

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

NEOMEDIA TECHNOLOGIES INC
Form 10QSB
November 18, 2003

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

FORM 10-QSB

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2003

OR

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

COMMISSION FILE NUMBER 0-21743

NEOMEDIA TECHNOLOGIES, INC.

(Exact Name of Small Business Issuer as Specified In Its Charter)

DELAWARE
(State or Other Jurisdiction of
Incorporation or Organization)

36-3680347
(I.R.S. Employer
Identification No.)

2201 SECOND STREET, SUITE 402, FORT MYERS, FLORIDA
(Address of Principal Executive Offices)

33901
(Zip Code)

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

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

As of November 10, 2003, there were 235,783,873 outstanding shares of the issuer's Common Stock.

1

PART I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NEOMEDIA TECHNOLOGIES, INC. AND SUBSIDIARIES

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

CONDENSED CONSOLIDATED BALANCE SHEET (IN THOUSANDS, EXCEPT SHARE DATA)

| | SEPTEMBER 30, 2003 ----- |
|--|--------------------------------|
| ASSETS | |
| Current assets: | |
| Cash and cash equivalents | \$ 1,048 |
| Restricted cash | 600 |
| Trade accounts receivable, net of allowance for doubtful accounts of \$28 | 178 |
| Inventories, net | 13 |
| Prepaid expenses and other current assets | 511 |
| | ----- |
| Total current assets | 2,350 |
| Property and equipment, net | 72 |
| Capitalized patents, net | 2,055 |
| Capitalized and purchased software costs, net | 60 |
| Other long-term assets | 704 |
| | ----- |
| Total assets | \$ 5,241 ===== |
| LIABILITIES AND SHAREHOLDERS' DEFICIT | |
| Current liabilities: | |
| Accounts payable | \$ 3,096 |
| Amounts due under financing agreements | 345 |
| Liabilities in excess of assets of discontinued business unit | 996 |
| Sales taxes payable | 194 |
| Accrued expenses | 2,782 |
| Deferred revenues | 576 |
| Cash advances payable through the issuance of common stock | 1,135 |
| Notes payable | 732 |
| Current portion of long-term debt | 591 |
| Other | 37 |
| | ----- |
| Total current liabilities | 10,484 |
| Long-term debt, net of current portion | 94 |
| | ----- |
| Total liabilities | 10,578 ----- |
| Shareholders' deficit: | |
| Preferred stock, \$0.01 par value, 25,000,000 shares authorized, none issued and outstanding | -- |
| Additional paid-in capital, preferred stock | -- |
| Common stock, \$0.01 par value, 1,000,000,000 shares authorized, 207,764,771 shares issued and 205,781,109 outstanding 2,058 | 2,058 |
| Additional paid-in capital | 68,469 |
| Deferred stock-based compensation | (260) |
| Accumulated deficit | (74,825) |
| Treasury stock, at cost, 201,230 shares of common stock | (779) |
| | ----- |

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

| | |
|---|----------|
| Total shareholders' deficit | (5,337) |
| | ----- |
| Total liabilities and shareholders' deficit | \$ 5,241 |
| | ===== |

The accompanying notes are an integral part of this condensed consolidated balance sheet.

2

NEOMEDIA TECHNOLOGIES, INC. AND SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS (IN THOUSANDS, EXCEPT PER SHARE DATA)

| | THREE MONTHS ENDED SEPTEMBER 3 | |
|--|--------------------------------|-----------|
| | 2003 | 2002 |
| | ----- | ----- |
| NET SALES: | | |
| License fees | \$ 69 | \$ 15 |
| Resale of software and technology equipment and service fees | 392 | 3,25 |
| | ----- | ----- |
| Total net sales | 461 | 3,40 |
| | ----- | ----- |
| COST OF SALES: | | |
| License fees | 76 | 8 |
| Resale of software and technology equipment and service fees | 378 | 2,74 |
| | ----- | ----- |
| Total cost of sales | 454 | 2,82 |
| | ----- | ----- |
| GROSS PROFIT | 7 | 58 |
| | | |
| Sales and marketing expenses | 146 | 20 |
| General and administrative expenses | 1,940 | 99 |
| Research and development costs | 78 | 15 |
| | ----- | ----- |
| Loss from operations | (2,157) | (77 |
| | | |
| Other expenses: | | |
| Loss on extinguishment of debt | 24 | - |
| Interest expense | 24 | - |
| | ----- | ----- |
| NET LOSS | \$ (2,205) | \$ (77 |
| | ===== | ===== |
| NET LOSS PER SHARE--BASIC AND DILUTED | \$ (0.01) | \$ (0.0 |
| | ===== | ===== |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES--BASIC AND DILUTED | 151,698,465 | 22,979,75 |
| | ===== | ===== |

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

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

3

NEOMEDIA TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

| | NINE MONTHS ENDED SEPTEMBER 30 | |
|--|--------------------------------|------------|
| | 2003 | 2002 |
| NET SALES: | | |
| License fees | \$ 338 | \$ 303 |
| Resale of software and technology equipment and service fees | 1,671 | 8,149 |
| Total net sales | 2,009 | 8,452 |
| COST OF SALES: | | |
| License fees | 227 | 764 |
| Resale of software and technology equipment and service fees | 1,566 | 6,607 |
| Total cost of sales | 1,793 | 7,371 |
| GROSS PROFIT | 216 | 1,081 |
| Sales and marketing expenses | 407 | 719 |
| General and administrative expenses | 3,409 | 3,556 |
| Research and development costs | 243 | 683 |
| Loss on impairment of assets | -- | 1,003 |
| Loss from operations | (3,843) | (4,880) |
| Other expenses: | | |
| Loss on extinguishment of debt | 24 | -- |
| Interest expense | 193 | 99 |
| Loss from continuing operations | (4,060) | (4,979) |
| Loss on disposal of discontinued business unit (Note 1) | -- | (1,523) |
| NET LOSS | \$ (4,060) | \$ (6,502) |
| NET LOSS PER SHARE FROM | | |
| CONTINUING OPERATIONS--BASIC AND DILUTED | \$ (0.05) | \$ (0.24) |

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

| | | |
|---|------------|------------|
| NET LOSS PER SHARE FROM DISCONTINUED OPERATIONS--BASIC AND DILUTED | \$ -- | \$ (0.07) |
| | ===== | ===== |
| NET LOSS PER SHARE--BASIC AND DILUTED | \$ (0.05) | \$ (0.31) |
| | ===== | ===== |
| WEIGHTED AVERAGE NUMBER OF COMMON SHARES--BASIC AND DILUTED | 89,440,869 | 20,736,080 |
| | ===== | ===== |

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

4

NEOMEDIA TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(IN THOUSANDS)

| | NINE MONTHS ENDED 2003 ----- |
|---|------------------------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | |
| Net loss | (\$4,060) |
| Adjustments to reconcile net loss to net cash used in operating activities: | |
| Depreciation and amortization | 368 |
| Loss on disposal of discontinued business unit | -- |
| Loss on impairment of assets | -- |
| Expense associated with option and warrant repricing | 748 |
| Fair value of expense portion of stock-based compensation granted for professional services | 442 |
| Interest expense allocated to debt | 75 |
| Discount related to issuance of employee common stock | 688 |
| Loss on payments of accounts payable in stock | 24 |
| (Increase)/decrease in value of life insurance policies | (10) |
| Changes in operating assets and liabilities | |
| Trade accounts receivable, net | 149 |
| Other current assets | 217 |
| Accounts payable, amounts due under financing agreements, liabilities in excess of assets of discontinued business unit, accrued expenses and stock liability | (395) |
| Deferred revenue other current liabilities | (303) |
| | ----- |
| Net cash used in operating activities | (2,057) |
| | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | |
| Capitalization of software development and purchased intangible assets | (22) |
| Acquisition of property and equipment | (42) |
| | ----- |
| Net cash used in investing activities | (64) |
| | ----- |

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

CASH FLOWS FROM FINANCING ACTIVITIES:

| | |
|---|--------------|
| Net proceeds from issuance of common stock | 2,405 |
| Net proceeds payable through the issuance of common stock | 1,135 |
| Net proceeds from exercise of stock warrants | 250 |
| Net proceeds from exercise of stock options | 90 |
| Borrowings under notes payable and long-term debt | 75 |
| Transfer to restricted cash for long-term debt | (600) |
| Repayments on notes payable and long-term debt | (260) |
| Issuance of deferred stock-based compensation | -- |
| | ----- |
| Net cash provided by financing activities | 3,099 |
| | ----- |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | 978 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 70 |
| | ----- |
| CASH AND CASH EQUIVALENTS | \$ 1,048 |
| | ===== |

SUPPLEMENTAL CASH FLOW INFORMATION:

| | |
|--|-------|
| Interest paid/(received) during the year | \$ 6 |
| Income taxes paid | -- |
| Non-cash investing and financing activities: | |
| Reduction in accounts payable for debt paid in stock | 72 |
| Cancellation of common stock issued in 2001 to offset stock subscription receivable | -- |
| Fair value of stock and warrants issued with debt | 56 |
| Fair value of stock issued for services | 148 |
| Fair value of stock compensation deferred to future periods | 64 |
| Direct costs associated with Equity Line of Credit | 5,693 |
| Net effect of issuance and subsequent cancellation of common stock underlying notes receivable | -- |

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

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

1. BASIS OF PRESENTATION AND NATURE OF BUSINESS OPERATIONS

BASIS OF PRESENTATION

The condensed consolidated financial statements include the financial statements of NeoMedia Technologies, Inc. and its wholly-owned subsidiaries ("NeoMedia" or the "Company"). The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-QSB and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

complete consolidated financial statements. These condensed consolidated financial statements and related notes should be read in conjunction with the Company's Form 10-K for the fiscal year ended December 31, 2002. In the opinion of management, these condensed consolidated financial statements reflect all adjustments which are of a normal recurring nature and which are necessary to present fairly the consolidated financial position of NeoMedia as of September 30, 2003, and the results of operations and cashflows for the three-month and nine-month periods ended September 30, 2003 and 2002. The results of operations for the three-month and nine-month periods ended September 30, 2003 are not necessarily indicative of the results which may be expected for the entire fiscal year. All significant intercompany accounts and transactions have been eliminated in preparation of the condensed consolidated financial statements.

