NEOMEDIA TECHNOLOGIES INC
Form 10-Q/A
May 01, 2007

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

FORM 10 - Q/A
Amendment No. 1
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended September 30, 2006

OR

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

Commission File Number 0-21743

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

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

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

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

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

Large Accelerated Filer o Accelerated Filer x Non-accelerated Filer o

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

As of October 23, 2006, there were 663,369,101 outstanding shares of the issuer's Common Stock, and 22,000 outstanding shares of the issuer's Series C convertible preferred stock.

EXPLANATORY NOTE

Restatement of Prior Reported Amounts

This form 10-Q/A is being filed to restate the revenue and cost of goods sold reported by NeoMedia filed on form 10-Q for the three and nine months ended September 30, 2006 (the "Original Filing"). This amendment amends and restates the Original Filing solely as a result of, and to reflect, the restatement, and no other information in the Original Filing is amended hereby except for an update to NeoMedia's revenue recognition policy.

The restatement of revenue and cost of goods sold is required because while preparing NeoMedia's annual report for the year ended December 31, 2006, the Company became aware that it incorrectly applied the principles of EITF 99-19. The Company, in reviewing its accounting practices with respect to revenue recognition of its subsidiary NeoMedia Telecom Services, became aware that it incorrectly applied the principles of EITF 99-19, "Reporting Revenue Gross as a Principal vs. Net as an Agent." As a result, the Company had overstated its net sales and its cost of goods sold during the three and nine months ended September 30, 2006. These amounts are reflected on the statement of operations. The adjustment does not affect net income (loss) during any period. The adjustment does not affect the statement of cash flows or balance sheet.

The NeoMedia Telecom Services business was acquired in March 2006 through the acquisition by the Company of BSD Software. Therefore the adjustment does not affect any results reported during the three and nine months ended September 30, 2005.

As a result, the Company has restated certain financial information that was previously reported in its unaudited quarterly reports on Form 10-Q for the three and nine month periods ended September 30, 2006. The following tables provide a reconciliation of amounts previously reported by the Company.

	Previously Reported	Restatement Adjustment	Restated Amount
Three months ended September 30, 2006			
Net sales	$ 6,249	($2,658)	$ 3,591
Cost of sales	4,112	(2,658)	1,454
Nine months ended September 30, 2006			
Net sales	$ 14,129	($5,285)	$ 8,844
Cost of sales	8,887	(5,285)	3,602

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PART I — FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

		September 30, 2006 (unaudited)		December 31, 2005 *
ASSETS				
Current assets:				
Cash and cash equivalents	$	3,133	$	1,704
Trade accounts receivable, net of allowance for doubtful accounts of $96 and $203, respectively		6,097		130
Inventories, net of allowance for obsolete & slow-moving inventory of $0		53		2
Investment in marketable securities		255		104
Prepaid expenses and other current assets		753		121
Assets held for sale		3,451		4,058
Total current assets		13,742		6,119
Leasehold improvements & property and equipment, net		564		110
Goodwill		50,082		—
Other Intangible assets, net		21,405		3,274
Cash surrender value of life insurance policy		797		769
Loan to Mobot		—		1,500
Other long-term assets		1,232		639
Total assets	$	87,822	$	12,411
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Accounts payable	$	5,550	$	1,502
Amounts payable under settlement agreements		97		97
Liabilities of discontinued business unit		676		676
Liabilities held for sale		750		669
Taxes payable		1,178		85
Accrued expenses		4,771		1,833
Deferred revenues and other		1,925		307
Notes payable		2,340		3,015
Derivative financial instruments		26,677		—
Total current liabilities		43,964		8,184
Long term debentures payable		73		—
Preferred stock, $0.01 par value, 25,000,000 shares authorized, 22,000 issued and outstanding, liquidation value of $22,000.		2,931		—

Shareholders' equity:				
Common stock, $0.01 par value, 5,000,000,000 shares authorized, 656,853,390 and 475,387,910 shares issued and 655,211,964 and 467,601,717 outstanding, respectively		6,552		4,676
Additional paid-in capital		155,359		106,287
Deferred equity financing costs		—		(13,256)
Accumulated deficit		(119,618)		(92,524)
Accumulated other comprehensive loss		(660)		(177)
Treasury stock, at cost, 201,230 shares of common stock		(779)		(779)
Total shareholders' equity		40,854		4,227
Total liabilities and shareholders' equity	$	87,822	$	12,411

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

* - Derived from NeoMedia's audited financial statements for the year ended December 31, 2005 and reclassified assets and liabilities held for sale related to the Micro Paint business unit.

