing processes. If we fail to increase our production capacity efficiently, our sales may not increase in line with our expectations and our operating margins could fluctuate or decline.



***We are dependent on a limited number of customers.***

Our license revenues for the year ended December 31, 2018 were earned from seventeen OEM, ODM and Tier 1 customers. We earned NRE from four customers for the year ended December 31, 2018. During the year ended December 31, 2018, three customers represented approximately 61% of our consolidated net revenues. Our customer concentration may change significantly from period-to-period depending on a customer's product cycle and changes in our industry. In addition, our customer composition may change as we transition to selling sensor modules in parallel to our licensing business. The response of customers to our sensor products, loss of a major customer, a reduction in net revenues of a major customer for any reason, or a failure of a major customer to fulfill its financial or other obligations due to us could have a material adverse effect on our business, financial condition, and future revenue stream.

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

We historically generated revenue through technology licensing agreements with companies that must design, manufacture and sell their products incorporating our touch technology. The majority of our license fees earned in 2018 and 2017 were from customer shipments of printer products. Although we have broadened our business model to selling sensors in addition to licensing our technology, we expect to continue to receive licensing revenue from current and new customers who have products in their development cycle. If our customers are not able to design, manufacture or sell their products, or are delayed in producing their products, our revenues, profitability, and liquidity, as well as our brand image, may be adversely affected.

***The length of a customer's product development and release cycle depends on many factors outside of our control and could cause us to incur significant expenses without offsetting revenues, or revenues that vary significantly from quarter to quarter.***

The development and release cycle for customer products is lengthy and unpredictable. Our customers often undertake significant evaluation and design in the qualification of our products, which contributes to a lengthy product release cycle. The typical product development and release cycle is eighteen to sixty months. The development and release cycle may be longer in some cases, particularly for automotive vehicle products. There is no assurance that a customer will adopt our technology after the evaluation or design phase. The lengthy and variable development and release cycle for products may also have a negative impact on the timing of our revenues, causing our revenues and results of operations to vary significantly from quarter to quarter.

***We and our license customers rely upon component suppliers to sell products containing our technology.***

Under our licensing model, OEMs, ODMs and Tier 1 suppliers manufacture or contract to manufacture controller chips containing our touch technology. As an alternative to sourcing controller chips on their own, our customers may opt to use customized optical controller chips designed specifically for our technology. As part of their product development process, our customers must qualify the chip components used in our products. Under our sensor model, we use controller chips supplied by ST Microelectronics or Texas Instruments in our module products. If the controller chips provided by Texas Instruments, ST Microelectronics or another supplier experience quality control problems, our technology may be disqualified by one or more of our customers and our supply chain may be disrupted. The dependence on third parties to supply controller chips with our touch technology exposes us to a number of risks including their inability to obtain an adequate supply of components, the failure to meet our customer requirements, or their failure to remain in business or adjust to market conditions. If we and our customers are unable to obtain controller chips with our touch technology, we may not be able to meet demand, which could have a material adverse effect on our business, financial condition, results of operations and cash flows.

***It can be difficult for us to verify royalty amounts owed to us under licensing agreements, and this may cause us to lose potential revenue.***

Our license agreements typically require our licensees to document the sale of licensed products and report this data to us on a quarterly basis. Although our standard license terms give us the right to audit books and records of our licensees to verify this information, audits can be expensive, time consuming, incomplete and subject to dispute. From time to time, we audit certain of our licensees to verify independently the accuracy of the information contained in their royalty reports in an effort to decrease the likelihood that we will not receive the royalty revenues to which we are entitled under the terms of our license agreements, but we cannot give assurances that these audits will be effective.

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

We operate in a highly competitive, rapidly evolving environment, and our success depends on our ability to develop and introduce new touch technology that our customers and end users choose to buy. If we are unsuccessful at developing new touch technologies that are appealing to our customers and end users, with acceptable functionality, quality, prices and terms, we will not be able to compete effectively and our ability to generate revenues will suffer. The development of new touch technology is very difficult and requires high levels of innovation and competence. The development process is also lengthy and costly. If we fail to anticipate our end users' needs or technological trends accurately or if we are unable to complete development in a cost effective and timely fashion, we will be unable to introduce new touch technology into the market or successfully compete with other providers. As we introduce new or enhanced touch technology or integrate new touch technology into new or existing customer products, we face risks including, among other things, disruption in customers' ordering patterns, inability to deliver new touch technology to meet customers' demand, possible product and technology defects, and potentially unfamiliar sales and support environments. Premature announcements or leaks of new products, features, or technologies may exacerbate some of these risks. Our failure to manage the transition to newer touch technology or the integration of newer technology into new or existing customer products could adversely affect our business, results of operations, and financial condition.

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

As a result of the unpredictability in our customer product development and the nature of the markets in which we compete, it is extremely difficult for us to forecast accurately. We base our current and future expense levels largely on our investment plans and estimates of future events, although certain of our expense levels are, to a large extent, fixed. We may be unable to adjust spending in a timely manner to compensate for any unexpected revenue shortfall. Accordingly, any significant shortfall in revenues relative to our planned expenditures would have an immediate adverse effect on our business, results of operations and financial condition.

In addition, we are subject to the following factors, among others, that may negatively affect and cause fluctuations in our operating results:

the announcement or introduction of new products or technologies by our competitors;

our ability to upgrade and develop our infrastructure to accommodate growth;

our ability to attract and retain key personnel in a timely and cost-effective manner;

technical difficulties;

the amount and timing of operating costs and capital expenditures relating to the expansion of our business, operations, and infrastructure; and

general economic conditions as well as economic conditions specific to the touchscreen industry.

Further, as a strategic response to changes in the competitive environment, we may from time to time make certain pricing, service, or marketing decisions that could have a material and adverse effect on our business, results of operations, and financial condition. Due to the foregoing factors, our revenues and operating results are and will remain difficult to forecast.

***We have had a history of losses and may require additional capital to fund our operations, which may not be available on commercially attractive terms or at all.***

We have experienced substantial net losses in each fiscal period since our inception. These net losses resulted from a lack of substantial revenues and the significant costs incurred in the development and acceptance of our technology. Our ability to continue as a going concern is dependent on our ability to implement our business plan. If our operations do not become cash flow positive, we may be forced to seek sources of capital to continue operations. No assurances can be given that we will be successful in obtaining such additional financing on reasonable terms, or at all. If adequate funds are not available when needed on acceptable terms, or at all, we may be unable to adequately fund our business plan, which could have a negative effect on our business, results of operations, and financial condition.

***We must enhance our sales and technology development organizations.***

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

***We may make acquisitions and strategic investments that are dilutive to existing shareholders, resulting in unanticipated accounting charges or otherwise adversely affect our results of operations.***

We may decide to grow our business through business combinations or other acquisitions of businesses, products or technologies that allow us to complement our existing touch technology offerings, expand our market coverage, increase our workforce or enhance our technological capabilities. If we make any future acquisitions, we could issue stock that would dilute our shareholders' percentage ownership, or we may incur substantial debt, reduce our cash reserves and/or assume contingent liabilities. Further, acquisitions and strategic investments may result in material charges, adverse tax consequences, substantial depreciation, deferred compensation charges, in-process research and development charges, and the amortization of amounts related to deferred compensation and identifiable purchased intangible assets or impairment of goodwill. Any of these could negatively impact our results of operations.

***We are dependent on the services of our key personnel.***

Our senior management team consists of two executive officers. In April 2018, Håkan Persson became our new Chief Executive Officer. In February 2019, Lars Lindqvist notified our Board of Directors of his intention to resign from his position as Chief Financial Officer. To assist in the transition, Mr. Lindqvist intends to continue serving as Chief Financial Officer until mid-2019 and a search to identify a qualified candidate to fill his position permanently has been initiated. Changes in our management and the unplanned loss of the services of any member of management could have a materially adverse effect on our operations and future prospects.

***Our revenues and growth are dependent on licensing fees from our intellectual property.***

Our success depends in large part on our proprietary technology and other intellectual property rights. We rely on a combination of patents, copyrights, trademarks and trade secrets, confidentiality provisions, and licensing arrangements to establish and protect our proprietary rights. Our intellectual property, particularly our patents, may not provide us with a significant competitive advantage. If we fail to protect or to enforce our intellectual property rights successfully, our competitive position could suffer, which could harm our results of operations. Our pending patent applications for registration may not be allowed, or others may challenge the validity or scope of our patents. Even if our patents registrations are issued and maintained, these patents may not be of adequate scope or benefit to us or may be held invalid and unenforceable against third parties. We may need to expend significant resources to secure and protect our intellectual property. The loss of intellectual property rights may adversely impact our ability to generate revenues and expand our business.

***We may not be successful in our strategic efforts around patent monetization.***

Our success depends in part on our ability to effectively utilize our intellectual property. From time to time, we explore opportunities to monetize our patents. If in the future we enter into alternative patent monetization strategies, including the sale of patents, our financial condition, revenue and results of operations could be impacted. No assurance can be given that we will enter into agreements related to our patent portfolio or that we will be successful in any strategic efforts around patent monetization.

***If third parties infringe upon our intellectual property, we may expend significant resources enforcing our rights or suffer competitive injury.***

Existing laws, contractual provisions and remedies afford only limited protection for our intellectual property. We may be required to spend significant resources to monitor and police our intellectual property rights. Effective policing of the unauthorized use of our technology or intellectual property is difficult and litigation may be necessary in the future to enforce our intellectual property rights. Intellectual property litigation is not only expensive, but time-consuming, regardless of the merits of any claim, and could divert attention of our management from operating the business. Intellectual property lawsuits are subject to inherent uncertainties due to, among other things, the complexity of the technical issues involved, and we cannot assure you that we will be successful in asserting our intellectual property rights. Attempts may be made to copy or reverse engineer aspects of our technology or to obtain and use information that we regard as proprietary. We may not be able to detect infringement and may lose competitive position in the market before they do so. In addition, competitors may design around our technology or develop competing technologies. We cannot assure you that we will be able to protect our proprietary rights against unauthorized third party copying or use. The unauthorized use of our technology or of our proprietary information by competitors could have an adverse effect on our ability to sell our technology.

***The laws of foreign countries may not provide protection of our intellectual property rights to the same extent as the laws of the United States, which may make it more difficult for us to protect our intellectual property.***

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

***We have an international presence in countries and must manage currency risks.***

A significant portion of our business is conducted in currencies other than the U.S. dollar (the currency in which our consolidated financial statements are reported), primarily the Swedish Krona and, to a lesser extent, the Euro, Japanese Yen, Korean Won and Taiwan Dollars. For the year ended December 31, 2018, our revenues from North America, Asia, and Europe were 50%, 40%, and 10% respectively. We incur a significant portion of our expenses in Swedish Krona, including a significant portion of our research and development expenses and a substantial portion of our general and administrative expenses. As a result, appreciation of the value of the Swedish Krona relative to the other currencies, particularly the U.S. dollar, could adversely affect operating results. We do not currently undertake hedging transactions to cover our currency exposure, but we may choose to hedge a portion of our currency exposure in the future as it deems appropriate.