NATURE OF BUSINESS OPERATIONS

The Company is structured and evaluated by its Board of Directors and Management as two distinct business units:

NeoMedia Internet Switching Services (NISS) (formerly named NeoMedia Application Services), and

NeoMedia Consulting and Integration Services (NCIS) (formerly named NeoMedia SI)

NISS (physical world-to-Internet offerings) is the Company's core business and is based in the United States, with development and operating facilities in Fort Myers, Florida. NISS develops and supports the Company's physical world to Internet core technology, including our linking "switch" and our application platforms. NISS also manages the Company's valuable intellectual property portfolio, including the identification and execution of licensing opportunities surrounding the patents.

NCIS (systems integration service offerings) is the original business line upon which the Company was organized. This unit resells client-server equipment and related software, and general and specialized consulting services. Systems integration services also identifies prospects for custom applications based on our products and services. During 2002, this unit expanded its business offerings to include a higher Value-Add called Storage Area Networks (SAN). The operations are based in Lisle, Illinois.

RECLASSIFICATIONS

Certain amounts in the 2002 condensed consolidated financial statements have been reclassified to conform to the 2003 presentation.

RECENT ACCOUNTING PRONOUNCEMENTS

In April 2002, the FASB issued Statement No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." This Statement rescinds FASB Statement No. 4, "Reporting Gains and Losses from Extinguishment of Debt," and an amendment of that Statement, FASB Statement No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements" and FASB Statement No. 44, "Accounting for Intangible Assets of Motor Carriers." This Statement amends FASB Statement No. 13, "Accounting for Leases," to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required accounting for certain lease modifications that

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

have economic effects that are similar to sale-leaseback transactions. NeoMedia has implemented the provision of SFAS No. 145 and has concluded that the adoption does not have a material impact on the Company's financial statements.

In July 2002, the FASB issued SFAS No. 146 "Accounting for Exit or Disposal Activities." The provisions of this statement are effective for disposal activities initiated after December 31, 2002, with early application encouraged. NeoMedia has implemented the provision of SFAS No. 146 and has concluded that the adoption does not have a material impact on the Company's financial statements.

In October 2002, the FASB issued Statement No. 147, "Acquisitions of Certain Financial Institutions—an amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9," which removes acquisitions of financial institutions from the scope of both Statement 72 and Interpretation 9 and requires that those transactions be accounted for in accordance with Statements No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets. In addition, this Statement amends SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, to include in its scope long-term customer-relationship intangible assets of financial institutions such as depositor- and borrower-relationship intangible assets and credit cardholder intangible assets. The requirements relating to acquisitions of financial institutions is effective for acquisitions for which the date of acquisition is on or after October 1, 2002. The provisions related to accounting for the impairment or disposal of certain long-term customer-relationship intangible assets are effective on October 1, 2002. The adoption of this Statement did not have a material impact to the Company's financial position or results of operations as the Company has not engaged in either of these activities.

In December 2002, the FASB issued Statement No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure," which amends FASB Statement No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of Statement 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition guidance and annual disclosure provisions of Statement 148 are effective for fiscal years ending after December 15, 2002, with earlier application permitted in certain circumstances. The interim disclosure provisions are effective for financial reports containing financial statements for interim periods beginning after December 15, 2002. The adoption of this statement did not have a material impact on the Company's financial position or results of operations as the Company has not elected to change to the fair value based method of accounting for stock-based employee compensation.

In November 2002, the FASB issued FASB Interpretation No. 45, "Guarantor's accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" (FIN 45). FIN 45 requires that upon issuance of a guarantee, a guarantor must recognize a liability for the fair value of an obligation assumed under a guarantee. FIN 45 also requires additional disclosures by a guarantor in its interim and annual financial statements about the obligations associated with guarantees issued. The recognition provisions of FIN 45 are effective for any guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The adoption of FIN45 did not have a material effect on the Company's financial position, results of operations, or cash flows.

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities." Interpretation 46 changes the criteria by which one company includes another entity in its consolidated financial statements. Previously, the criteria was based on control through voting interest. Interpretation 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. A company that consolidates a variable interest entity is called the primary beneficiary of that entity. The consolidation requirements of Interpretation 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. The adoption of this statement did not have a material impact to the Company's financial position or results of operations.

During October 2003, the FASB issued Staff Position No. FIN 46, deferring the effective date for applying the provisions of FIN 46 until the end of the first interim or annual period ending after December 31, 2003 if the

7

variable interest was created prior to February 1, 2003 and the public entity has not issued financial statements reporting that variable interest entity in accordance with FIN 46. The FASB also indicated it would be issuing a modification to FIN 46 prior to the end of 2003. Accordingly, the Company has deferred the adoption of FIN 46 with respect to VIEs created prior to February 1, 2003. Management is currently assessing the impact, if any, FIN 46 may have on the Company; however, management does not believe there will be any material impact on its consolidated financial statements, results of operations or liquidity resulting from the adoption of this interpretation.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". This Statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". This Statement amends Statement 133 for decisions made (1) as part of the Derivatives Implementation Group process that effectively required amendments to Statement 133, (2) in connection with other Board projects dealing with financial instruments, and (3) in connection with implementation issues raised in relation to the application of the definition of a derivative, in particular, the meaning of an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, the meaning of underlying, and the characteristics of a derivative that contains financing components. The adoption of this statement did not have a material impact to the Company's financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. Some of the provisions of this Statement are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, Elements of Financial Statements. The remaining provisions of this Statement are consistent with the Board's proposal to revise that definition to encompass certain obligations that a reporting entity can or must settle by issuing its own equity shares, depending on the nature of the relationship established between the holder and the issuer. While the Board still plans to revise that definition through an amendment to Concepts Statement 6, the Board decided to defer issuing that amendment until it has concluded its deliberations on the next phase of this project. That next phase will deal with certain compound financial instruments including puttable shares, convertible bonds, and dual-indexed financial instruments. The adoption of this statement did not have a material impact on the Company's financial position or results of operations.

LOCH ENERGY, INC. ("LOCH")

On March 7, 2003, NeoMedia announced that that it had reached an agreement in principle to acquire and merge with Loch, an oil and gas provider based in Humble, Texas. On October 1, 2003, NeoMedia discovered that the royalty interest from future sales of oil owned by Loch were oversold, which would likely result in materially lower projected available cashflow from Loch's operations. This projected available cashflow was the basis for the proposed acquisition by NeoMedia. On October 2, 2003, NeoMedia's Board of Directors voted to cancel the Memorandum of Terms signed on March 13, 2003, and terminate the acquisition and merger.

EQUITY LINE OF CREDIT WITH CORNELL CAPITAL PARTNERS, LP ("CORNELL")

On February 11, 2003, NeoMedia and Cornell entered into an Equity Line of Credit Agreement under which Cornell agreed to purchase up to \$10 million of NeoMedia's common stock over a two-year period, with the timing and amount of the purchase at the Company's discretion. The maximum amount of each purchase is \$150,000 with a minimum of seven days between purchases. The shares are valued at 98% of the lowest closing bid price during the five-day period following the delivery of a notice of purchase by NeoMedia. The Company pays 5% of the gross proceeds of each purchase to Cornell. On February 14, 2003, the SEC declared effective the S-1 registration statement containing 100 million shares underlying the Equity Line of Credit.

During the nine months ended September 30, 2003, the Company has received gross funding of \$3,597,000 from the sale of stock under the Equity Line of Credit, through the sale of 87,933,244 shares of its common

stock. The following table summarizes funding received from the Equity Line of Credit during the nine months ended September 30, 2003:

| | FIRST QUARTER | SECOND QUARTER | THIRD QUARTER | NINE MONTHS ENDED SEPTEMBER 30 2003 |
|-------|------------------|-------------------|------------------|--|
| ----- | ----- | ----- | ----- | ----- |

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

| | | | | |
|----------------------------------|------------|------------|--------------|-------------|
| Number of shares sold to Cornell | 3,452,373 | 28,411,871 | 56,069,000 | 87,933,24 |
| Gross funds received by NeoMedia | \$ 312,000 | \$ 685,000 | \$ 2,600,000 | \$ 3,597,00 |
| Less: discount and fees* | (28,000) | (50,000) | (226,000) | (304,00 |
| | ----- | ----- | ----- | ----- |
| Net funding received by NeoMedia | \$ 284,000 | \$ 635,000 | \$ 2,374,000 | \$ 3,293,00 |
| | ----- | ----- | ----- | ----- |

* - Includes placement fees, escrow fees, and a 5% reduction in gross proceeds retained by Cornell.