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

	Three Months Ended September 30			
	2006		2005 (*)	
Net sales	$	3,591	$	193
Cost of sales		1,454		116
Gross profit		2,137		77
Sales and marketing expenses		2,795		589
General and administrative expenses		2,659		765
Research and development costs		1,013		123
Stock based compensation expense		2,320		93
Loss from operations		(6,650)		(1,493)
Gain on extinguishment of debt		—		1
Interest income (expense), net		(112)		(77)
Write-off of deferred equity financing costs		(13,256)		—
Change in fair value from revaluation of warrants and embedded conversion features		(9,271)		—
NET LOSS FROM CONTINUING OPERATIONS		**(29,289)**		**(1,569)**
DISCONTINUED OPERATIONS (Note 4)				
Net loss from Micro Paint business to be sold		(1,620)		(381)
NET LOSS		(30,909)		(1,950)
Accretion of dividends on convertible preferred stock		(604)		—
NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS		**(31,513)**		**(1,950)**
Comprehensive Loss:				
Net loss		(30,909)		(1,950)
Other comprehensive loss:				
Unrealized loss on marketable securities		(312)		(4)
Foreign currency translation adjustment		108		15
COMPREHENSIVE LOSS	**$**	**(31,113)**	**$**	**(1,939)**
Loss per share from continuing operations—basic and diluted	**$**	**(0.05)**	**$**	**(0.00)**
Loss per share from discontinued operations—basic and diluted	**$**	**(0.00)**	**$**	**(0.00)**
Net loss per share—basic and diluted	**$**	**(0.05)**	**$**	**(0.00)**
Loss per share attributable to common shareholders — basic and diluted	**$**	**(0.05)**	**$**	**(0.00)**

Weighted average number of common shares—basic and diluted	**644,720,857**	**456,695,836**

* - Reclassifiied operations related to the Micro Paint business unit to discontinued operations (Note 4).

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

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

	Nine Months Ended September 30			
	2006		2005 (*)	
Net sales	$	8,844	$	762
Cost of sales		3,602		440
Gross profit		5,242		322
Sales and marketing expenses		6,719		1,332
General and administrative expenses		6,752		2,143
Research and development costs		2,309		365
Stock based compensation expense		4,948		593
Loss from operations		(15,486)		(4,111)
Gain (loss) on extinguishment of debt		(1,858)		172
Interest income (expense), net		(191)		(223)
Write-off of deferred equity financing costs		(13,256)		—
Change in fair value from revaluation of warrants and embedded conversion features		6,523		—
NET LOSS FROM CONTINUING OPERATIONS		(24,268)		(4,162)
DISCONTINUED OPERATIONS (Note 4)				
Net loss from Micro Paint business to be sold		(2,826)		(1,307)
NET LOSS		(27,094)		(5,469)
Accretion of dividends on convertible preferred stock		(1,220)		—
NET LOSS ATTRIBUTABLE TO COMMON SHAREHOLDERS		(28,314)		(5,469)
Comprehensive Loss:				
Net loss		(27,094)		(5,469)
Other comprehensive loss:				
Unrealized loss on marketable securities		(49)		(133)
Foreign currency translation adjustment		(434)		24
COMPREHENSIVE LOSS	$	(27,577)	$	(5,578)
Loss per share from continuing operations—basic and diluted	**$**	(0.04)	**$**	(0.01)
Loss per share from discontinued operations—basic and diluted	**$**	(0.00)	**$**	(0.00)
Net loss per share—basic and diluted	**$**	(0.04)	**$**	(0.01)
Loss per share attributable to common shareholders — basic and diluted	**$**	(0.05)	**$**	(0.01)

Weighted average number of common shares—basic and diluted	**602,132,555**	**451,487,240**

* - Reclassified operations related to the Micro Paint business unit to discontinued operations (Note 4).

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

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

	Nine Months Ended September 30, 2006	2005 (*)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss from continuing operations	($24,268)	($4,162)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,209	359
Loss on early extinguishment of debt	1,858	—
Change in fair value from revaluation of warrants and embedded conversion features	(6,523)	—
Write-off of deferred equity financing costs	13,256	—
Stock-based compensation expense	4,948	593
Interest expense allocated to debt	22	—
Increase in value of life insurance policies	(28)	(13)
Changes in operating assets and liabilities		
Trade accounts receivable, net	(918)	(28)
Inventory	55	—
Other current assets	(252)	(671)
Accounts payable, amounts due under settlement agreements, liabilities in excess of assets of discontinued business unit and accrued expenses	553	(283)
Deferred revenue other current liabilities	707	(118)
Net cash used in operating activities	(8,381)	(4,323)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid to acquire Mobot, Inc., Sponge Ltd., Gavitec AG, and 12Snap AG, net of cash acquired	(11,891)	—
Acquisition of property and equipment	(339)	(54)
Capitalization of software development and purchased intangible assets	(160)	(1,639)
Investment in iPoint-media	—	(500)
Advances to discontinued Micro Paint Repair subsidiary	(1,633)	(1,924)
Acquisition related costs	(164)	—
Amounts issued under notes receivable	(500)	—
Net cash used in investing activities	(14,687)	(4,117)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowing under notes payable and convertible debt instrument	5,000	9,932
Repayments on notes payable and convertible debt instrument	(2,530)	(5,811)
Net proceeds from issuance of common stock, net of issuance costs of $24 in 2006 and $105 in 2005	210	6,262
Net proceeds from issuance of Series C convertible preferred stock, net of issuance costs of $2,725 in 2006	14,066	—
Net proceeds from exercise of stock options and warrants	8,419	909