***Security breaches and other disruptions to our information technology infrastructure could interfere with our operations, compromise confidential information, and expose us to liability which could materially adversely impact our business and reputation.***

In the normal course of business, we rely on information technology networks and systems to process, transmit, and store electronic information, and to manage or support a variety of business processes and activities. Additionally, we collect and store certain data, including proprietary business information and customer and employee data, and may have access to confidential or personal information in certain of our businesses that is subject to privacy and security laws, regulations, and customer-imposed controls. Despite our cybersecurity measures, our information technology networks and infrastructure may be vulnerable to damage, disruptions, or shutdowns due to attack by hackers or breaches, employee error or malfeasance, power outages, computer viruses, telecommunication or utility failures, systems failures, natural disasters, or other catastrophic events. Any such events could result in legal claims or proceedings, liability or penalties under privacy laws, disruption in operations, and damage to our reputation, which could materially adversely affect our business.

***Third parties that maintain our confidential and proprietary information could experience a cybersecurity incident.***

We rely on third parties to provide or maintain some of our information technology and related services. We do not exercise direct control over these systems. Despite the implementation of security measures at third party locations, these services are also vulnerable to security breaches or other disruptions. Despite assurances from third parties to protect this information and, where we believe appropriate, our monitoring of the protections employed by these third parties, there is a risk the confidentiality of data held by us or by third parties may be compromised and expose us to liability for such breach.



***If we are unable to detect material weaknesses in our internal control, our financial reporting and our Company may be adversely affected.***

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to evaluate the effectiveness of our internal controls over financial reporting as of the end of each fiscal year, and to include a management report assessing the effectiveness of our internal controls over financial reporting in our annual report on Form 10-K for that fiscal year. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud involving a company have been, or will be, detected. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and we cannot assure you that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become ineffective because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. We cannot assure you that we or our independent registered public accounting firm will not identify a material weakness in our internal controls in the future. A material weakness in our internal controls over financial reporting would require management and our independent registered public accounting firm to consider our internal controls as ineffective. If our internal controls over financial reporting are not considered effective, we may experience a loss of public confidence, which could have an adverse effect on our business and on the market price of our common stock.

### **Risks Related to Owning Our Stock**

***If our common stock is delisted from the Nasdaq, our business, financial condition, results of operations and stock price could be adversely affected, and the liquidity of our stock and our ability to obtain financing could be impaired.***

On December 27, 2017, we received a notice from The Nasdaq Stock Market (the "Nasdaq") indicating that, for 30 consecutive days, the bid price for our common stock had closed below the minimum \$1.00 per share requirement for continued listing on the Nasdaq. To regain compliance, we effected a 1-for-10 reverse stock split on October 1, 2018. There can be no assurance, however, that we will be able to maintain our listing on the Nasdaq.

Any delisting of our common stock from the Nasdaq could adversely affect our ability to attract new investors, decrease the liquidity of our outstanding shares of common stock, reduce our flexibility to raise additional capital, reduce the price at which our common stock trades, and increase the transaction costs inherent in trading such shares.

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

Our Board of Directors has the authority to issue up to 1,000,000 shares of preferred stock and to determine the price, rights, preferences and privileges of those shares without any further vote or action by the stockholders. The rights of the holders of common stock will be subject to, and may be materially adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock. Furthermore, certain other provisions of our certificate of incorporation and bylaws may have the effect of delaying or preventing changes in control or management, which could adversely affect the market price of our common stock. In addition, we are subject to the provisions of Section 203 of the Delaware General Corporation Law, an anti-takeover law.

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

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

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

- actual or anticipated fluctuations in our operating results or future prospects;
- our announcements or our competitors' announcements of new technology;
- the public's reaction to our press releases, our other public announcements, and our filings with the SEC;
- strategic actions by us or our competitors, such as acquisitions or restructurings;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;

changes in accounting standards, policies, guidance, interpretations or principles;

changes in our growth rates or our competitors' growth rates;

developments regarding our patents or proprietary rights or those of our competitors;

our inability to raise additional capital as needed;

concern as to the efficacy of our technology;

changes in financial markets or general economic conditions;

sales of common stock by us or members of our management team; and

changes in stock market analyst recommendations or earnings estimates regarding our common stock, other comparable companies, or our industry generally.

***Future sales of our common stock by our stockholders could negatively affect our stock price.***

On December 28, 2018, in a private placement transaction, we sold 2,940,767 shares of our common stock to existing investors including two current members of our Board of Directors and eight current employees.

In August 2017, we sold 975,000 shares to new investors, including two current members of our Board of Directors. We also issued warrants to purchase up to 325,000 shares of common stock at an exercise price of \$20.00 per share. The 2017 Warrants became exercisable on August 8, 2018, and will expire on August 8, 2020. None of the warrants have been exercised to date.

Sales of a substantial number of shares of our common stock in the public market by insiders or large stockholders, or the perception that these sales might occur, could depress the market price of our common stock and could impair our ability to raise capital through the sale of additional equity securities.

***Our ability to issue shares of common stock is limited currently due to the lack of sufficient shares of authorized stock.***

We have issued or reserved substantially all our available shares of authorized common stock. Unless and until a sufficient number of options or warrants expire or the number of shares of our authorized common stock increases, our ability to obtain liquidity through equity sales may be limited. Although we anticipate proposing an increase in our authorized common stock at our 2019 Annual Meeting of Stockholders, there can be no assurance that our stockholders will approve such an increase. An inability in the future to issue additional shares of common stock may adversely affect our capacity to raise additional capital, pursue strategic investments, and incentive employees.

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

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

*A limited number of stockholders, including directors, hold a significant number of shares of our outstanding common stock.*

Our two largest stockholders, including the Chairman of our Board of Directors, hold approximately one-third of the shares of our outstanding voting stock. A significant number of additional shares of our common stock are beneficially owned by current and previous members of our management and our Board of Directors. This concentration of ownership could impact the outcome of stockholder votes, including votes concerning the election of directors, the adoption or amendment of provisions in our certificate of incorporation and our bylaws, and the approval of mergers and other significant corporate transactions. These factors may also have the effect of delaying or preventing a change in our management or our voting control.

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

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

## **ITEM 1B. UNRESOLVED STAFF COMMENTS**

None.

## **ITEM 2. PROPERTIES**

On August 22, 2016, we entered into a lease of office space located at 2880 Zanker Road, San Jose, CA 95134. The lease is renewed monthly.

On October 1, 2016 we entered into a lease of office space located at 405 Elpulimento Shinjuku, 6-7-1, Shinjuku-ku, Tokyo, Japan. The lease is valid through September 30, 2020 and can be terminated with two months' written notice before the termination date.

On July 1, 2014, Neonode Technologies AB entered into a lease for 7,007 square feet of office space located at Storgatan 23C, Stockholm, Sweden. The lease is extended on a yearly basis unless written notice three months prior to

expiration date.

On December 1, 2015, Pronode Technologies AB entered into a lease agreement for 9,040 square feet of workshop located at Faktorvägen 17, Kungsbacka, Sweden. The lease is valid through December 9, 2020 and can be terminated with nine months' written notice before the termination date.

In January 2015, our subsidiary Neonode Korea Ltd. entered into a lease agreement located at B-1807, Daesung D-Polis, 543-1, Seoul, South Korea. The lease may be cancelled with 2 months' notice.

On December 1, 2015, Neonode Taiwan Ltd. entered into a lease agreement located at Rm. 2406, International Trade Building, Keelung Rd., Sec.1, Taipei, Taiwan. The lease is renewed monthly.

For the years ended December 31, 2018 and 2017, we recorded approximately \$687,000 and \$681,000, respectively, for rent expense.

### **ITEM 3. LEGAL PROCEEDINGS**

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

### **ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

## **PART II**

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

#### **Market Information**

Our common stock is quoted on the Nasdaq Stock Market under the symbol NEON.

## **Holders**

As of March 1, 2019, there were approximately 3,660 stockholders of record of our common stock as determined by counting our record holders and the number of participants reflected in a security position listing provided to us by the Depository Trust Company. Because such “DTC participants” are brokers and other institutions holding shares of our common stock on behalf of their customers, we do not know the actual number of unique “street name” stockholders represented by these record holders.

## **Dividends**

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



## **ITEM 6. SELECTED FINANCIAL DATA**

Not Applicable

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

The following discussion and analysis should be read in conjunction with our consolidated financial statements and the related notes thereto included elsewhere in this Annual Report.

### **Overview**

Neonode Inc. develops user interface and optical interactive touch and gesture solutions. Our patented technology offers multiple features including the ability to sense an object's size, depth, velocity, pressure, and proximity to any type of surface.

In 2010, we began licensing to Original Equipment Manufacturers ("OEMs") and Tier 1 suppliers who embed our technology into products they develop, manufacture and sell. Since 2010, our licensing customers have sold approximately 67 million devices that use our technology. In October 2017, we augmented our licensing business and started to manufacture and ship sensor modules that incorporate our technology. We sell these embedded sensors to OEMs, ODM's and Tier 1 suppliers for use in their products.

As of December 31, 2018, we had entered into forty-one technology license agreements with global OEMs and Tier 1 suppliers. This compares with forty-one technology license agreements as of December 31, 2017. During the year ended December 31, 2018, we had seventeen customers using our touch technology in products that were being shipped to their customers. The majority of our license fees earned in 2018 and 2017 were from customer shipments of printers. As of December 31, 2018, our license customers in the automotive and printer markets have not released all the products that are currently in development and that are planned to go into production and market release over the next 12 to 24 months.

We now offer our technology to our current and new customers under either a license agreement or a supply agreement, where we sell them a manufactured embedded sensor module that has been customized for use in their products. As of December 31, 2018, we entered into six supply agreements to purchase our embedded sensor modules

with global OEMs, ODMs and Tier 1 suppliers. In addition to direct shipments to our customers, we distribute our embedded sensor modules through DigiKey. As of December 31, 2018, DigiKey sold and shipped 474 sensor module development kits. We anticipate our revenue will be generated by a combination of royalties from our existing and new license customers plus sales of our sensor modules.

We intend to continue expanding our sensor module product offerings in 2019, including new sensors for delivery to the automotive and other key markets in 2019. We expect that over time the sales of sensors components may constitute the majority of our revenue.

In the fourth quarter of 2016, we started selling AirBar, a Neonode branded consumer product incorporating one of our sensor modules, through distributors and directly to consumers. We have no current plans to develop new Neonode branded products for the consumer markets.

## **Critical Accounting Policies and Estimates**

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and include the accounts of Neonode Inc. and its wholly owned subsidiaries, as well as Pronode Technologies AB (Sweden), a 51% majority owned subsidiary of Neonode Technologies AB. The non-controlling interests are reported below net loss including non-controlling interests under the heading “Net loss attributable to non-controlling interests” in the consolidated statements of operations, below comprehensive loss under the heading “Comprehensive income loss attributable to non-controlling interests” in the consolidated statements of comprehensive loss and shown as a separate component of stockholders’ equity in the consolidated balance sheets. See “Non-controlling Interests” for further discussion. All inter-company accounts and transactions have been eliminated in consolidation.

The consolidated balance sheets at December 31, 2018 and 2017 and the consolidated statements of operations, comprehensive loss and cash flows for the years ending 2018 and 2017 include our accounts and those of our wholly owned subsidiaries as well as Pronode Technologies AB (Sweden).