Subsequent to September 30, 2003, the Company sold an additional 12,066,756 shares to Cornell under the Equity Line of Credit, resulting in an additional discount of \$1,172,000.

Funding received from Cornell during the nine months ended September 30, 2003, was in the form of a debt instrument, under which the Company would pay down the principal on the promissory note through the issuance of "puts" of common stock to Cornell over a period of several weeks. Under this structure, the Company also has the option to repay any remaining balances on the advances from operating cash, and cancel all future puts against that promissory note. The Company did not elect to make any cash payments to against advances during 2003.

On September 11, 2003, the Company received an advance from Cornell in the gross amount of \$500,000 before Cornell discounts and fees. As of September 30, 2003, the Company had not issued any shares against this advance to Cornell. Accordingly, the company has recorded the advance balance of \$500,000 in "Cash advances payable through the issuance of common stock" on its condensed consolidated balance sheet as of September 30, 2003. During October 2003, the Company issued 1,066,756 shares to Cornell against this advance, reducing the balance to approximately \$376,000.

On September 29, 2003, the Company received an advance from Cornell in the gross amount of \$1,500,000 before Cornell discounts and fees. As of September 30, 2003, the Company had issued to Cornell 15,000,000 shares against the advance, valued at approximately \$865,000. The Company has recorded the unpaid advance amount of \$635,000 as "Cash advances payable through the issuance of common stock" on the condensed consolidated balance sheet as of September 30, 2003. During October 2003, the Company issued an additional 11,000,000 shares to Cornell to pay off the advance in full.

On October 27, 2003, the Company and Cornell entered into a \$20 million Standby Equity Distribution Agreement. The terms of the agreement are identical to the terms of the previous Equity Line of Credit, except that the maximum "draw" under the new agreement is \$280,000 per week, not to exceed \$840,000 in any 30-day period, and Cornell will purchase up to \$20 million of the Company's common stock. As a consideration fee for Cornell to enter into the agreement, the Company issued 10 million warrants to Cornell with an exercise price of \$0.05 per share, and a term of five years.

OPTION REPRICING

During May 2003, the Company re-priced approximately 8.0 million stock options under a 6-month repricing program. Under the terms of the program, the exercise price for outstanding options under the Company's 2002, 1998, and 1996 Stock Option Plans was restated to \$0.01 per share for a period of 6 months. In accordance with FASB Interpretation, FIN 44, Accounting for Certain Transactions Involving Stock Transactions, the award has been accounted for as variable from

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

May 19, 2003 through the period ended June 30, 2002. Accordingly, the Company recognized approximately \$544,000 and \$710,000 as compensation in general and administrative expense during the three and nine month periods ended September 30, 2003. Approximately 4.4 million options were exercised under the repricing program during the nine months ended September 30, 2003. During September 2003, the deadline for the option repricing was extended to December 31, 2003 by the Stock Option Committee of NeoMedia's Board of Directors.

DISPOSAL OF QODE BUSINESS UNIT

On August 31, 2001, the Company signed a non-binding letter of intent to sell the assets and liabilities of its former Ft. Lauderdale-based Qode business unit, which it acquired in March 2001, to The Finx Group, Inc., a holding company based in Elmsford, NY. The Finx Group was to assume \$620,000 in Qode payables and \$800,000 in long-term leases in exchange for the issuance of 500,000 shares of the Finx Group, right to use and sell Qode services, and up to \$5 million in affiliate revenues over the next five years. During the third and fourth quarters of 2001 and the first quarter of 2002, the company recorded a \$2.6 million expense from the write-down of the Qode assets/liabilities to net realizable value.

During June 2002, the Finx Group notified the Company that it did not intend to carry out the letter of intent due to capital constraints. As a result, during the three-month period ended June 30, 2002, the Company recorded an additional expense of \$1.5 million for the write-off of remaining Qode assets. As of September 30, 2003, the Company had approximately \$996,000 of liabilities relating to the Qode system remaining on its books.

OTHER EVENTS

On March 13, 2003, the Company repaid the remaining balance of \$85,000 on a note due to Michael Kesselbrenner, a private investor. The original note had been issued in the amount of \$165,000 on December 2, 2002, with a term of 150 days. In connection with the default provision of the note, the Company entered into a Pledge Agreement, dated December 2, 2002, under which the Company issued 53,620,020 shares of common

9

stock to an unrelated third party as collateral for the note. The note balance of \$85,000 was paid off on March 13, 2003, and the 53,620,020 shares were returned to the Company on April 4, 2003 and retired.

On April 2, 2003, the Company was issued its sixth US Patent. The technology covered by the patent allows for a connection from human-or machine-readable input to generate a tailored response that can utilize a profile of the person making the link between the code-carrying physical object and the desired electronic information.

On April 17, 2003, the Board of Directors of the Company approved the payment in full of approximately \$154,000 of liabilities owed by the Company to Charles W. Fritz, the Company's Founder and Chairman of the Board of Directors, through the issuance of 15,445,967 shares of common stock. The Company recognized a discount expense in general and administrative expenses of approximately \$15,000 relating to this transaction with Mr. Fritz.

On April 21, 2003, the Company sold 25,000,000 shares of its common stock, par value \$0.01, in a private placement at a price of \$0.01 per share. In connection with the sale, the Company also granted the purchaser 25,000,000

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

warrants to purchase shares of the Company's common stock at an exercise price of \$0.01 per share. The warrants had a fair value of \$298,000 and have been recorded as a cost of issuance. The purchaser was William E. Fritz, a member of the Company's Board of Directors. Proceeds to the Company from sale of the shares were \$250,000. The Company recognized a discount expense in general and administrative expenses of approximately \$50,000 relating to this transaction with Mr. Fritz. On August 6, 2003, Mr. Fritz exercised his warrants and purchased 25,000,000 additional shares of common stock at a price of \$0.01 per share.

During April 2003, the Company repriced approximately 1.9 million warrants held by Thornhill Capital LLC ("Thornhill"), an outside consultant to the Company. Of the 1.9 million warrants, 1.5 million had an exercise price of \$0.05 per share, and approximately 0.4 million had an exercise price of \$2.09 per share. All 1.9 million warrants were repriced to \$0.00 per share. The Company recognized an expense of approximately \$27,000 related to this transaction during the second quarter of 2003. These warrants were exercised immediately after the repricing.

During April 2003, the Company entered into a consulting agreement with William Fritz, an outside director, for consulting and advisement services relating to the merger with Loch Energy, Inc., and to the subsequent implementation of various management programs surrounding the business. The agreement calls for total payments of \$250,000 over a period of one year. During August 2003, the Company paid the consulting contract in full. During September 2003, the consulting contract was rescinded and the full \$250,000 was returned to us.

On July 9, 2003, the Company borrowed \$25,000 from William E. Fritz, one of its outside directors. This amount was added to the principal of a \$10,000 note payable to Mr. Fritz that matures in April 2004, with all other terms of the note remaining the same. As consideration for the loan, the Company granted Mr. Fritz 2,500,000 warrants to purchase shares of the Company's common stock at an exercise price of \$0.01 per share. The warrants had a fair value of approximately \$74,000. In accordance with EITF 00-27, the Company recorded the relative fair value of the warrants as a discount against the note, and is amortizing the discount over the life of the note.

On July 16, 2003, the Company's Board of Directors voted to authorize the issuance of approximately 34.4 million stock options to employees, contingent upon the passage at the Company's annual meeting on September 24, 2003, of a proposal to adopt a 2003 Stock Option Plan, under which 150 million options would be allocated for future issuance. The Company expensed approximately \$624,000 related to the issuance of these options during the quarter ended September 30, 2003. The 2003 Stock Option Plan was approved by NeoMedia's shareholders. Subsequent to September 30, 2003, the Company issued the 34.4 million options.

On July 21, 2003, the Company entered into a consulting agreement with an unrelated party under which the Company paid the consultant 3.6 million shares of the Company's common stock for services to be performed over a period of one year. The Company recorded expense of \$19,000 and the remaining \$81,000 was recorded as deferred compensation.

On July 28, 2003, the Company signed a binding letter of intent to purchase Secure Source Technologies ("SST"), a provider of security solutions and covert security technology for the manufacturing and financial

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

services industries, in exchange for 3.5 million shares of the Company's common stock. On October 8, 2003, the merger was completed, and the Company issued 3.5 million shares to the stockholders of SST. With the purchase of SST, the Company acquired eight additional patents that compliment its existing intellectual property portfolio.

On August 29, 2003, the Company borrowed \$50,000 from William E. Fritz, one of its outside directors, under an unsecured note payable. The note was paid in full during September 2003.

On September 3, 2003, the Company issued 10 million warrants to an unrelated consultant for professional services rendered in the third and fourth quarter of 2003. The warrants have an exercise price of \$0.01 and a term of five years. Services provided by the consultant include capital-raising services in the third quarter of 2003, advisory services relating to our Standby Equity Distribution Agreement with Cornell Capital Partners, and merger and acquisition advisement provided during the third and fourth quarters of 2003. The Company recorded approximately \$19,000 as expense, \$74,000 as deferred compensation, and \$47,000 as cost of raising capital against additional paid in capital.

On September 24, 2003, the Company's shareholders voted to (i) increase the number of shares of common stock, par value \$0.01 per share, that the Company is authorized to issue from 200,000,000 to 1,000,000,000; and (ii) implement the 2003 Stock Option Plan, under which the Company is authorized to grant to employees, directors, and consultants up to 150,000,000 options to purchase shares of its common stock.

On September 29, 2003, the Company transferred \$600,000 to an escrow account to be used to pay principal and interest relating to its note payable to AirClic, Inc. ("AirClic") which is subject to a lawsuit between the Company and AirClic (see "Legal Proceedings"). On October 3, 2003, NeoMedia paid AirClic the principal plus interest in the approximate amount of \$610,000. On November 3, 2003, NeoMedia reached a settlement agreement with AirClic which will end the suit. The parties are currently drafting the release document and expect the suit to be dismissed by the end of November 2003.

On September 30, 2003, the Company received requests from the SEC's Southeast Regional Office for certain documents including those concerning negotiations and arrangements with certain strategic partners and consultants, patents, recent issuances of securities, investor relations, and the stock ownership by the Company's officers and directors. The Company responded promptly and fully and will cooperate with any further requests. The SEC's letter states that the staff's inquiry is informal and should not be construed as an indication of any violation of law or as a reflection on any person, entity, or security.

PRO-FORMA INFORMATION REQUIRED BY SFAS 148

At September 30, 2003, the Company has four stock-based employee compensation plans (the 2003 Stock Option Plan, the 2002 Stock Option Plan, the 1998 Stock Option Plan, and the 1996 Stock Option Plan). The Company accounts for those plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock-based employee compensation cost is reflected in net loss, except when options granted under those plans had an exercise price less than the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss and loss per share if the company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

| | THREE MONTHS ENDED SEPTEMBER 30, | | NINE MONTHS ENDED SEPTEMBER 30, | |
|--|-------------------------------------|-----------|------------------------------------|-----------|
| | 2003 | 2002 | 2003 | 2002 |
| Net Loss, as reported | (\$2,205) | (\$ 773) | (\$4,060) | (\$6,502) |
| Compensation recognized under APB 25 | 623 | -- | 623 | -- |
| Compensation recognized under SFAS 123 | (925) | (313) | (1,361) | (629) |
| Pro-forma net loss | (\$2,507) | (\$1,086) | (\$4,798) | (\$7,131) |
| Net Loss per share: | | | | |
| Basic and diluted - as reported | (\$ 0.01) | (\$ 0.03) | (\$ 0.05) | (\$ 0.31) |
| Basic and diluted - pro-forma | (\$ 0.02) | (\$ 0.05) | (\$ 0.05) | (\$ 0.34) |

SEGMENT REPORTING

The Company is structured and evaluated by its Board of Directors and Management as two distinct business units:

NeoMedia Internet Switching Services (NISS), is based in the United States, with development and operating facilities in Fort Myers, Florida. NISS develops and supports the Company's physical world to Internet core technology, including our linking "switch" and our application platforms. NISS also manages the Company's valuable intellectual property portfolio, including the identification and execution of licensing opportunities surrounding the patents.

NeoMedia Consulting and Integration Services (NCIS) is the Company's systems integration business unit. This unit resells client-server equipment and related software, and general and specialized consulting services. NCIS also identifies prospects for custom applications based on NeoMedia's products and services. This unit recently added to its business offerings a much higher Value-Add called Storage Area Networks (SAN). The operations are based in Lisle, Illinois.

The Company's reportable segments are strategic business units that offer different technology and marketing strategies. The Company's areas of operations are principally in the United States. No single foreign country or geographic area is significant to the consolidated financial statements

Consolidated net sales, net operating losses for the nine months ended September 30, 2003 and 2002, and identifiable assets as of September 30, 2003, were as follows:

(in thousands)

| THREE MONTHS ENDED SEPTEMBER 30, | | NINE MONTHS ENDED SEPTEMBER 30, | |
|-------------------------------------|------|------------------------------------|------|
| 2003 | 2002 | 2003 | 2002 |

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

NET SALES:

| | | | | |
|--|--------|----------|----------|----------|
| NeoMedia Consulting & Integration Services | \$ 448 | \$ 3,391 | \$ 1,971 | \$ 8,424 |
| NeoMedia Internet Switching Service | 13 | 13 | 38 | 28 |
| | ----- | ----- | ----- | ----- |
| | \$ 461 | \$ 3,404 | \$ 2,009 | \$ 8,452 |
| | ----- | ----- | ----- | ----- |

NET LOSS:

| | | | | |
|--|-----------|----------|-----------|-----------|
| NeoMedia Consulting & Integration Services | (\$1,855) | (\$ 338) | (\$3,310) | (\$ 546) |
| NeoMedia Internet Switching Service | (350) | (435) | (750) | (5,956) |
| | ----- | ----- | ----- | ----- |
| | (\$2,205) | (\$ 773) | (\$4,060) | (\$6,502) |
| | ----- | ----- | ----- | ----- |

| | |
|--|--------------------------------|
| | AS OF SEPTEMBER 30, 2003 |
| IDENTIFIABLE ASSETS | |
| NeoMedia Consulting & Integration Services | \$ 603 |
| NeoMedia Internet Switching Service | 2,115 |
| Corporate | 2,523 |
| | ----- |
| | \$ 5,241 |
| | ----- |

11

SUBSEQUENT EVENTS

On October 8, 2003, the Company completed its acquisition of Secure Source Technologies, Inc., a provider of security solutions and covert security technology for the manufacturing and financial services industries, for 3.5 million shares of NeoMedia common stock. With the purchase of SST, the Company acquired eight additional patents that compliment its existing intellectual property portfolio.

On October 20, 2003, the Company entered into a consulting agreement with an unrelated third party to provide services related to the implementation of the Company's PaperClick for Camera Cell Phone business plan in Europe over a 12-month period. The consultant was paid 1,000,000 options with an exercise price of \$0.01 per share and a term of three years.

On October 20, 2003, the Company entered into a consulting agreement with an unrelated third party to provide services related to the implementation of the Company's domestic business plan relating to PaperClick patent business plan over a 12-month period. The consultant was paid 500,000 options with an exercise price of \$0.01 per share and a term of three years.

On October 27, 2003, The Company entered into a Standby Equity Distribution Agreement with Cornell Capital Partners, LP. Pursuant to the Standby Equity Distribution Agreement, the Company may, at its discretion, periodically sell to Cornell shares of common stock for a total purchase price of up to \$20 million. For each share of common stock purchased under the Standby Equity Distribution Agreement, Cornell Capital Partners will pay 98% of the lowest closing bid price of the Company's common stock on the OTC Bulletin Board or other principal market on which our common stock is traded for the 5 trading

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

days immediately following the notice date. The amount of each advance is subject to a maximum of \$280,000 per week, not to exceed \$840,000 in any 30-day period, with a minimum of 6 trading days between advances. As a consideration fee for Cornell to enter into the agreement, the Company issued 10 million warrants to Cornell with an exercise price of \$0.05 per share, and a term of five years. On November 7, 2003 the Company filed a Registration Statement on Form SB-2 to register the sale of up to 200,000,000 shares under the Standby Equity Distribution Agreement, as well as the 10,000,000 warrants issued to Cornell Capital Partners.

Effective October 31, 2003, NeoMedia adopted the 2003 Stock Incentive Plan. Under the terms of the Plan, 30,000,000 shares of common stock are initially authorized to be issued to pay compensation and other expenses related to employees, former employees, consultants, and non-employee directors. On November 3, 2003, NeoMedia filed a Form S-8 to register all 30,000,000 shares under the 2003 Stock Incentive Plan.

On November 10, 2003, the Company announced that that it has signed a non-binding letter of intent to acquire and merge with CSI International, Inc. ("CSI"), of Calgary, Alberta, Canada, a private technology products company and worldwide leader in the micro paint repair industry. The LOI calls for the issuance of 7,000,000 shares of the Company's common stock to be issued in exchange for all outstanding shares of CSI. In addition, the Company will pay \$3.5 million cash. The merger is subject to completion of due diligence by both sides.