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

### ***Estimates***

The preparation of consolidated financial statements in conformity with U.S. GAAP requires making estimates and assumptions that affect, at the date of the consolidated financial statements, the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from these estimates.

Significant estimates include, but are not limited to: for revenue recognition, determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price of performance obligations,

variable consideration, and other obligations such as product returns and refunds, and product warranties; provisions for uncollectible receivables; net realizable value of inventory; recoverability of capitalized project costs and long-lived assets; the valuation allowance related to our deferred tax assets; and the fair value of options issued for stock-based compensation.

### ***Revenue Recognition***

We recognize revenue when control of products is transferred to our customers, and when services are completed and accepted by our customers; the amount of revenue we recognize reflects the consideration we expect to receive for those products or services. Our contracts with customers may include combinations of products and services, for example, a contract that includes products and related engineering services. We structure our contracts such that distinct performance obligations, such as product sales or license fees, and related engineering services, are clearly defined in each contract.

Sales of license fees and AirBar and sensor modules are on a per-unit basis; therefore, we generally satisfy performance obligations as units are shipped to our customers. Non-recurring engineering service performance obligations are satisfied as work is performed and accepted by our customers.

We recognize revenue net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities. We treat all product shipping and handling charges (regardless of when they occur) as activities to fulfill the promise to transfer goods, therefore we treat all shipping and handling charges as expenses.

*Licensing Revenues:*

We earn revenue from licensing our internally developed intellectual property (“IP”). We enter into IP licensing agreements that generally provide licensees the right to incorporate our IP components in their products, with terms and conditions that vary by licensee. Fees under these agreements may include license fees relating to our IP, and royalties payable to us following the distribution by our licensees of products incorporating the licensed technology. The license for our IP has standalone value and can be used by the licensee without maintenance and support.

For technology license arrangements that do not require significant modification or customization of the underlying technology, we recognize technology license revenue when the license is made available to the customer and the customer has a right to use that license. At the end of each reporting period, we record unbilled license fees, using prior royalty revenue data by customer to make accurate estimates of those royalties.

Explicit return rights are not offered to customers. There have been no returns through December 31, 2018.

*Engineering Services:*

For technology license or sensor module contracts that require modification or customization of the underlying technology to adapt that technology to customer use, we determine whether the technology license or sensor module, and engineering consulting services represent separate performance obligations. We perform our analysis on a contract-by-contract basis. If there are separate performance obligations, we determine the standalone selling price (“SSP”) of each separate performance obligation to properly recognize revenue as each performance obligation is satisfied. We provide engineering consulting services to our customers under a signed Statement of Work (“SOW”).

Deliverables and payment terms are specified in each SOW. We generally charge an hourly rate for engineering services, and we recognize revenue as engineering services specified in contracts are completed and accepted by our customers. Any upfront payments we receive for future non-recurring engineering services are recorded as unearned revenue until that revenue is earned.

We believe that recognizing non-recurring engineering services revenues as progress towards completion of engineering services and customer acceptance of those services occurs best reflects the economics of those transactions, because engineering services as tracked in our systems correspond directly with the value to our customers of our performance completed to date. Hours performed for each engineering project are tracked and reflect progress made on each project and are charged at a consistent hourly rate.

Revenues from engineering services contracts that are short-term in nature are recorded when those services are complete and accepted by customers.

Revenues from engineering services contracts with substantive defined deliverables for which payment terms in the SOW are commensurate with the efforts required to produce such deliverables are recognized as they are completed and accepted by customers.

Estimated losses on all SOW projects are recognized in full as soon as they become evident. In the years ended December 31, 2018 and 2017, no losses related to SOW projects were recorded.

*Sensor Modules Revenues:*

We earn revenue from sales of sensor modules hardware products to our OEM, ODM and Tier 1 supplier customers, who embed our hardware into their products, and from sales of branded consumer products that incorporate our sensor modules sold through distributors or directly to end users. These distributors are generally given business terms that allow them to return unsold inventory, receive credits for changes in selling prices, and participate in various cooperative marketing programs. Our sales agreements generally provide customers with limited rights of return and warranty provisions.

The timing of revenue recognition related to AirBar modules depends upon how each sale is transacted - either point-of-sale or through distributors. We recognize revenue for AirBar modules sold point-of-sale (online sales and other direct sales to customers) when we provide the promised product to the customer.

Because we generally use distributors to provide AirBar and sensor modules to our customers, however, we analyze the terms of distributor agreements to determine when control passes from us to our distributors. For sales of AirBar and sensor modules sold through distributors, revenues are recognized when our distributors obtain control over our products. Control passes to our distributors when we have a present right to payment for products sold to distributors,

the distributors have legal title to and physical possession of products purchased from us, and the distributors have significant risks and rewards of ownership of products purchased.

Distributors participate in various cooperative marketing and other incentive programs, and we maintain estimated accruals and allowances for these programs. If actual credits received by distributors under these programs were to deviate significantly from our estimates, which are based on historical experience, our revenue could be adversely affected.

Under U.S. GAAP, companies may make reasonable aggregations and approximations of returns data to accurately estimate returns. Our AirBar returns and warranty experience to date has enabled us to make reasonable returns estimates, which are supported by the fact that our product sales involve homogenous transactions. The reserve for future sales returns is recorded as a reduction of our accounts receivable and revenue and was insignificant as of December 31, 2018 and 2017. If the actual future returns were to deviate from the historical data on which the reserve had been established, our revenue could be adversely affected.

#### ***Accounts Receivable and Allowance for Doubtful Accounts***

Our accounts receivable is stated at net realizable value. Our policy is to maintain allowances for estimated losses resulting from the inability of our customers to make required payments.



### ***Inventory***

Inventory is stated at the lower of cost or net realizable value, using the first-in, first-out method (“FIFO”) valuation method. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Any adjustments to reduce the cost of inventories to their net realizable value are recognized in earnings in the current period. During the fourth quarter of 2017, after a comprehensive evaluation of our AirBar business we recorded a \$1.1 million write-down, included in our cost of goods sold, to reduce our AirBar specific component and finished goods inventory to estimated net realizable value and to revalue the purchase price from the initial order of one component by \$0.12 each. The component was originally valued at an average price basis but due to slow selling inventory, we revalued at a higher specific price. The total price adjustment related to this component included in cost of sales was approximately \$0.1 million. In addition, we recorded a \$0.1 million write-down related to this component repricing which is included in our Research and Development expense. We also recorded a \$0.5 million write-off related to production development units, included in inventory, which is included in our Research and Development expense. As of December 31, 2018, the Company’s inventory consists primarily of components that will be used in the manufacturing of our sensor modules. We segregate inventory for reporting purposes by raw materials, work-in-process, and finished goods.

### ***Investment in Joint Venture***

We invested \$3,000, a 50% interest in Neoeye AB. We account for our investment using the equity method of accounting since the investment provides us the ability to exercise significant influence, but not control, over the investee. Significant influence is generally deemed to exist if we have an ownership interest in the voting stock of the investee of between 20% and 50%, although other factors, such as representation on the investee’s Board of Directors, are considered in determining whether the equity method of accounting is appropriate. Under the equity method of accounting, the investment, originally recorded at cost, is adjusted to recognize our share of net earnings or losses of the investee and will be recognized in the consolidated statements of operations and will also be adjusted by contributions to and distributions from Neoeye. We are not required to guarantee any obligations of the JV. There have been no operations of Neoeye through December 31, 2018.

We review our investment in Neoeye to determine whether events or changes in circumstances indicate that the carrying amount may not be recoverable. The primary factors we consider in our determination are the financial condition, operating performance and near-term prospects of Neoeye. If a decline in value is deemed to be other than temporary, we would recognize an impairment loss.

### ***Projects in Process***

Projects in process consist of costs incurred toward the completion of various projects for certain customers. These costs are primarily comprised of direct engineering labor costs and project-specific equipment costs. These costs are capitalized on our balance sheet as an asset and deferred until revenue for each project is recognized in accordance with our revenue recognition policy. Costs capitalized in projects in process were \$0 and \$1,000 as of December 31, 2018 and 2017, respectively.

### ***Property and Equipment***

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

#### Estimated useful lives

Computer equipment	3 years
Furniture and fixtures	5 years
Equipment	7 years

Equipment purchased under a capital lease is depreciated over the term of the lease, if that lease term is shorter than the estimated useful life.

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

### ***Long-Lived Assets***

We assess any impairment by estimating the future cash flows from the associated asset in accordance with relevant accounting guidance. If the estimated undiscounted future cash flow related to these assets decreases or the useful life is shorter than originally estimated, we may incur charges for impairment of these assets. As of December 31, 2018, we believe there was no impairment of our long-lived assets. There can be no assurance, however, that market conditions will not change or sufficient demand for our products and services will continue, which could result in impairment of long-lived assets in the future.

### ***Research and Development***

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

### ***Stock-Based Compensation Expense***

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

We account for equity instruments issued to non-employees at their estimated fair value.

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

### ***Non-controlling Interests***

We recognize any non-controlling interest, also known as a minority interest, as a separate line item in equity in the consolidated financial statements. A non-controlling interest represents the portion of equity ownership in a less-than-wholly owned subsidiary not attributable to us. Generally, any interest that holds less than 50% of the outstanding voting shares is deemed to be a non-controlling interest; however, there are other factors, such as decision-making rights, that are considered as well. We include the amount of net income (loss) attributable to non-controlling interests in consolidated net income (loss) on the face of the consolidated statements of operations.

We provide either in the consolidated statement of stockholders’ equity, if presented, or in the notes to consolidated financial statements, a reconciliation at the beginning and the end of the period of the carrying amount of total equity (net assets), equity (net assets) attributable to the parent, and equity (net assets) attributable to the non-controlling interest that separately discloses:

- (1) Net income or loss
- (2) Transactions with owners acting in their capacity as owners, showing separately contributions from and distributions to owners.
- (3) Each component of other comprehensive income or loss



### ***Foreign Currency Translation and Transaction Gains and Losses***

The functional currency of our foreign subsidiaries is the applicable local currency, the Swedish Krona, the Japanese Yen, the South Korean Won and the Taiwan Dollar. The translation from Swedish Krona, Japanese Yen, South Korean Won or the Taiwan Dollar to U.S. Dollars is performed for balance sheet accounts using current exchange rates in effect at the balance sheet date and for income statement accounts using a weighted average exchange rate during the period. Gains or (losses) resulting from translation are included as a separate component of accumulated other comprehensive income (loss). Gains or (losses) resulting from foreign currency transactions are included in general and administrative expenses in the accompanying consolidated statements of operations and were \$(58,000) and \$(84,000) during the years ended December 31, 2018 and 2017, respectively. Foreign currency translation gains or (losses) were \$(357,000) and \$72,000 during the years ended December 31, 2018 and 2017, respectively.

### ***Net Loss per Share***

Net loss per share amounts have been computed based on the weighted-average number of shares of common stock outstanding during the years ended December 31, 2018 and 2017. We effected a 1-for-10 reverse stock split on October 1, 2018. All shares of common stock and potential common stock equivalents in the calculations used to determine weighted average number of shares of common stock outstanding have been adjusted to reflect the effects of the reverse stock split for all periods presented. Net loss per share, assuming dilution amounts from common stock equivalents, is computed based on the weighted-average number of shares of common stock and potential common stock equivalents outstanding during the period. The weighted-average number of shares of common stock and potential common stock equivalents used in computing the net loss per share for years ended December 31, 2018 and 2017 exclude the potential common stock equivalents, as the effect would be anti-dilutive.