CRITICAL ACCOUNTING POLICIES

The U.S. Securities and Exchange Commission ("SEC") recently issued Financial Reporting Release No. 60, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies" ("FRR 60"), suggesting companies provide additional disclosure and commentary on their most critical accounting policies. In FRR 60, the SEC defined the most critical accounting policies as the ones that are most important to the portrayal of a company's financial condition and operating results, and require management to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, our most critical accounting policies include: stock-based compensation; and the valuation of intangibles, which affects our amortization and write-offs of goodwill and other intangibles. The Company also has other key accounting policies, such as our policies for revenue recognition, including the deferral of a portion of revenues on sales to distributors, and allowance for bad debt. The methods, estimates and judgments the Company uses in applying these most critical accounting policies have a significant impact on the results the Company reports in our financial statements.

INTANGIBLE ASSET VALUATION. The determination of the fair value of certain acquired assets and liabilities is subjective in nature and often involves the use of significant estimates and assumptions. Determining the fair values and useful lives of intangible assets especially requires the exercise of judgment. While there are a

number of different generally accepted valuation methods to estimate the value of intangible assets acquired, the Company primarily uses the weighted-average probability method outlined in SFAS 144. This method requires significant management judgment to forecast the future operating results used in the

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

analysis. In addition, other significant estimates are required such as residual growth rates and discount factors. The estimates the Company has used are consistent with the plans and estimates that the Company uses to manage its business, based on available historical information and industry averages. The judgments made in determining the estimated useful lives assigned to each class of assets acquired can also significantly affect our net operating results.

STOCK-BASED COMPENSATION. The Company records stock-based compensation to outside consultants at fair market value in general and administrative expense. The Company does not record expense relating to stock options granted to employees with an exercise price greater than or equal to market price at the time of grant. The Company reports pro-forma net loss and loss per share in accordance with the requirements of SFAS 148 (see above). This disclosure shows net loss and loss per share as if the Company had accounted for its employee stock options under the fair value method of those statements. Pro-forma information is calculated using the Black-Scholes pricing method at the date of grant. This option valuation model requires input of highly subjective assumptions. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing model does not necessarily provide a reliable single measure of fair value of its employee stock options.

REVENUE RECOGNITION. We derive revenues from two primary sources: (1) license revenues and (2) resale of software and technology equipment and service fee revenues.

License fees, including Intellectual Property license, represent revenue from the licensing of NeoMedia's proprietary software tools and applications products. NeoMedia licenses its development tools and application products pursuant to non-exclusive and non-transferable license agreements. Resales of software and technology equipment represent revenue from the resale of purchased third party hardware and software products and from consulting, education, maintenance and post contract customer support services.

The basis for license fee revenue recognition is substantially governed by American Institute of Certified Public Accountants ("AICPA") Statement of Position 97-2 "Software Revenue Recognition" ("SOP 97-2"), as amended. License revenue is recognized if persuasive evidence of an agreement exists, delivery has occurred, pricing is fixed and determinable, and collectibility is probable.

Revenue for resale of software and technology equipment and service fee is recognized based on guidance provided in Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," as amended (SAB 101). Software and technology equipment resale revenue is recognized when all of the components necessary to run software or hardware have been shipped. Service revenues include maintenance fees for providing system updates for software products, user documentation and technical support and are recognized over the life of the contract. Software license revenue from long-term contracts has been recognized on a percentage of completion basis, along with the associated services being provided. Other service revenues, including training and consulting, are recognized as the services are performed. The Company uses stand-alone pricing to determine an element's vendor specific objective evidence (VSOE) in order to allocate an arrangement fee amongst various pieces of a multi-element contract. NeoMedia records an allowance for uncollectible accounts on a customer-by-customer basis as appropriate.

INTANGIBLE ASSETS

At the end of each quarter, or upon occurrence of material events relating

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

to a specific intangible item, the Company performs impairment tests on each of its intangible assets, which include capitalized patent costs, and capitalized and purchased software costs. In doing so, the Company evaluates the carrying value of each intangible asset with respect to several factors, including historical revenue generated from each intangible asset, application of the assets in our current business plan, and projected revenue to be derived from the asset. Intangible asset balances are then adjusted to their current net realizable value based on these criteria if impaired. No impairment charges were taken during the three-month or nine-month periods ended September 30, 2003. During the nine months ended September 30, 2002, the Company recognized an impairment charge of \$1.0 million relating to its PaperClick software product.

13

FINANCING AGREEMENTS

As of September 30, 2003, the Company was party to a commercial financing agreement with GE Access that provides short-term financing for certain computer hardware and software purchases. This arrangement allows the Company to re-sell high-dollar technology equipment and software without committing cash resources to financing the purchase. The Company and GE Access are currently operating under an additional arrangement under which GE Access retains 50% of the Company's proceeds from sales financed by GE Access, and applies the portion of proceeds toward past due balances. This arrangement reduces by half the Company's cash flow from resales of equipment and software financed by GE Access, until the balance owed to GE Access is paid in full. During October 2003, the Company and GE entered into an additional agreement under which the Company also makes regular payment against its past due balances. Termination of the Company's financing relationship with GE Access could have a material adverse effect the Company's financial condition. Management expects the agreement to remain in place in the near future. As of September 30, 2003, the amount payable under this financing arrangement was approximately \$345,000.

OTHER DEBTS

On December 2, 2002, the Company issued to Michael Kesselbrenner, a private investor, a promissory note in the principal amount of \$165,000, bearing interest at a rate of 12% per annum, with a maturity of 150 days. In connection with the default provision of the promissory note, the Company entered into a pledge agreement, dated December 2, 2002, under which the Company issued 53,620,020 shares of common stock to an unrelated third party as collateral for the Promissory Note. The investor only funded \$84,000 of the principal amount of the note. The Company repaid this note during March 2003, and the shares held in escrow were returned during April 2003. The Company has no further obligation under this note.

During November 2002, NeoMedia issued Convertible Secured Promissory Notes with an aggregate face value of \$60,000 to 3 separate parties, including Charles W. Fritz, Chairman of the Board of Directors of NeoMedia; William E. Fritz, an outside director; and James J. Keil, an outside director. The notes bear interest at a rate of 15% per annum, and matured at the earlier of i.) four months, or ii.) the date the shares underlying the Cornell Equity Line of Credit were registered with the SEC. The notes were convertible, at the option of the holder, into either cash or shares of our common stock at a 30% discount to either market price upon closing, or upon conversion, whichever is lower. NeoMedia also granted to the holders an additional 1,355,670 shares of its common stock and 60,000 warrants to purchase shares of its common stock at \$0.03 per share, with a term of three years. The warrants and shares were issued in

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

January 2003. In addition, since this debt is convertible into equity at the option of the note holder at beneficial conversion rates, an embedded beneficial conversion feature was recorded as a debt discount and amortized using the effective interest rate over the life of the debt in accordance with EITF 00-27. Total cost of beneficial conversion feature, fair value of the stock and cost of warrants issued exceed the face value of the notes payable, therefore, only \$60,000, the face amount of the note, was recognizable as debt discount, and amortized over the life of the notes payable. During March 2003, two of the affiliated parties, Mr. William Fritz and Mr. Keil, agreed to extend the maturity date due to the Company's capital constraints. The Company repaid Charles Fritz's note in full during March 2003, and repaid James J. Keil's note in full during April 2003. The Company paid \$30,000 of the principal on William Fritz's note during April 2003, and entered into a new note with Mr. Fritz for the remaining \$10,000. The new note bears interest at a rate of 10% per annum and matures in April 2004. The new note also includes a provision under which, as consideration for the loan, Mr. Fritz will receive a 3% royalty on all future revenue generated from the Company's intellectual property.

GOING CONCERN

The accompanying condensed consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Through September 30, 2003, the Company has not been able to generate sufficient revenues from its operations to cover its costs and operating expenses. Although the Company has been able to issue its common stock or other financing for a significant portion of its expenses, it is not known whether NeoMedia will be able to continue this practice, or if its revenue will increase significantly to be able to meet its cash

14

operating expenses. This, in turn, raises substantial doubt about the Company's ability to continue as a going concern. Management believes that the Company will be able to raise additional funds through its Standby Equity Distribution Agreement with Cornell. However, there can be no assurances that the market for the Company's stock will support the sale of sufficient shares of NeoMedia's stock to raise sufficient capital to sustain operations. The condensed consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

15

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Over the past several years, NeoMedia Technologies, Inc.'s ("NeoMedia") focus has been aimed toward the intellectual property commercialization unit of its Internet Switching Systems (NISS, formerly NAS) business. NISS consists of

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

the patented PaperClick™ technology that enables users to link directly from the physical to the digital world, as well as the patents surrounding certain physical-world-to-web linking processes. NeoMedia's mission is to invent, develop, and commercialize technologies and products that effectively leverage the integration of the physical and electronic to provide clear functional value for NeoMedia's end-users, competitive advantage for their business partners and return-on-investment for their investors. To this end, NeoMedia has signed four intellectual property licenses since its inception, and also recently acquired eight additional patents as part of its acquisition of Secure Source Technologies, Inc. On September 8, 2003, NeoMedia announced its PaperClick for Camera Cell Phones product, which reads and decodes UPC/EAN or other bar codes to link users to the Internet, providing information and enabling e-commerce on a compatible camera cell phone, such as the Nokia 3650 model. On October 30, 2003, NeoMedia unveiled its go-to-market strategy for the product. NeoMedia has already established relationships with several key partners outlined in the strategy, including agents Big Gig Strategies and SRP Consulting, European advertising agency 12Snap, and worldwide brand communication company Seven.

NeoMedia's quarterly operating results have been subject to variation and will continue to be subject to variation, depending upon factors, such as the mix of business among NeoMedia's services and products, the cost of material, labor and technology, particularly in connection with the delivery of business services, the costs associated with initiating new contracts, the economic condition of NeoMedia's target markets, and the cost of acquiring and integrating new businesses.

RESULTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2003 AS COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2002

NET SALES. Total net sales for the three months ended September 30, 2003 were \$461,000, which represented a \$2,943,000, or 86%, decrease from \$3,404,000 for the three months ended September 30, 2002. This decrease primarily resulted from reduced resales of Sun Microsystems equipment due to increased competition and general economic conditions. NeoMedia intends to continue to pursue additional resales of equipment, software and services, and to the extent that such sales can be made, NeoMedia expects resales to more closely resemble the results for the three months ended September 30, 2003, rather than the three months ended September 30, 2002.

LICENSE FEES. License fees were \$69,000 for the three months ended September 30, 2003, compared with \$150,000, for the three months ended September 30, 2002, a decrease of \$81,000, or 54%. NeoMedia will continue to attempt to increase license sales. NeoMedia expects license fees to remain materially constant over the next 12 months.

RESALES OF SOFTWARE AND TECHNOLOGY EQUIPMENT AND SERVICE FEES. Resales of software and technology equipment and service fees decreased by \$2,862,000, or 88%, to \$392,000 for the three months ended September 30, 2003, as compared to \$3,254,000 for the three months ended September 30, 2002. This decrease primarily resulted from increased competition and general economic conditions. NeoMedia intends to continue to pursue additional resales of equipment, software and services, and to the extent that such sales can be made, NeoMedia expects resales to more closely resemble the results for the three months ended September 30, 2003, rather than the three months ended September 30, 2002.

COST OF SALES. Cost of license fees was \$76,000 for the three months ended September 30, 2003, a decrease of \$4,000, or 0.5%, compared with \$80,000 for the three months ended September 30, 2002. The decrease is consistent with 2003 and NeoMedia expects license fees will not fluctuate materially over the next 12 months. Cost of resales was \$378,000 for the three months ended September 30, 2003, a decrease of \$2,364,000, or 86%, compared with \$2,742,000 for the three months ended September 30, 2002. The decrease resulted from decreased resales

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

for the three months ended September 30, 2003 compared with the same period in 2002. Cost of resales as a percentage of related resales was 96% in 2003, compared to 84% in 2002. This increase is due to an increased sales mix of lower-margin equipment products sold in 2003 compared to 2002, combined with the general erosion

16

of margins in the resale sector. NeoMedia expects costs of resales to fluctuate with the sales of its equipment, software, and services over the next 12 months.

GROSS PROFIT. Gross profit was \$7,000 for the three months ended September 30, 2003, compared with \$582,000 for the three months ended September 30, 2002. This decrease of \$575,000, or 99%, was the result of lower resales of, and lower margins on, computer equipment, software, and services in 2003 relative to 2002.

SALES AND MARKETING. Sales and marketing expenses were \$146,000 for the three months ended September 30, 2003, a decrease of \$61,000, or 29%, compared with \$207,000 for the three months ended September 30, 2002. This decrease resulted primarily from reduced sales commissions earned on lower sales in 2003 as compared with 2002, as well as a smaller sales force in 2003. NeoMedia expects sales and marketing expense to fluctuate with sales of its proprietary and resold products over the next 12 months.

GENERAL AND ADMINISTRATIVE. General and administrative expenses increased by \$944,000, or 95%, to \$1,940,000 for the three months ended September 30, 2003, compared to \$996,000 for the three months ended September 30, 2002. The increase resulted primarily from non-cash expenses relating to the Company's option repricing program, expense for stock options issued with exercise prices below market price, and stock-based professional service expense. NeoMedia expects general and administrative expense to remain materially constant over the next 12 months.

RESEARCH AND DEVELOPMENT. During the three months ended September 30, 2003, NeoMedia charged to expense \$78,000 of research and development costs, a decrease of \$72,000 or 48% compared to \$150,000 charged to expense for the three months ended September 30, 2002. The decrease is primarily due to a continued reduction in research and development overhead since the first quarter of 2002. NeoMedia expects research and development costs will not fluctuate materially over the next 12 months.

(GAIN) LOSS ON EXTINGUISHMENT OF DEBT. During the three months ended September 30, 2003, the Company recognized a net loss from extinguishment of debt of \$24,000 due to the difference between the cash or market value of stock issued to settle debt and the carrying value of the debt at the time of settlement.

INTEREST EXPENSE/(INCOME), NET. Interest expense/(income) consists primarily of interest accrued for creditors as part of financed purchases, past due balances, notes payable and interest earned on cash equivalent investments. Interest expense/(income) increased by \$22,000 to \$24,000 for the three months ended September 30, 2003 from \$2,000 for the three months ended September 30, 2002, due to interest expense during the third quarter of 2003 associated with notes payable and past due trade accounts payable.

NET LOSS. The net loss for the three months ended September 30, 2003 was \$2,205,000, which represented a \$1,432,000, or 185% increase from a loss of \$773,000 for the three months ended September 30, 2002. The increase resulted

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

primarily from non-cash expenses in 2003 relating to the company's option repricing program, expense for stock options issued with exercise prices below market price, and stock-based professional service expense, as well as lower sales and gross profit in 2003 compared to 2002.

RESULTS OF OPERATIONS FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2003 AS COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2002

NET SALES. Total net sales for the nine months ended September 30, 2003 were \$2,009,000, which represented a \$6,443,000, or 76%, decrease from \$8,452,000 for the nine months ended September 30, 2002. This decrease primarily resulted from reduced resales of Sun Microsystems equipment due to increased competition and general economic conditions. NeoMedia intends to continue to pursue additional resales of equipment, software and services, and to the extent that such sales can be made, NeoMedia expects resales to more closely resemble the results for the nine months ended September 30, 2003, rather than the nine months ended September 30, 2002.

LICENSE FEES. License fees were \$338,000 for the nine months ended September 30, 2003, compared with \$303,000, for the nine months ended September 30, 2002, an increase of \$35,000, or 12%. NeoMedia will continue to attempt to increase sales of these high-margin products. NeoMedia expects license fees to remain materially constant over the next 12 months.

17

RESALES OF SOFTWARE AND TECHNOLOGY EQUIPMENT AND SERVICE FEES. Resales of software and technology equipment and service fees decreased by \$6,478,000, or 79%, to \$1,671,000 for the nine months ended September 30, 2003, as compared to \$8,149,000 for the nine months ended September 30, 2002. This decrease primarily resulted from increased competition and general economic conditions. NeoMedia intends to continue to pursue additional resales of equipment, software and services, and to the extent that such sales can be made, NeoMedia expects resales to more closely resemble the results for the nine months ended September 30, 2003, rather than the nine months ended September 30, 2002.

COST OF SALES. Cost of license fees was \$227,000 for the nine months ended September 30, 2003, a decrease of \$537,000, or 70%, compared with \$764,000 for the nine months ended September 30, 2002. The decrease resulted from reduced amortization expense in 2003 of capitalized development costs relating to the PaperClick, MLM/Affinity, and Qode products that were written off during 2002. Cost of resales was \$1,566,000 for the nine months ended September 30, 2003, a decrease of \$5,041,000, or 76%, compared with \$6,607,000 for the nine months ended September 30, 2002. The decrease resulted from decreased resales in 2003 compared with 2002. Cost of resales as a percentage of related resales was 94% for the nine months ended September 30, 2003, compared to 82% for the same period in 2002. This increase is due to an increased sales mix of lower-margin equipment products sold in 2003 compared to 2002, combined with the general erosion of margins in the resale sector. NeoMedia expects costs of resales to fluctuate with the sales of its equipment, software, and services over the next 12 months.

GROSS PROFIT. Gross profit was \$216,000 for the nine months ended September 30, 2003, compared with \$1,081,000 for the nine months ended September 30, 2002. This decrease of \$865,000, or 80%, was primarily the result of lower resales of, and lower margin on, computer equipment, software, and services in 2003 relative to 2002.

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

SALES AND MARKETING. Sales and marketing expenses were \$407,000 for the nine months ended September 30, 2003, a decrease of \$312,000, or 43%, compared with \$719,000 for the nine months ended September 30, 2002. This decrease resulted primarily from reduced sales commissions earned on lower sales in 2003 as compared with 2002, as well as a smaller sales force in 2003. NeoMedia expects sales and marketing expense to fluctuate with sales of its proprietary and resold products over the next 12 months.

GENERAL AND ADMINISTRATIVE. General and administrative expenses decreased by \$147,000, or 4%, to \$3,409,000 for the nine months ended September 30, 2003, compared to \$3,556,000 for the nine months ended September 30, 2002. The increase resulted primarily from non-cash expenses relating to the company's option repricing program, expense for stock options issued with exercise prices below market price, and stock-based professional service expense. NeoMedia expects general and administrative expense to remain materially constant over the next 12 months.