### ***Other Comprehensive Income (Loss)***

Our other comprehensive income (loss) includes foreign currency translation gains and losses. The cumulative amount of translation gains and losses are reflected as a separate component of stockholders' equity in the consolidated balance sheets as accumulated other comprehensive loss.

### ***Cash Flow Information***

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Cash flows in foreign currencies have been converted to U.S. Dollars at an approximate weighted-average exchange rate for the respective reporting periods. The weighted-average exchange rates for the consolidated statements of operations were as follows:

	Years ended	
	December 31,	
	2018	2017
Swedish Krona	8.70	8.54
Japanese Yen	110.43	112.15
South Korean Won	1,100.50	1,128.65
Taiwan Dollar	30.15	30.41

Exchange rates for the consolidated balance sheets were as follows:

	Years ended	
	December 31,	
	2018	2017
Swedish Krona	8.87	8.21
Japanese Yen	109.69	112.65
South Korean Won	1,113.63	1,066.31
Taiwan Dollar	30.61	29.66

### ***Deferred Revenues***

We defer license fees until we have met all accounting requirements for revenue recognition when the license is made available to the customer and the customer has a right to use that license. Engineering development fee revenues are deferred until engineering services have been completed and accepted by our customers. We defer the timing of revenue recognition related to AirBar modules depending upon how each sale is transacted - either point-of-sale or through distributors. We recognize revenue for AirBar modules sold point-of-sale (online sales and other direct sales to customers) when we provide the promised product to the customer.

Because we generally use distributors to provide AirBar and sensor modules to our customers, however, we analyze the terms of distributor agreements to determine when control passes from us to our distributors. For sales of AirBar and sensor modules sold through distributors, revenues are recognized when our distributors obtain control over our products. Control passes to our distributors when we have a present right to payment for products sold to distributors, the distributors have legal title to and physical possession of products purchased from us, and the distributors have significant risks and rewards of ownership of products purchased.

Under U.S. GAAP, companies may make reasonable aggregations and approximations of returns data to accurately estimate returns. Our AirBar and sensor module returns and warranty experience to date has enabled us to make reasonable returns estimates, which are supported by the fact that our product sales involve homogenous transactions. The reserve for future sales returns is recorded as a reduction of our accounts receivable and revenue and was insignificant as of December 31, 2018 and 2017.

The following table presents our deferred revenues by source (in thousands)



	Years ended	
	December	
	31,	
	2018	2017
Deferred license fees	\$-	\$1,089
Deferred AirBar revenues	59	137
Deferred sensor modules revenues	16	22
	\$75	\$1,248

### *New Accounting Pronouncements*

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2014-09, “*Revenues from Contracts with Customers (Topic 606)*” (“ASU 2014-09”) to address the new revenue recognition accounting standard, ASC 606 – Revenues from Contracts with Customers. The new standard was effective January 1, 2018 for public entities. Under the new standard, revenue is recognized upon transfer of control of goods or services to customers, and the amount of revenue recognized should reflect the consideration expected to be received for the transfer of those goods or services to customers. Disclosures are required to describe the nature, amount, timing, and uncertainty of revenue and cash flows that may arise from contracts with customers. Beginning with the first quarter of 2018, our financial results reflect adoption of the standard. See the Revenue Recognition section in Note 2 of the consolidated financial statements for further discussion.

In February 2016, the FASB issued ASU No. 2016-02, “*Leases (Topic 842)*” (“ASU 2016-02”). Under ASU 2016-02, lessees will be required recognize the following for all leases (with the exception of short-term leases) at the commencement date: a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Lessees must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements.

The effective date of the new lease standard (ASC 842) is January 1, 2019, and we adopted the new standard on that date. Our lease standard implementation plan has been reviewed and approved by executive management. We are using the modified retrospective approach, which allows us to make any necessary transition adjustments at January 1, 2019. We elected the optional transition method, which allows us to continue to use disclosures required by the prior standard during 2019, the year of adoption. There are also several practical expedients available to make the transition more efficient and cost-effective for companies. We elected the package of three practical expedients available to us; doing so will allow us to not reassess existing leases.

We currently have a limited number of leased capital assets, all of which will be classified as finance leases under the new lease standard. We maintain a lease inventory for those assets; they are currently reported on our consolidated balance sheets and will continue to be reported on our consolidated balance sheets under the new standard. We also have a small number of leases which are currently classified as operating leases; we analyzed those leases, and will include two material operating leases on our consolidated balance sheets beginning January 1, 2019. We do not anticipate any equity adjustment related to our implementation of the new standard, and we will continue to provide disclosures related to leases. Because of the small number of assets we lease, we do not need to make systems changes to comply with the new standard. We plan to continue to track leased assets outside of our accounting systems. We do

not expect material changes in financial ratios, leasing practices, or tax reporting.

In June 2016, the FASB issued ASU No. 2016-13, “*Financial Instruments-Credit Losses (Topic 326)*”-Measurement of Credit Losses on Financial Instruments”, (“ASU 2016-13”), supplemented by ASU 2018-19, “*Codification Improvements to Topic 326, Financial Instruments – Credit Losses*”, (“ASU 2018-19”). The new standard requires entities to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. ASU 2016-13 and ASU 2018-19 will become effective for fiscal years beginning after December 15, 2019, with early adoption permitted. We are currently evaluating the impact ASU 2016-13 and ASU 2018-19 will have on our consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, “*Intra-Entity Transfers of Assets Other Than Inventory.*” This ASU requires entities to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. For public entities, this ASU is effective for annual reporting periods beginning after December 15, 2017, including interim reporting periods within those annual reporting periods. We adopted ASU 2016-16 in the first quarter ended March 31, 2018. The impact of adoption of this standard is immaterial to the consolidated financial statements.

In July 2018, the FASB issued ASU No. 2018-09, “*Codification Improvements (Topic 740, among others)*”, (“ASU 2018-09”), and in March 2018, the FASB issued ASU No. 2018-05, “*Income Taxes (Topic 740)*”, (“ASU 2018-05”). The updates were issued to address the income tax accounting and SEC reporting implications of the Tax Act. The new legislation contained several key tax provisions that affected us, including the one-time mandatory transition tax on accumulated foreign earnings and a reduction of the corporate income tax rate from 35% to 21% effective January 1, 2018, among other changes.

We were required to recognize the effect of the tax law changes in the period of enactment. Because we have negative accumulated foreign earnings, we are not subject to the one-time repatriation tax. We have re-measured our U.S. deferred tax assets and liabilities, which resulted in a reduction of our net deferred tax assets with a corresponding adjustment to our valuation allowance. As a result, no tax expense was recorded related to the enactment of the Tax Act. We consider the accounting of deferred tax re-measurement and one-time transition tax calculation to be complete.

## Results of Operations

We develop user interface and optical interactive touch and gesture solutions. Since 2010, under our licensing agreements, OEMs and Tier 1 suppliers have sold approximately 67 million devices that use our technology. In December 2017, we augmented our licensing business and started to manufacture and sell sensor modules that incorporate our technology.

A summary of our financial results for the years ended December 31, is as follows (in thousands, except percentages):

	2018	2017	Variance in Dollars	Variance in Percent
<b>Revenue:</b>				
License Fees	\$7,954	\$8,684	\$ (730 )	(8.4 )%
Percentage of revenue	93.2 %	84.8 %		
Sensor Modules	227	814	(587 )	(72.1 )%
Percentage of revenue	2.7 %	7.9 %		
NRE	357	743	(386 )	(52.0 )%
Percentage of revenue	4.2 %	7.3 %		
Total Revenue	\$8,538	\$10,241	\$ (1,703 )	(16.6 )%
<b>Cost of Sales:</b>				
Sensor Modules	\$638	\$1,758	\$ (1,120 )	(63.7 )%
Percentage of revenue	7.5 %	17.2 %		
NRE	283	585	(302 )	(51.6 )%
Percentage of revenue	3.3 %	5.7 %		
Total Cost of Sales	\$921	\$2,343	\$ (1,422 )	(60.7 )%
Total Gross Margin	\$7,617	\$7,898	\$ (281 )	(3.6 )%
<b>Operating Expense:</b>				
Research and Development	\$5,278	\$6,078	\$ (800 )	(13.2 )%
Percentage of revenue	61.8 %	59.3 %		
Sales and Marketing	1,995	2,772	(777 )	(28.0 )%
Percentage of revenue	23.4 %	27.1 %		
General and Administrative	4,221	4,524	(303 )	(6.7 )%
Percentage of revenue	49.4 %	44.2 %		
Total Operating Expenses	\$11,494	\$13,374	\$ (1,880 )	(14.1 )%
Percentage of revenue	134.6 %	130.6 %		
Operating Loss	\$(3,877 )	\$(5,476 )	\$ 1,599	(29.2 )%
Percentage of revenue	45.4 %	53.5 %		

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Other Expenses	(52 )	(75 )	23	(30.7 )%
Percentage of revenue	0.6 %	0.7 %		
Net Loss attributable to Neonode Inc.	\$(3,060 )	\$(4,705 )	\$ 1,645	(34.9 )%
Percentage of revenue	35.8 %	45.9 %		
Net Loss attributable to Neonode Inc. Per Share	\$(0.52 )	\$(0.89 )	\$ 0.37	(41.6 )%

**Revenues**

All of our sales for the years ended December 31, 2018 and 2017 were to customers located in the United States, Europe and Asia.

The following table presents revenues by market and NRE for the years ended December 31, 2018 and 2017 (dollars in thousands):

	2018		
	Amount	Percentage	
Revenues from Automotive	\$1,627	19	%
Revenue from Consumer Electronics	6,327	74	%
Revenues from Sensor modules	227	3	%
Revenues from NRE	357	4	%
Total	\$8,538	100	%

	2017		
	Amount	Percentage	
Revenues from Automotive	\$2,148	21	%
Revenues from Consumer Electronics	6,536	64	%
Revenues from Sensor modules	814	8	%
Revenues from NRE	743	7	%
Total	\$10,241	100	%

We have historically licensed our technology to OEMs, ODM's and Tier 1 suppliers who embed it in their products based upon our custom designs and we charge these customers a non-recurring fee to offset our engineering costs. We sell a Neonode branded consumer product, AirBar and in October 2017 we added sales of embedded sensor modules to our business model. Our new sensor modules provide a hardware- based technology solution, which allows our customers a way to use our zForce AIR technology while forgoing the complex design and manufacturing phase associated with our licensing model. We now earn revenue from a combination of licensing plus selling our embedded sensor modules and AirBar.

During 2018 and 2017 we focused our efforts on maintaining our current licensing customers and finalizing their designs for new products expected to be released over the coming 18 months and we made investments finalizing the design of selected embedded sensor modules and setting-up our manufacturing facility in Sweden.

As of December 31, 2018, we had entered into forty-one technology license agreements with global OEMs, ODMs and Tier 1 suppliers. This compares with forty-one technology license agreements with global OEMs, ODM's and Tier 1 suppliers as of December 31, 2017. Seventeen of our customers are currently shipping products.

We expect to continue to earn license fees in future years and anticipate our customers will continue to release new products that embed our technology under a license agreement. License fees were the majority of our total revenue in the past two years and decreased by 8% in 2018 as compared to 2017, primarily due to a 24% decrease in license fees earned from our automotive customers, a 30% decrease in license fees from our e-reader customers partially offset by a 3% increase in license fees earned from our printer customers.

In October 2017 we began selling our embedded sensor modules. We are focusing our efforts on our key markets such as: automotive, medical devices and industrial applications. During 2017, we entered into a U.S. distribution agreement with Digi-Key and they currently have a range of sensor modules and development kits for sale. We currently have supply agreements for sensor modules with ten customers. We sold \$113,000 and \$61,000 of sensor modules in 2018 and 2017, respectively.

In 2015, we entered into a joint development and cooperation agreement with Autoliv to develop a new HMI sensing product for vehicle steering wheel applications. An addendum to the initial agreement was entered into in December 2016 for a Steering Wheel software upgrade for a fee of \$600,000. The final milestone was completed in December 2017 and the entire \$600,000 fee was recognized as revenue as of the end of 2017.

Non-recurring engineering fees (“NRE”) decreased 52% in 2018 as compared to 2017 due to a decline of new license customers and related NRE design projects. In 2018 and 2017, 80% and 69% of our total NRE fees were earned from automotive projects. We expect to continue to earn NRE fees in 2019 and future years, mainly related to new license fee projects with current customers and customization of sensor modules for the automotive industry.

### ***Gross Margin***

Our combined total gross margin was 89% in 2018 compared to 77% in 2017. The increase in total gross margin in 2018 as compared to 2017 is primarily due to lower NRE revenues with low margin and a \$0.4 million write down for obsolete or slow moving sensor module and AirBar component and finished goods inventory in 2018 compared to \$1.1 million in 2017. License fees accounted for 93% of total revenue in 2018 compared to 85% in 2017, with a 100% gross margin. NRE projects had a 21% gross margin in 2018 compared to 21% in 2017.

Our cost of revenues includes the direct cost of production of certain customer prototypes, costs of engineering personnel, engineering consultants to complete the engineering design contracts and cost of goods sold for sensor modules includes fully burdened manufacturing costs, outsourced final assembly costs, and component costs of sensor modules.

### ***Research and Development***

Product research and development (“R&D”) expenses for 2018 were 62% of total revenue compared to 59% in 2017. R&D in 2018 decreased 13% compared to 2017 primarily related to reduced prototype costs, consultancy costs and costs related to sensor modules. There were twenty-four employees and three consultants in our Research and Development department in 2018 compared to twenty-four employees and four consultants in 2017.

Our R&D groups are primarily tasked with developing technology and software platforms to support our sensor modules and our customer integration activities for both our sensor hardware and license agreements.



### ***Sales and Marketing***

Sales and marketing expenses for 2018 were 23% of total revenue compared to 27% in 2017. Sales and marketing expenses in 2018 decreased 28% from 2017 primarily related to a reduction in advertising, travel and professional fees. We had six employees and three consultants in our sales and marketing department in 2018 compared to six employees and five consultants in 2017. Included in sales and marketing expenses is approximately \$6,000 of non-cash stock expense for the year ended December 31, 2018 compared to approximately \$50,000 for the same period in 2017.

Our sales activities focus on OEM, ODM and Tier 1 customers who will license our technology or purchase and embed our touch sensor modules into their products. Our customers will then sell and market their products incorporating our technology to their customers. We expect to expand our licensing and sensor module sales and marketing activities in 2019 and future years to capture market share in our target markets.

### ***General and Administrative***

General and administrative (“G&A”) expenses were 49% of revenue in 2018 compared to 44% in 2017. Total G&A expenses in 2018 decreased 7% from 2017. The decrease is primarily related to lower directors and professional fees as well as lower costs related to patents. As of December 31, 2018, we had ten full-time employees and one consultant in our G&A department fulfilling management and accounting responsibilities compared to nine full-time employees and two consultants as of December 31, 2017. Included in G&A expenses is approximately \$23,000 of non-cash stock-based compensation expense for the year ended December 31, 2018 compared to approximately \$22,000 for the same period in 2017.

### ***Interest Expense***

Interest expense for the year ended December 31, 2018 was \$49,000 compared to \$75,000 for the year ended December 31, 2017. The interest expense was mainly related to capital leases.

### ***Foreign Currency Translation and Transaction Gains and Losses***

The functional currency of our foreign subsidiaries is the applicable local currency, the Swedish Krona, the Japanese Yen, the South Korean Won and the Taiwan Dollar. The translation from Swedish Krona, Japanese Yen, South Korean Won or the Taiwan Dollar to U.S. Dollars is performed for balance sheet accounts using current exchange rates in effect at the balance sheet date and for income statement accounts using a weighted average exchange rate during the period. Gains or (losses) resulting from translation are included as a separate component of accumulated other comprehensive income (loss). Gains or (losses) resulting from foreign currency transactions are included in general and administrative expenses in the accompanying consolidated statements of operations and were \$(58,000) and \$(84,000) during the years ended December 31, 2018 and 2017, respectively. Foreign currency translation gains or (losses) were \$(357,000) and \$72,000 during the years ended December 31, 2018 and 2017, respectively.

### ***Income Taxes***

Our effective tax rate was 0% in the year ended December 31, 2018 and 1% in the year ended 2017. We recorded valuation allowances in 2018 and 2017 for deferred tax assets related to net operating losses due to the uncertainty of realization.

### ***Net Loss***

As a result of the factors discussed above, we recorded a net loss of \$3.1 million for the year ended December 31, 2018, compared to a net loss of \$4.7 million for the year ended December 31, 2017.

### ***Contractual Obligation and Off-Balance Sheet Arrangements***

We do not have any transactions, arrangements, or other relationships with unconsolidated entities that are reasonably likely to affect our liquidity or capital resources other than the operating leases incurred in the normal course of business.

We have no special purpose or limited purpose entities that provide off-balance sheet financing, liquidity, or market or credit risk support. We do not engage in leasing, hedging, research and development services, or other relationships that expose us to liability that is not reflected on the face of the consolidated financial statements.

### *Operating Leases*

On August 22, 2016, we entered into a lease of office space located at 2880 Zanker Road, San Jose, CA 95134. The lease is renewed monthly.

On October 1, 2016 we entered into a lease of office space located at 405 Elpulimento Shinjuku, 6-7-1, Shinjuku-ku, Tokyo, Japan. The lease is valid through September 30, 2020 and can be terminated with two months' written notice before the termination date.

On July 1, 2014, Neonode Technologies AB entered into a lease for 7,007 square feet of office space located at Storgatan 23C, Stockholm, Sweden. The lease is extended on a yearly basis unless written notice three months prior to expiration date.

On December 1, 2015, Pronode Technologies AB entered into a lease agreement for 9,040 square feet of workshop located at Faktorvägen 17, Kungsbacka, Sweden. The lease is valid through December 9, 2020 and can be terminated with nine months' written notice before the termination date.

In January 2015, our subsidiary Neonode Korea Ltd. entered into a lease agreement located at B-1807, Daesung D-Polis. 543-1, Seoul, South Korea. The lease may be cancelled with 2 months' notice.

On December 1, 2015, Neonode Taiwan Ltd. entered into a lease agreement located at Rm. 2406, International Trade Building, Keelung Rd., Sec.1, Taipei, Taiwan. The lease is renewed monthly.

For the years ended December 31, 2018 and 2017, we recorded approximately \$687,000 and \$681,000, respectively, for rent expense.



### *Equipment Subject to Capital Lease*

In April 2014, we entered into a lease for certain specialized milling equipment. Under the terms of the lease agreement we are obligated to purchase the equipment at the end of the original six-year lease term for 10% of the original purchase price of the equipment. In accordance with relevant accounting guidance the lease is classified as a capital lease. The lease payments and depreciation period began on July 1, 2014 when the equipment went into service. The implicit interest rate of the lease is 4% per annum.

Between the second and the fourth quarters of 2016, we entered into six leases for component production equipment. Under the terms of five of the lease agreements we are obligated to purchase the equipment at the end of the original 3-5-year lease terms for 5-10% of the original purchase price of the equipment. In accordance with relevant accounting guidance the leases are classified as capital leases. The lease payments and depreciation periods began between June and November 2016 when the equipment went into service. The implicit interest rate of the leases is currently approximately 3% per annum. One of the leases is a hire-purchase agreement where the equipment is required to be paid off after 5 years. In accordance with relevant accounting guidance the lease is classified as a capital lease. The lease payments and depreciation period began on July 1, 2016 when the equipment went into service. The implicit interest rate of the lease is currently approximately 3% per annum.

In 2017, we entered into one lease for component production equipment. Under the terms of the lease agreement the lease will be renewed within one year of the end of the original four-year lease term. In accordance with relevant accounting guidance the lease is classified as a capital lease. The lease payments and depreciation periods began in May 2017 when the equipment went into service. The implicit interest rate of the lease is currently approximately 1.5% per annum.

In 2018, we entered into one lease for component production equipment. Under the terms of the agreement, the lease will be renewed within one year of the original four-year lease term. In accordance with relevant accounting guidance the lease is classified as a capital lease. The lease payments and depreciation periods began in August 2018 when the equipment went into service. The implicit interest rate of the lease is currently approximately 1.5% per annum.

### *Non-Recurring Engineering Development Costs*

On April 25, 2013, we entered into an Analog Device Development Agreement with an effective date of December 6, 2012 (the "NN1002 Agreement") with Texas Instruments ("TI") pursuant to which TI agreed to integrate our intellectual property into an ASIC. Under the terms of the NN1002 Agreement, we agreed to pay TI \$500,000 of non-recurring engineering costs at the rate of \$0.25 per ASIC for each of the first 2 million ASICs sold. As of December 31, 2018,

we had made no payments to TI under the NN1002 Agreement.

On December 4, 2014, we entered into an Analog Device Development Agreement (the “NN1003 Agreement”) with STMicroelectronics International N.V. (“STMicro”) pursuant to which STMicro agreed to integrate our intellectual property into an ASIC. The NN1003 ASIC only can be sold by STMicro exclusively to our licensees. Under the terms of the NN1003 Agreement, we agreed to reimburse STMicro up to \$835,000 of non-recurring engineering costs. As of December 31, 2018 we paid a total of \$835,000 of the non-recurring engineering costs.

### *Liquidity and Capital Resources*

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

- actual versus anticipated licensing of our technology;
- actual versus anticipated purchases of our sensor products, including AirBar
- actual versus anticipated operating expenses;
- timing of our OEM customer product shipments;
- timing of payment for our technology licensing agreements;
- actual versus anticipated gross profit margin; and
- ability to raise additional capital, if necessary.

As of December 31, 2018, we had cash of \$6.6 million, as compared to \$5.8 million as of December 31, 2017.

Working capital (current assets less current liabilities) was \$8.2 million as of December 31, 2018, compared to working capital of \$6.2 million as of December 31, 2017.