RESEARCH AND DEVELOPMENT. During the nine months ended September 30, 2003, NeoMedia charged to expense \$243,000 of research and development costs, a decrease of \$440,000 or 64% compared to \$683,000 charged to expense for the nine months ended September 30, 2002. The decrease is primarily due to a continued reduction in research and development overhead since first quarter 2002. NeoMedia expects research and development costs will not fluctuate materially over the next 12 months.

LOSS ON IMPAIRMENT OF ASSETS. During the nine months ended September 30, 2002, NeoMedia recognized a loss on impairment of assets of \$1,003,000 for the write-off capitalized development costs relating to its PaperClick physical-world-to-internet software. NeoMedia did not take an impairment charge during the nine months ended September 30, 2003.

(GAIN) LOSS ON EXTINGUISHMENT OF DEBT. During the three months ended September 30, 2003, the Company recognized a net loss from extinguishment of debt of \$24,000, due to the difference between the cash or market value of stock issued to settle debt and the carrying value of the debt at the time of settlement.

INTEREST EXPENSE (INCOME), NET. Interest expense/(income) consists primarily of interest accrued for creditors as part of financed purchases, past due balances, notes payable and interest earned on cash equivalent investments. Interest expense/(income) increased by \$94,000, or 95%, to \$193,000 for the nine months ended September 30, 2003 from \$99,000 for the nine months ended September 30, 2002, due to interest expense during the third quarter of 2003 associated with notes payable and past due trade accounts payable.

18

LOSS ON DISPOSAL OF DISCONTINUED BUSINESS UNIT. During the nine months ended September 30, 2002, the Company recognized a loss on disposal of discontinued business unit of \$1,523,000 to write off the remaining Qode-related assets. No disposal loss was recognized in 2003.

NET LOSS. The net loss for the nine months ended September 30, 2003 was \$4,060,000, which represented a \$2,442,000, or 38% decrease from a loss of \$6,502,000 for the nine months ended September 30, 2002. The decrease resulted primarily from an impairment charge of \$1,003,000 relating to NeoMedia's PaperClick assets and a loss on disposal of the Company's Qode business unit of \$1,523,000 in 2002. The decrease was offset by higher non-cash expenses in 2003

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

relating to the company's option repricing program, expense for stock options issued with exercise prices below market price, and stock-based professional service expense, as well as lower sales and gross profit in 2003 compared to 2002.

LIQUIDITY AND CAPITAL RESOURCES

The accompanying unaudited financial statements have been prepared assuming NeoMedia will continue as a going concern. Accordingly, the financial statements do not include any adjustments that might result from NeoMedia's inability to continue as a going concern. NeoMedia may obtain up to \$20 million over the next two years through its Standby Equity Distribution Agreement with Cornell Capital Partners LP. As of October 31, 2003, NeoMedia had obtained gross funding of \$3.6 million under its previous Equity Line of Credit Agreement with Cornell Capital Partners. Management believes that this additional financing will be sufficient to sustain operations through December 31, 2003, however, there can be no assurances that the market for NeoMedia's stock will support the sale of sufficient shares of NeoMedia's common stock to raise sufficient capital to sustain operations beyond that date. If necessary funds are not available, NeoMedia's business and operations would be materially adversely affected and in such event, NeoMedia would attempt to reduce costs and adjust its business plan.

Net cash used in operating activities was approximately \$2,057,000 for the nine-month period ended September 30, 2003, compared with \$589,000 for the nine-month period ended September 30, 2002. During the nine months ended September 30, 2003, trade accounts receivable inclusive of costs in excess of billings decreased \$149,000, while accounts payable, amounts due under financing arrangements, accrued expenses, and deferred revenue decreased \$698,000. During the nine months ended September 30, 2002, trade accounts receivable increased \$610,000, while accounts payable, amounts due under financing arrangements, accrued expenses, and deferred revenue increased \$2,067,000. NeoMedia's net cash flow from/(used in) investing activities for the nine months ended September 30, 2003 and 2002, was (\$64,000) and (\$24,000), respectively. Net cash provided by financing activities for the nine months ended September 30, 2003 and 2002, was \$3,099,000 and \$488,000, respectively.

During the nine months ended September 30, 2003 and 2002 NeoMedia's net loss totaled approximately \$4,060,000 and \$6,502,000, respectively. As of September 30, 2003 NeoMedia had accumulated losses from operations of approximately \$74,825,000, had a working capital deficit of approximately \$8,134,000, and approximately \$1,048,000 in cash balances. As of September 30, 2003, the Company also had \$600,000 of restricted cash that was used in October to pay off the majority of the AirClic promissory note and accrued interest (see "Legal Proceedings").

Management believes it will need to have access to capital from the Cornell Standby Equity Distribution Agreement or other financing sources, or NeoMedia will need to generate additional cash from its current operations to sustain NeoMedia's operations in the fourth quarter of 2003. The failure of management to accomplish these initiatives will adversely affect NeoMedia's business, financial conditions, and results of operations and its ability to continue as a going concern.

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES. NeoMedia's chief executive officer and chief financial officer, after evaluating the effectiveness of NeoMedia's "disclosure controls and procedures" (as defined in Sections 13a-14(c) of the Securities Exchange Act of 1934) as of the end of the period reported in this quarterly report (the "Evaluation Date"), NeoMedia's disclosure controls and procedures were effective and designed to ensure that material information relating to NeoMedia and its consolidated subsidiaries is accumulated and would be made known to them by others within those entities as appropriate to allow timely decisions regarding required disclosures.

CHANGES IN INTERNAL CONTROLS. NeoMedia does not believe that there are significant deficiencies in the design or operation of its internal controls that could adversely affect its ability to record, process, summarize and report financial data. Although there were no significant changes in NeoMedia's internal controls or in other factors that could significantly affect those controls subsequent to the Evaluation Date, NeoMedia's senior management, in conjunction with its Board of Directors, continuously reviews overall company policies and improves documentation of important financial reporting and internal control matters. NeoMedia is committed to continuously improving the state of its internal controls, corporate governance and financial reporting.

LIMITATIONS ON THE EFFECTIVENESS OF CONTROLS. NeoMedia's management, including the Chief Executive Officer and Chief Financial Officer, does not expect that its disclosure or internal controls will prevent all errors or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are 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 a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

20

PART II -- OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

NeoMedia is involved in the following legal actions arising in the normal course of business, both as claimant and defendant.

NEOMEDIA SHAREHOLDERS

During January 2002, certain of NeoMedia's shareholders filed a complaint with the Securities and Exchange Commission, alleging that the shareholders were not included in the special shareholders meeting of November 25, 2001, to vote on the issuance of 19 million shares of NeoMedia common stock. On March 11, 2002, NeoMedia filed its response claiming that NeoMedia had fully complied with all of its obligations under the laws and regulations administered by the Securities and Exchange Commission, as well as with its obligation under Delaware General Corporation Law. No further action has been taken with respect to this matter.

AIRCLIC, INC. LITIGATION

On September 6, 2001, AirClic, Inc. ("AirClic") filed suit against

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

NeoMedia in the Court of Common Pleas, Montgomery County, Pennsylvania, seeking, among other things, the accelerated repayment of a \$500,000 loan it advanced to NeoMedia pursuant to the terms of a Secured Promissory Note made on July 11, 2003 and a non-binding Letter of Intent dated July 3, 2001 between AirClic and NeoMedia. The note was secured by substantially all of NeoMedia's intellectual property, including the core physical world-to-Internet technologies. In the suit, NeoMedia acknowledged our obligations under the note but filed a counterclaim against AirClic seeking damages for fraud, negligent misrepresentation and promissory estoppel.

On October 3, 2003, NeoMedia paid AirClic the principal plus interest in the approximate amount of \$610,000. On November 3, 2003, NeoMedia reached a settlement agreement with AirClic which will end the suit. The parties are currently drafting the release document and expect the suit to be dismissed by the end of November 2003. As of September 30, 2003, the Company had transferred \$600,000 into a restricted cash account to be used to satisfy the AirClic obligation. This restricted cash, along with additional funds of approximately \$10,000 transferred subsequently, was used to pay the principal plus interest on October 3, 2003. The Company had an additional accrual of \$100,000 as of September 30, 2003, to pay AirClic's legal fees.

DIGITAL:CONVERGENCE LITIGATION

On June 26, 2001, NeoMedia filed a \$3 million lawsuit in the U.S. District Court, Northern District of Texas, Dallas Division, against Digital:Convergence Corporation for breach of contract regarding a \$3 million promissory note due on June 24, 2001 that was not paid. NeoMedia is seeking payment of the \$3 million note plus interest and attorneys fees. NeoMedia has not accrued any gain contingency related to this matter. On March 22, 2002, Digital:Convergence filed under Chapter 7 of the United States Bankruptcy Code. The matter is pending before the bankruptcy court.