Net cash used in operating activities for the year ended December 31, 2018 of \$2.9 million was primarily the result of a net loss including noncontrolling interests of approximately \$3.9 million. Cash used to fund net losses is reduced by approximately \$1.0 million in non-cash operating expenses, mainly comprised of depreciation and amortization and stock-based compensation.

Accounts receivable and unbilled revenues decreased by approximately \$0.5 million as of December 31, 2018 compared with December 31, 2017. During 2018 and 2017, we were successful in collecting cash from sales to our customers substantially in accordance with our standard payment terms to those customers.



Accounts payable and accrued expenses increased approximately \$41,000 as of December 31, 2018 compared to December 31, 2017.

Deferred revenue decreased approximately \$0.9 million during 2018 mainly related to recognition of prepaid license fees from two customers during 2018.

Net cash used in operating activities for the year ended December 31, 2017 of \$5.6 million was primarily the result of (i) a net loss including noncontrolling interests of approximately \$5.5 million and (ii) approximately \$1.1 million in net cash used in changes in operating assets and liabilities, primarily accounts receivable, inventory, prepaid expenses and other current assets, accounts payable and accrued expenses, and deferred revenues. Cash used to fund net losses is reduced by approximately \$1.0 million in non-cash operating expenses, mainly comprised of depreciation and amortization and stock-based compensation.

Accounts receivable decreased approximately \$0.5 million as of December 31, 2017 compared with December 31, 2016. During 2017, we were successful in collecting cash from sales to our customers substantially in accordance with our standard payment terms to those customers.

Accounts payable and accrued expenses decreased approximately \$0.9 million as of December 31, 2017 compared to December 31, 2016.

Deferred revenue decreased approximately \$0.7 million during 2017 mainly related to recognition of prepaid license fees from two customers during 2017.

Net cash provided by financing activities during the year ended December 31, 2018 of \$4.1 million was the result of net proceeds of approximately \$4.6 million from the sale of our common stock reduced by principal payments on capital leases of \$0.6 million.

Net cash provided by financing activities during the year ended December 31, 2017 was the result of net proceeds of approximately \$9.1 million from the sale of our common stock. This increase was offset by down payments of \$438,000 on leasing equipment.

In the years ended December 31, 2018 and 2017, we purchased \$236,000 and \$656,000, respectively of fixed assets, consisting primarily of leasing equipment and engineering equipment.

On December 28, 2018, we entered into a Securities Purchase Agreement with foreign investors as part of a non-brokered private placement pursuant to which we issued a total of 2,940,767 shares of common stock at \$1.60 per share for a purchase price of \$4.6 million in net proceeds. The common stock issued in the private placement was not registered for resale and we are not required under the Securities Purchase Agreement to register the issued stock for resale. The purchasers in the private placement included Neonode directors, Ulf Rosberg and Andreas Bunge, and members of management and certain employees of the company, including Chief Executive Officer Hakan Persson and Chief Financial Officer Lars Lindqvist. The Neonode directors and members of management and employees individually purchased an aggregate of approximately \$2 million of common stock as part of the private placement. In addition, our existing majority shareholder Peter Lindell also purchased shares. Mr. Lindell and Mr. Rosberg are now each a beneficial owner of approximately 18% of Neonode common stock as a result of the private placement.

In August 2017, we entered into a Securities Purchase Agreement with accredited investors as part of a private placement pursuant to which we issued a total of 975,000 shares of common stock at \$10.00 per share, and warrants, for an aggregate purchase price of \$9.75 million in gross proceeds. We received approximately \$9.1 million in net proceeds. Under the terms of the 2017 Securities Purchase Agreement, we also issued warrants (the “2017 Warrants”) to investors in the private placement to purchase up to a total of 325,000 shares of common stock at an exercise price of \$20.00 per share. The 2017 Warrants became exercisable on August 8, 2018 and will expire on August 8, 2020. If the 2017 Warrants are fully exercised, we will receive approximately \$6.5 million in proceeds. There are no registration rights associated with the securities to be issued and sold pursuant to the 2017 Securities Purchase Agreement.

In March 2017, we filed a \$20 million shelf registration statement with the SEC that became effective on March 24, 2017. Subject to the availability of sufficient shares of authorized common stock, we may from time to time issue shares of our common stock under our shelf registration in amounts, at prices, and on terms to be announced when and if the securities are offered. The specifics of any future offerings, along with the use of proceeds of any securities offered, will be described in a prospectus supplement and any other offering materials, at the time of the offering. Our shelf registration statement will expire on March 24, 2020.

On September 27, 2018, the Company filed the certificate of first amendment to its restated certificate of incorporation with the state of Delaware to effect a reverse stock split, effective October 1, 2018. The Company also filed a certificate of second amendment to its restated certificate of incorporation with the state of Delaware to reduce the number of authorized shares of common stock from 100,000,000 to 10,000,000 shares. The filing did not affect the number of authorized preferred stock of 1,000,000 shares.

As a result of the reverse stock split, every ten shares of issued and outstanding common stock were converted into one share of common stock, without any change in the par value per share. No fractional shares were issued, therefore shareholders entitled to receive a fractional share in connection with the reverse stock split received a cash payment instead. There was no financial impact to the Company's consolidated financial statements. All shares and per share information in this Form 10-K have been retroactively adjusted for all periods presented to reflect the reverse stock split, including reclassifying any amount equal to the reduction in par value of common stock to additional paid-in capital.

The consolidated financial statements included herein have been prepared on a going concern basis, which contemplates continuity of operations and the realization of assets and the repayment of liabilities in the ordinary course of business. We expect our revenues from license fees, sales of sensor modules and non-recurring engineering fees will enable us to reduce our operating losses in 2019. We have received purchase orders from our distributors for AirBar and entered into an agreement with an OEM customer for our sensor modules.

In addition, we have improved the overall cost efficiency of our operations, as a result of the transition from providing our customers a full custom design solution to providing sensor modules which require limited custom design work. We intend to continue to implement various measures to improve our operational efficiencies. No assurances can be given that management will be successful in meeting its revenue targets and reducing its operating loss. However, management believes that execution of its business plan and the capital invested pursuant to the December 2018 Securities Purchase Agreement should provide us with sufficient liquidity to meet our short-term operating requirements.

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

arrangements. Historically, we have been able to access the capital markets through sales of common stock and warrants to generate liquidity. Our management believes it could raise capital through public or private offerings if needed to provide us with sufficient liquidity. However, because we have reserved substantially all remaining shares of authorized stock for outstanding options and warrants, our ability to obtain liquidity through equity sales may be limited unless and until those securities expire or our stockholders approve an increase in the number of shares of authorized stock. We anticipate seeking such stockholder approval at our 2019 Annual Meeting of Stockholders.

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

#### **ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Not applicable.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

<b>Index to the Consolidated Financial Statements</b>	Page
<u>Report of Independent Registered Public Accounting Firm</u>	F-2
<u>Consolidated Balance Sheets as of December 31, 2018 and 2017</u>	F-3
<u>Consolidated Statements of Operations for the years ended December 31, 2018 and 2017</u>	F-4
<u>Consolidated Statements of Comprehensive Loss for the years ended December 31, 2018 and 2017</u>	F-5
<u>Consolidated Statements of Stockholders' Equity for the years ended December 31, 2018 and 2017</u>	F-6
<u>Consolidated Statements of Cash Flows for the years ended December 31, 2018 and 2017</u>	F-8
<u>Notes to the Consolidated Financial Statements</u>	F-9

F-1

## **REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders

Neonode Inc.

### **Opinion on the Consolidated Financial Statements**

We have audited the accompanying consolidated balance sheets of Neonode Inc. (a Delaware corporation) and subsidiaries (the “Company”) as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive loss, stockholders’ equity and cash flows for each of the two years in the period ended December 31, 2018, and the related notes (collectively referred to as the “consolidated financial statements”). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

### **Basis for Opinion**

These consolidated financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

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Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

KMJ Corbin & Company LLP

We have served as the Company's auditor since 2009.

Costa Mesa, California

March 7, 2019

F-2

**NEONODE INC.****CONSOLIDATED BALANCE SHEETS**

(In thousands, except share and per share amounts)

	As of December 31, 2018	As of December 31, 2017
<b>ASSETS</b>		
Current assets:		
Cash	\$ 6,555	\$ 5,796
Accounts receivable and unbilled revenues, net	1,830	1,010
Projects in process	-	1
Inventory	1,219	1,154
Prepaid expenses and other current assets	890	1,836
Total current assets	10,494	9,797
Investment in joint venture	3	3
Property and equipment, net	2,484	3,327
Other assets	261	-
Total assets	\$ 13,242	\$ 13,127
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 501	\$ 509
Accrued payroll and employee benefits	902	1,081
Accrued expenses	265	177
Deferred revenues	75	1,248
Current portion of capital lease obligations	570	568
Total current liabilities	2,313	3,583
Capital lease obligation, net of current portion	1,133	1,681
Total liabilities	3,446	5,264
Commitments and contingencies		
Stockholders' equity		
Series B Preferred stock, 54,425 shares authorized with par value of \$0.001; 82 and 83 shares issued and outstanding at December 31, 2018 and 2017, respectively. (In the event of dissolution, each share of Series B Preferred stock has a liquidation preference equal to par value of \$0.001 over the shares of common stock)	-	-
Common stock, 10,000,000 shares authorized, with par value of \$0.001; 8,800,313 and 5,859,414 shares issued and outstanding at December 31, 2018 and 2017, respectively	9	6



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Additional paid-in capital	197,507		192,861	
Accumulated other comprehensive loss	(456	)	(99	)
Accumulated deficit	(185,222	)	(183,745	)
Total Neonode Inc. stockholders' equity	11,838		9,023	
Noncontrolling interests	(2,042	)	(1,160	)
Total stockholders' equity	9,796		7,863	
Total liabilities and stockholders' equity	\$ 13,242		\$ 13,127	

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

F-3

**NEONODE INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share amounts)

	Years Ended	
	December 31, 2018	December 31, 2017
Revenues:		
License fees	\$7,954	\$ 8,684
Sensor modules	227	814
Non-recurring engineering	357	743
Total revenues	8,538	10,241
Cost of revenues:		
Sensor modules	638	1,758
Non-recurring engineering	283	585
Total cost of revenues	921	2,343
Total gross margin	7,617	7,898
Operating expenses:		
Research and development	5,278	6,078
Sales and marketing	1,995	2,772
General and administrative	4,221	4,524
Total operating expenses	11,494	13,374
Operating loss	(3,877 )	(5,476 )
Other expense		
Interest expense	(49 )	(75 )
Other expense	(3 )	-
Total other expense	(52 )	(75 )
Loss before provision for income taxes	(3,929 )	(5,551 )
Provision for (benefit from) income taxes	13	(56 )
Net loss including noncontrolling interests	(3,942 )	(5,495 )
Less: Net loss attributable to noncontrolling interests	882	790
Net loss attributable to Neonode Inc.	\$(3,060 )	\$(4,705 )
Loss per common share:		
Basic and diluted loss per share	\$(0.52 )	\$(0.89 )

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Basic and diluted – weighted average number of common shares outstanding    5,884    5,289

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

F-4

**NEONODE INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

(In thousands)