OTHER LITIGATION

On August 20, 2001, Ripfire, Inc. filed suit against NeoMedia in the San Francisco County Superior Court seeking payment of \$138,000 under a software license agreement entered into between NeoMedia and Ripfire in May 2001 relating to implementation of the Qode Universal Commerce Solution. On September 6, 2002, NeoMedia settled this suit for \$133,000 of NeoMedia's common stock, to be valued at the time of registration of the shares. NeoMedia's stock was trading at approximately \$0.05 at that time. NeoMedia included for registration 2.7 million shares in the name of Ripfire in its form S-1 that was declared effective by the SEC on February 14, 2003. NeoMedia's stock was trading at approximately \$0.02 on February 14, 2003. The actual number of shares to be issued to Ripfire per the pricing outlined in the agreement was approximately 9.8 million. On March 31, 2003, NeoMedia issued the 2.7 million shares of common stock that had been registered in the S-1 to Ripfire. NeoMedia has a remaining accrued liability of \$106,000 relating to this matter as of September 30, 2003.

On November 30, 2001, Orsus Solutions USA, Inc., filed a summons seeking payment in full of approximately \$525,000 relating to a software and services contract associated with implementation of the Qode Universal Commerce Solution. On October 23, 2003, we settled this matter for 3 million shares of NeoMedia common stock, subject to registration, plus \$10,000 cash payments to be made over a period of 6 months. If the shares are not registered for re-sale by February 14, 2004, Orsus has the option to return the shares and receive cash

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

payments in lieu of the stock. The Company has an accrued liability of \$331,000 relating to this matter as of September 30, 2003.

On January 22, 2002, Rapidigm, Inc. sued NeoMedia to collect unpaid professional service expense incurred in 2001 in the amount of approximately \$15,000. NeoMedia and Rapidigm reached a settlement in February 2002, under which NeoMedia made payments totaling approximately \$7,000. On April 22, 2003, Rapidigm obtained a judgment for the remaining balance of the liability plus court fees and interest. NeoMedia has continued to make payments against the liability, and has a remaining accrued liability of approximately \$3,000 as of September 30, 2003.

On July 27, 2002, NeoMedia's former General Counsel filed suit in U.S. District Court, Ft. Myers division, seeking payment of the 2000 executive incentive, severance and unpaid vacation days in the amount of approximately \$154,000. In June 2001, NeoMedia's compensation committee approved an adjustment to the 2000 executive incentive plan that reduced the executive incentive payout as a result of the write-off of the Digital:Convergence intellectual property license contract in the second quarter of 2001. As a result, NeoMedia reduced the accrual for such payout by an aggregate of approximately \$1.1 million in the second quarter of 2002. The plaintiff is seeking payment of the entire original incentive payout. On November 12, 2002, NeoMedia settled the lawsuit. The settlement calls for cash payments totaling approximately \$90,000 over a period of ten months, plus 250,000 vested options to purchase shares of NeoMedia's common stock at an exercise price of \$0.01 with a term of five years. NeoMedia had a liability of approximately \$7,000 relating to this matter as of September 30, 2003.

On September 12, 2002, R. R. Donnelley & Sons Company filed a summons in the Circuit Court of The Twentieth Judicial Circuit in and for Lee County, Florida, seeking payment of approximately \$92,000 in past due professional services bills, plus interest and attorney fees. During July 2003, NeoMedia settled the suit for cash payments over a period of approximately one year. NeoMedia has an accrued liability of approximately \$97,000 relating to this matter as of September 30, 2003.

On September 13, 2002, Wachovia Bank, N.A., owner of the building in which NeoMedia's Ft. Myers, Florida headquarters is located, filed a complaint in Circuit Court of The Twentieth Judicial Circuit in and for Lee County, Florida, seeking payment of approximately \$225,000 in past due rents. The complaint also seeks payment of all future rent payments under the lease term, which expires in January 2004, as well as possession of the premises. On October 28, 2002, NeoMedia and Wachovia reached a settlement on this matter. The settlement calls for cash payments of past due rents of approximately \$250,000 over a period of 16 months. NeoMedia also vacated approximately 70% of the unused space in its headquarters, and the rent for the remainder of the lease, which expires in January 2004, was reduced according to square footage used. NeoMedia has accrued a liability of approximately \$180,000 relating to this matter as of September 30, 2003.

On October 21, 2002, International Digital Scientific, Inc. ("IDSI") filed a demand for arbitration relating to past due payments on an uncollateralized note payable by NeoMedia to IDSI dated October 1, 1994. The note was issued in exchange for the purchase by NeoMedia of computer software from IDSI. The note calls for NeoMedia to make payments of the greater of: (i) 5% of the collected gross revenues from sales of software or (ii) \$16,000 per month. As of September 30, 2003, NeoMedia had recorded a current portion of long term debt to IDSI of approximately \$591,000. The net carrying value of future obligation under the note was approximately \$684,000 as of September 30, 2003. On October 31, 2003, NeoMedia paid off all past due and future obligations under the note to IDSI through the issuance of 8,000,000 shares of its common stock. If the shares are not registered for re-sale by February 14, 2004, IDSI has the option to return

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

the shares and proceed under the terms of the original purchase agreement. .

On October 28, 2002, Merrick & Klimek, P.C., filed a complaint against NeoMedia seeking payment of approximately \$170,000 in past due legal services. The amount in question is subject to an unsecured promissory note that matured unpaid on February 28, 2002. On May 1, 2003, NeoMedia settled the suit for cash payments totaling approximately \$196,000, to be paid at a rate of \$30,000 per quarter until the balance is

22

satisfied. If the balance is paid within one year of the settlement, NeoMedia will not pay interest charges. NeoMedia has a remaining liability of approximately \$120,000 relating to this matter as of September 30, 2003.

On November 11, 2002, Avnet/Hallmark Computer Marketing Group filed a complaint against NeoMedia seeking payment of approximately \$66,000 in past due amounts relating to hardware and software re-sold by NeoMedia. During December 2002, NeoMedia made payment of approximately \$30,000 to Avnet, reducing the balance owed to approximately \$37,000. On April 1, 2003, the plaintiff received a judgment from the circuit court for the remaining balance. NeoMedia and Avnet have agreed to a payment plan under which the Company will pay the balance in full by April 2004. NeoMedia had a liability of approximately \$37,000 relating to this matter as of September 30, 2003.

On December 30, 2002, Brooks Automation, Inc. filed a complaint against NeoMedia seeking payment of approximately \$37,000 in past due amounts relating to software re-sold by NeoMedia. On January 16, 2003, NeoMedia and Brooks Automation reached a settlement under which NeoMedia will pay the amount owed to Brooks Automation. NeoMedia had a liability of approximately \$37,000 relating to this matter as of September 30, 2003.

On February 6, 2003, Allen Norton & Blue, P.A., filed a complaint against NeoMedia seeking payment of approximately \$25,000 in past due legal services. The parties have agreed to a payment plan relating to this matter under which the balance will be paid over approximately 12 months. NeoMedia had a liability of approximately \$19,000 relating to this matter as of September 30, 2003.

On April 18, 2003, a former participant in NeoMedia's 2001 self-insured health plan sued NeoMedia to recover approximately \$40,000 in unpaid health claims from 2001. NeoMedia is attempting to negotiate a settlement prior to the court date. NeoMedia had accrued the claims related to this suit in the amount of approximately \$51,000 as of September 30, 2003.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS (A), (B), (C) AND (D)

On September 24, 2003, the Company's shareholders voted to increase the number of shares of common stock, par value \$0.01 per share, that the Company is authorized to issue from 200,000,000 to 1,000,000,000.

ITEM 3. DEFAULT UPON SENIOR SECURITIES

(a) NeoMedia is in default on the securities held by AirClic, IDSI and Merrick & Klimek, P.C., as more fully described in Item 1., Legal Proceedings.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On September 24, 2003, the Company held a shareholder meeting, at which its shareholders approved the following three proposals:

- a) To re-elect the current Board of Directors until the next annual meeting of shareholders.
- b) To increase the number of authorized common shares, \$0.01 par value, from 200,000,000 to 1,000,000,000
- c) To approve the 2003 Stock Option Plan, under which the Company is authorized to issue options to purchase up to 150,000,000 shares of common stock

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS:

| EXHIBIT NO. ----- | DESCRIPTION ----- | LOCATION ----- |
|----------------------|---|-------------------|
| 31.1 | Certification by Chief Executive Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Provided herewith |
| 31.2 | Certification by Chief Financial Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 | Provided herewith |
| 32.1 | Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Provided herewith |
| 32.2 | Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 | Provided herewith |

(b) REPORTS ON FORM 8-K:

NeoMedia filed a report on Form 8-K on October 3, 2003, reporting that it had terminated its letter of intent to merge with Loch Energy, Inc.

Edgar Filing: NEOMEDIA TECHNOLOGIES INC - Form 10QSB

NeoMedia filed a report on Form 8-K on October 9, 2003, reporting that it had completed its pending merger with Secure Source Technologies, Inc.

24

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NEOMEDIA TECHNOLOGIES, INC.
Registrant

Date: November 17, 2003

By: /s/ Charles T. Jensen

Charles T. Jensen, President, Acting Chief Executive
Officer, Chief Operating Officer, and Director

Date: November 17, 2003

By: /s/ David A. Dodge

David A. Dodge, Vice President,
Chief Financial Officer, and Controller

25