	Years Ended	
	December 31,	December 31,
	2018	2017
Net loss including noncontrolling interests	\$ (3,942)	\$ (5,495 )
Other comprehensive income (loss):		
Foreign currency translation adjustments	(357 )	72
Comprehensive loss	(4,299)	(5,423 )
Less: Comprehensive loss attributable to noncontrolling interests	882	790
Comprehensive loss attributable to Neonode Inc.	\$ (3,417)	\$ (4,633 )

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

## NEONODE INC.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

	Series B Preferred Stock Shares Issued	Series B Preferred Stock Amount	Common Stock Shares Issued	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Neonode Inc. Stockholders Equity	Noncontrolling Interests	Total Stockholders' Equity
Balances, January 1, 2017	83	\$ -	4,884	\$ 5	\$ 183,711	\$ (171 )	\$ (179,040 )	\$ 4,505	\$ (370 )	\$ 4,135
Stock option and warrant compensation expense to employees and directors	-	-	-	-	72	-	-	72	-	72
Proceeds from sale of common stock, net of offering costs	-	-	975	1	9,078	-	-	9,079	-	9,079
Foreign currency translation adjustment	-	-	-	-	-	72	-	72	-	72
Net loss	-	-	-	-	-	-	(4,705 )	(4,705 )	(790 )	(5,495 )
Balances, December 31, 2017	83	-	5,859	6	192,861	(99 )	(183,745 )	9,023	(1,160 )	7,863

F-6

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	Series B Preferred Stock Shares Issued	Series B Preferred Stock Amount	Common Stock Shares Issued	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Total Neonode Inc. Stockholders' Equity	Noncontrolling Interests	Total Stockholders' Equity
Stock option compensation expense to employees and directors	-	-	-	-	29	-	-	29	-	29
Conversion of Series B Preferred Stock to common stock	(1 )	-	-	-	-	-	-	-	-	-
Proceeds from sale of common stock, net of offering costs	-	-	2,941	3	4,617	-	-	4,620	-	4,620
Adjustment related to adoption of ASC 606 revenue recognition	-	-	-	-	-	-	1,583	1,583	-	1,583
Foreign currency translation adjustment	-	-	-	-	-	(357 )	-	(357 )	-	(357 )
Net loss	-	-	-	-	-	-	(3,060 )	(3,060 )	(882 )	(3,942 )
Balances, December 31, 2018	82	\$ -	8,800	\$ 9	\$197,507	\$ (456 )	\$ (185,222 )	\$ 11,838	\$ (2,042 )	\$ 9,796

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

**NEONODE INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

	2018	2017
Cash flows from operating activities:		
Net loss (including noncontrolling interests)	\$(3,942)	\$(5,495)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock-based compensation expense	29	72
Depreciation and amortization	1,008	953
Loss on disposal of property and equipment	6	-
Changes in operating assets and liabilities:		
Accounts receivable	481	542
Projects in process	1	(1 )
Inventory	(142 )	(372 )
Prepaid expenses and other current assets	556	293
Accounts payable and accrued expenses	41	(896 )
Deferred revenues	(897 )	(677 )
Net cash used in operating activities	(2,859)	(5,581)
Cash flows from investing activities:		
Purchase of property and equipment	(236 )	(656 )
Proceeds from sale of property and equipment	4	-
Net cash used in investing activities	(232 )	(656 )
Cash flow from financing activities:		
Proceeds from issuance of common stock and warrants, net of offering costs	4,620	9,079
Proceeds from note payable	-	1,713
Payments on note payable	-	(1,713)
Principal payments on capital lease obligations	(551 )	(438 )
Net cash provided by financing activities	4,069	8,641
Effect of exchange rate changes on cash	(219 )	(84 )
Net change in cash	759	2,320
Cash at beginning of year	5,796	3,476
Cash at end of year	\$6,555	\$5,796

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Supplemental disclosure of cash flow information:

Cash paid for interest	\$49	\$73
Cash paid for income taxes	\$13	\$219

Supplemental disclosure of non-cash investing and financing activities:

Purchase of equipment with capital lease obligations	\$169	\$1,287
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The accompanying notes are an integral part of these consolidated financial statements.

F-8



## NEONODE INC.

### Notes to the Consolidated Financial Statements

#### 1. Nature of the Business and Operations

##### Background and Organization

Neonode Inc. (“we”, “us”, “our”, or the “Company”) was incorporated in the State of Delaware in 1997 as the parent of Neonode AB, a company founded in February 2004 and incorporated in Sweden. On December 29, 2008, we entered into a share exchange agreement with AB Cypresen nr 9683 (renamed Neonode Technologies AB), a Swedish engineering company, and Neonode Technologies AB became our wholly owned subsidiary. In 2013, we established additional wholly owned subsidiaries: Neonode Japan Inc. (Japan); Neno User Interface Solutions AB (Sweden) (sold December 27, 2018); NEON Technology Inc. (U.S.) (dissolved November 19, 2018); and Neonode Americas Inc. (U.S.) (dissolved November 19, 2018). In 2014, we established one additional wholly owned subsidiary: Neonode Korea Ltd. (South Korea). In 2015, we established one additional wholly owned subsidiary: Neonode Taiwan Ltd. (Taiwan). In 2015, we established Pronode Technologies AB, a majority-owned subsidiary of Neonode Technologies AB. In 2016, we entered into a joint venture, named Neoeye AB, between SMART EYE AB and our subsidiary Neonode Technologies AB.

##### *Operations*

Neonode Inc., collectively with its subsidiaries is referred to as “Neonode”, develops and licenses user interfaces and optical touch technology to Original Equipment Manufacturers (“OEMs”) and Tier 1 suppliers who embed the Neonode technology into devices that they produce and sell. In the fourth quarter of 2016, Neonode started to manufacture and sell AirBar. In December 2017, we began selling embedded sensors modules that incorporate Neonode technology.

##### *Liquidity*

We incurred net losses of approximately \$3.1 million and \$4.7 million for the years ended December 31, 2018 and 2017, respectively, and had an accumulated deficit of approximately \$185.2 million as of December 31, 2018. In addition, we used cash in operating activities of approximately \$2.9 million and \$5.6 million for the years ended

December 31, 2018 and 2017, respectively.

In March 2017, we filed a \$20 million shelf registration statement with the SEC that became effective on March 24, 2017. Subject to the availability of sufficient shares of authorized common stock, we may from time to time issue shares of our common stock under our shelf registration in amounts, at prices, and on terms to be announced when and if the securities are offered. The specifics of any future offerings, along with the use of proceeds of any securities offered, will be described in a prospectus supplement and any other offering materials, at the time of the offering. Our shelf registration statement will expire on March 24, 2020.

F-9

*December 2018 Private Placement*

On December 28, 2018, we entered into a Securities Purchase Agreement with foreign investors as part of a non-brokered private placement pursuant to which we issued a total of 2,940,767 shares of common stock at \$1.60 per share for a purchase price of \$4.6 million in net proceeds. The common stock issued in the private placement is not registered for resale and we are not required under the Securities Purchase Agreement to register the issued stock for resale. The purchasers in the private placement included Neonode directors, Ulf Rosberg and Andreas Bunge, and members of management and certain employees of the company, including Chief Executive Officer, Hakan Persson, and Chief Financial Officer, Lars Lindqvist. The Neonode directors and members of management and employees individually purchased an aggregate of approximately \$2 millions of common stock as part of the private placement. In addition, existing major shareholder, Peter Lindell, also purchased shares. Mr. Lindell and Mr. Rosberg are now each a beneficial owner of approximately 18% of Neonode common stock as a result of the private placement.

*August 2017 Private Placement*

In August 2017, we entered into a Securities Purchase Agreement with accredited investors as part of a private placement pursuant to which we issued a total of 975,000 shares of common stock at \$10.00 per share, and warrants, for of an aggregate purchase price of \$9.75 million in gross proceeds. We received approximately \$9.1 million in net proceeds. Under the terms of the 2017 Securities Purchase Agreement, we also issued warrants (the “2017 Warrants”) to investors in the private placement to purchase up to a total of 325,000 shares of common stock at an exercise price of \$20.00 per share. The 2017 Warrants became exercisable on August 8, 2018 and will expire on August 8, 2020. If the 2017 Warrants are fully exercised, we will receive approximately \$6.5 million in proceeds. There are no registration rights associated with the securities to be issued and sold pursuant to the 2017 Securities Purchase Agreement.

The consolidated financial statements included herein have been prepared on a going concern basis, which contemplates continuity of operations and the realization of assets and the repayment of liabilities in the ordinary course of business. Management evaluated the significance of the Company’s operating loss and determined that the Company’s current operating plan and sources of capital would be sufficient to alleviate concerns about the Company’s ability to continue as a going concern.

We expect our revenues from license fees, sensor module, non-recurring engineering fees and AirBar sales will enable us to reduce our operating losses in 2019. In addition, we have improved the overall cost efficiency of our operations, as a result of the transition from providing our customers a full custom design solution to providing standardized sensor modules which require limited custom design work. We intend to continue to implement various measures to improve our operational efficiencies. No assurances can be given that management will be successful in meeting its revenue targets and reducing its operating loss.

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

F-10

## **2. Summary of Significant Accounting policies**

### ***Principles of Consolidation***

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and include the accounts of Neonode Inc. and its wholly owned subsidiaries, as well as Pronode Technologies AB, a 51% majority owned subsidiary of Neonode Technologies AB. The remaining 49% of Pronode Technologies AB is owned by Propoint AB, located in Gothenburg, Sweden. Pronode Technologies AB was organized to sell engineering services within the automotive markets. All inter-company accounts and transactions have been eliminated in consolidation.

Neonode consolidates entities in which we have a controlling financial interest. We consolidate subsidiaries in which we hold, directly or indirectly, more than 50% of the voting rights, and variable interest entities (“VIEs”) in which Neonode is the primary beneficiary.

The consolidated balance sheets at December 31, 2018 and 2017 and the consolidated statements of operations, comprehensive loss and cash flows for the years ended 2018 and 2017 include our accounts and those of our wholly owned subsidiaries as well as Pronode Technologies AB.

### ***Estimates***

The preparation of financial statements in conformity with U.S. GAAP requires making estimates and assumptions that affect, at the date of the financial statements, the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from these estimates.

Significant estimates include, but are not limited to: for revenue recognition, determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price of performance obligations, variable consideration, and other obligations such as product returns and refunds, and product warranties; provisions for uncollectible receivables; net realizable value of inventory; recoverability of capitalized project costs and long-lived assets; the valuation allowance related to our deferred tax assets; and the fair value of options issued for stock-based compensation.

*Cash*

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

*Concentration of Cash Balance Risks*

Cash balances are maintained at various banks in the U.S., Japan, Korea, Taiwan and Sweden. For deposits held with financial institutions in the U.S. the U.S. Federal Deposit Insurance Corporation, provides basic deposit coverage with limits up to \$250,000 per owner. The Swedish government provides insurance coverage up to 100,000 Euro per customer and covers deposits in all types of accounts. The Japanese government provides insurance coverage up to 10,000,000 Yen per customer. The Korea Deposit Insurance Corporation provides insurance coverage up to 50,000,000 Won per customer. The Central Deposit Insurance Corporation in Taiwan provides insurance coverage up to 3,000,000 Taiwan Dollar per customer. At times, deposits held with financial institutions may exceed the amount of insurance provided.

### ***Accounts Receivable and Allowance for Doubtful Accounts***

Accounts receivable is stated at net realizable value. Our policy is to maintain allowances for estimated losses resulting from the inability of our customers to make required payments. Credit limits are established through a process of reviewing the financial history and stability of each customer. Should all efforts fail to recover the related receivable, we will write off the account. We also record an allowance for all customers based on certain other factors including the length of time the receivables are past due and historical collection experience with customers. Our allowance for doubtful accounts was approximately \$149,000 as of December 31, 2018 and 2017.

### ***Projects in Process***

Projects in process consist of costs incurred toward the completion of various projects for certain customers. These costs are primarily comprised of direct engineering labor costs and project-specific equipment costs. These costs are capitalized on our balance sheet as an asset and deferred until revenue for each project is recognized in accordance with our revenue recognition policy. Costs capitalized in projects in process were \$1,000 as of December 31, 2017. There were no costs capitalized in projects in process as of December 31, 2018.

### ***Inventory***

Inventory is stated at the lower of cost or net realizable value, using the first-in, first-out method (“FIFO”) valuation method. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Any adjustments to reduce the cost of inventories to their net realizable value are recognized in earnings in the current period.

During the fourth quarter of 2017, after a comprehensive evaluation of our AirBar business we recorded a \$1.1 million write-down, included in our cost of goods sold, to reduce our AirBar specific component and finished goods inventory to estimated net realizable value and to revalue the purchase price from the initial order of one component by \$0.12 each. The component was originally valued at an average price basis but due to slow selling inventory, we revalued at a higher specific price. The total price adjustment related to this component included in cost of sales was approximately \$0.1 million. In addition, we recorded a \$0.1 million write-down related to this component repricing which is included in our Research and Development expense. We also recorded a \$0.5 million write-off related to production development units, included in inventory, which is included in our Research and Development expense.

As of December 31, 2018, the Company's inventory consists primarily of components that will be used in the manufacturing of our sensor modules. We segregate inventory for reporting purposes by raw materials, work-in-process, and finished goods.

Raw materials, work-in-process, and finished goods are as follows:

	December 31, 2018	December 31, 2017
Raw materials	\$ 246	164
Work-in-Process	220	231
Finished goods	753	759
Ending inventory	\$ 1,219	1,154

### ***Investment in JV***

We have invested \$3,000, a 50% interest in Neoeeye AB (see above). We account for our investment using the equity method of accounting since the investment provides us the ability to exercise significant influence, but not control, over the investee. Significant influence is generally deemed to exist if we have an ownership interest in the voting stock of the investee of between 20% and 50%, although other factors, such as representation on the investee's Board of Directors, are considered in determining whether the equity method of accounting is appropriate. Under the equity method of accounting, the investment, originally recorded at cost, is adjusted to recognize our share of net earnings or losses of the investee and will be recognized in the consolidated statements of operations and will also be adjusted by contributions to and distributions from Neoeeye. The Company is not required to guarantee any obligations of the JV. There have been no operations of Neoeeye through December 31, 2018.

We review our investment in Neoeeye to determine whether events or changes in circumstances indicate that the carrying amount may not be recoverable. The primary factors we consider in our determination are the financial condition, operating performance and near-term prospects of Neoeeye. If a decline in value is deemed to be other than temporary, we would recognize an impairment loss.



### ***Property and Equipment***

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

#### Estimated useful lives

Computer equipment	3 years
Furniture and fixtures	5 years
Equipment	7 years

Equipment purchased under a capital lease is depreciated over the term of the lease, if that lease term is shorter than the estimated useful life.

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

### ***Long-Lived Assets***

We assess any impairment by estimating the future cash flow from the associated asset in accordance with relevant accounting guidance. If the estimated undiscounted future cash flow related to these assets decreases or the useful life is shorter than originally estimated, we may incur charges for impairment of these assets. As of December 31, 2018, we believe there was no impairment of our long-lived assets. There can be no assurance, however, that market conditions will not change or sufficient demand for our products and services will continue, which could result in impairment of long-lived assets in the future.

### ***Foreign Currency Translation and Transaction Gains and Losses***

The functional currency of our foreign subsidiaries is the applicable local currency, the Swedish Krona, the Japanese Yen, the South Korean Won and the Taiwan Dollar. The translation from Swedish Krona, Japanese Yen, South Korean Won or the Taiwan Dollar to U.S. Dollars is performed for balance sheet accounts using current exchange

rates in effect at the balance sheet date and for income statement accounts using a weighted average exchange rate during the period. Gains or (losses) resulting from translation are included as a separate component of accumulated other comprehensive income (loss). Gains (losses) resulting from foreign currency transactions are included in general and administrative expenses in the accompanying consolidated statements of operations and were \$(58,000) and \$(84,000) during the years ended December 31, 2018 and 2017, respectively. Foreign currency translation gains or (losses) were \$(357,000) and \$72,000 during the years ended December 31, 2018 and 2017, respectively.

***Concentration of Credit and Business Risks***

Our customers are located in United States, Europe and Asia.

As of December 31, 2018, four customers represented approximately 67% of our consolidated accounts receivable.

As of December 31, 2017, two customers represented approximately 69% of our consolidated accounts receivable.

Customers who accounted for 10% or more of our net revenues during the year ended December 31, 2018 are as follows.

Hewlett-Packard Company – 35%

Epson – 14%

Canon – 12%

Customers who accounted for 10% or more of our net revenues during the year ended December 31, 2017 are as follows.

Hewlett-Packard Company – 28%  
Canon – 17%  
Bosch – 10%

The Company conducts business in the United States, Europe and Asia. At December 31, 2018, the Company maintained approximately \$2,537,000, \$7,187,000 and \$72,000 of its net assets in the United States, Europe and Asia, respectively. At December 31, 2017, the Company maintained approximately \$2,373,000, \$5,418,000 and \$72,000 of its net assets in the United States, Europe and Asia, respectively.

### ***Revenue Recognition***

We recognize revenue when control of products is transferred to our customers, and when services are completed and accepted by our customers; the amount of revenue we recognize reflects the consideration we expect to receive for those products or services. Our contracts with customers may include combinations of products and services, for example, a contract that includes products and related engineering services. We structure our contracts such that distinct performance obligations, such as product sales or license fees, and related engineering services, are clearly defined in each contract.

Sales of license fees and AirBar and sensor modules are on a per-unit basis; therefore, we generally satisfy performance obligations as units are shipped to our customers. Non-recurring engineering service performance obligations are satisfied as work is performed and accepted by our customers.

We recognize revenue net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities. We treat all product shipping and handling charges (regardless of when they occur) as activities to fulfill the promise to transfer goods, therefore we treat all shipping and handling charges as expenses.

### ***Licensing Revenues:***

We earn revenue from licensing our internally developed intellectual property (“IP”). We enter into IP licensing agreements that generally provide licensees the right to incorporate our IP components in their products, with terms and conditions that vary by licensee. Fees under these agreements may include license fees relating to our IP, and royalties payable to us following the distribution by our licensees of products incorporating the licensed technology. The license for our IP has standalone value and can be used by the licensee without maintenance and support.

For technology license arrangements that do not require significant modification or customization of the underlying technology, we recognize technology license revenue when the license is made available to the customer and the customer has a right to use that license. At the end of each reporting period, we record unbilled license fees, using prior royalty revenue data by customer to make accurate estimates of those royalties.

Explicit return rights are not offered to customers. There have been no returns through December 31, 2018.

*Engineering Services:*

For technology license or sensor module contracts that require modification or customization of the underlying technology to adapt that technology to customer use, we determine whether the technology license or sensor module, and engineering consulting services represent separate performance obligations. We perform our analysis on a contract-by-contract basis. If there are separate performance obligations, we determine the standalone selling price (“SSP”) of each separate performance obligation to properly recognize revenue as each performance obligation is satisfied. We provide engineering consulting services to our customers under a signed Statement of Work (“SOW”). Deliverables and payment terms are specified in each SOW. We generally charge an hourly rate for engineering services, and we recognize revenue as engineering services specified in contracts are completed and accepted by our customers. Any upfront payments we receive for future non-recurring engineering services are recorded as unearned revenue until that revenue is earned.

We believe that recognizing non-recurring engineering services revenues as progress towards completion of engineering services and customer acceptance of those services occurs best reflects the economics of those transactions, because engineering services as tracked in our systems correspond directly with the value to our customers of our performance completed to date. Hours performed for each engineering project are tracked and reflect progress made on each project and are charged at a consistent hourly rate.

Revenues from engineering services contracts that are short-term in nature are recorded when those services are complete and accepted by customers.

Revenues from engineering services contracts with substantive defined deliverables for which payment terms in the SOW are commensurate with the efforts required to produce such deliverables are recognized as they are completed and accepted by customers.

Estimated losses on all SOW projects are recognized in full as soon as they become evident. In the years ended December 31, 2018 and 2017, no losses related to SOW projects were recorded.

*Optical Sensor Modules Revenues:*

We earn revenue from sales of sensor modules hardware products to our OEM and Tier 1 supplier customers, who embed our hardware into their products, and from sales of branded consumer products that incorporate our sensor modules sold through distributors or directly to end users. These distributors are generally given business terms that allow them to return unsold inventory, receive credits for changes in selling prices, and participate in various cooperative marketing programs. Our sales agreements generally provide customers with limited rights of return and warranty provisions.

The timing of revenue recognition related to AirBar modules depends upon how each sale is transacted - either point-of-sale or through distributors. We recognize revenue for AirBar modules sold point-of-sale (online sales and other direct sales to customers) when we provide the promised product to the customer.

Because we generally use distributors to provide AirBar and sensor modules to our customers, however, we analyze the terms of distributor agreements to determine when control passes from us to our distributors. For sales of AirBar and sensor modules sold through distributors, revenues are recognized when our distributors obtain control over our products. Control passes to our distributors when we have a present right to payment for products sold to distributors,

the distributors have legal title to and physical possession of products purchased from us, and the distributors have significant risks and rewards of ownership of products purchased.

Distributors participate in various cooperative marketing and other incentive programs, and we maintain estimated accruals and allowances for these programs. If actual credits received by distributors under these programs were to deviate significantly from our estimates, which are based on historical experience, our revenue could be adversely affected.

Under U.S. GAAP, companies may make reasonable aggregations and approximations of returns data to accurately estimate returns. Our AirBar returns and warranty experience to date has enabled us to make reasonable returns estimates, which are supported by the fact that our product sales involve homogenous transactions. The reserve for future sales returns is recorded as a reduction of our accounts receivable and revenue and was insignificant as of December 31, 2018 and 2017. If the actual future returns were to deviate from the historical data on which the reserve had been established, our revenue could be adversely affected.

The following table presents disaggregated revenues by market for the years ended December 31, 2018 and 2017 (dollars in thousands):

	Year ended December 31, 2018			Year ended December 31, 2017		
	Amount	Percentage	%	Amount	Percentage	%
Net license revenues from automotive	\$1,627	19	%	\$2,148	21	%
Net license revenues from consumer electronics	6,327	74	%	6,536	64	%
Net revenues from sensor modules	227	3	%	814	8	%
Net revenues from non-recurring engineering	357	4	%			