Cash commitment fee for $100 million Standby Equity Distribution Agreement		—		(1,000)
Net cash provided by financing activities		25,165		10,292
EFFECT OF EXCHANGE RATE CHANGES ON CASH FOR CONTINUING OPERATIONS		(668)		—
NET INCREASE IN CASH AND CASH EQUIVALENTS FROM CONTINUING OPERATIONS		1,429		1,852
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		1,704		2,606
CASH AND CASH EQUIVALENTS, END OF PERIOD	**$**	**3,133**	**$**	**4,458**
SUPPLEMENTAL CASH FLOW INFORMATION:				
Interest paid during the period		48		47
Non-cash investing and financing activities:				
Unrealized gain (loss) on marketable securities		(361)		—
Prepaid acquisition costs applied to purchase price		168		—
Fair value of shares and notes receivable from Pickups Plus, Inc. acquired in exchange for Series C Convertible Preferred Stock		594		—
Carrying value of promissory note and accrued interest paid in exchange for Series C Convertible Preferred Stock		(3,208)		—
Fair value of shares issued to acquire Mobot, Inc., Sponge Ltd., Gavitec AG, 12Snap AG, and BSD Software, Inc.		46,964		—
Change in net assets resulting from acquisitions of Mobot, Inc., Sponge Ltd., Gavitec AG, 12Snap AG, and BSD Software, Inc.		62,240		—
Accretion of dividends on Series C Convertible Preferred Stock		1,824		—
Fair value of outstanding warrants reclassified to liabilities		13,884		—
Portion of change in fair value of outstanding warrants converted to liabilities recorded to paid-in capital		3,790		—
Fair value of Series C Convertible Preferred Stock (host instrument only)		4,908		—
Deferred stock-based financing costs associated with Series C Convertible Preferred Stock		3,198		—
Difference between net proceeds and recorded fair value of Series C Convertible Preferred Stock		4,041		—
Advance receivable from Mobot, Inc. forgiven upon acquisition		1,500		—
Gain (loss) on extinguishment of debt paid in common stock		—		349
Fair value of stock issued for services and deferred to future periods		—		239
Direct costs associated with Standby Equity Distribution Agreement and Equity Line of Credit		—		1,204
Fair value of warrants issued as fees related to the $100 million Standby Equity Distribution Agreement		—		12,256

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

*2005 cash flows have been reclassified to remove the cash flows from the NeoMedia Micro Paint Repair business unit, which has been reclassified to discontinued operations and assets and liabilities held for sale.

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

1. BASIS OF PRESENTATION AND NATURE OF BUSINESS OPERATIONS

Basis of Presentation

The condensed consolidated financial statements include the financial statements of NeoMedia Technologies, Inc. and its wholly-owned subsidiaries ("NeoMedia" or the "Company"). The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete consolidated financial statements. These condensed consolidated financial statements and related notes should be read in conjunction with the Company's Form 10-KSB for the fiscal year ended December 31, 2005. 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, 2006, the results of operations for the three and nine month periods ended September 30, 2006 and 2005, and cash flows for the nine month periods ended September 30, 2006 and 2005. The results of operations for the three and nine month periods ended September 30, 2006 are not necessarily indicative of the results which may be expected for the entire fiscal year. All significant intercompany accounts and transactions have been eliminated in preparation of the condensed consolidated financial statements.

Going Concern

The accompanying condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. Net loss for the nine months ended September 30, 2006 was $27,094,000, which includes a gain from the change in fair value from revaluation of warrants and embedded conversion features of $6,523,000 and a charge for the write-off of the deferred equity financing costs of $13,256,000. NeoMedia also reported net losses of $9,147,000 and $7,230,000 for the years ended December 31, 2005 and 2004, respectively, and has an accumulated deficit of $119,618,000 and a working capital deficit of $30,222,000 as of September 30, 2006.

In addition, NeoMedia has material liquidity events that could adversely affect its ability to continue as a going concern, primarily:

- In the event that NeoMedia's stock price at the time the consideration shares issued in connection with the acquisitions of Mobot, Sponge, Gavitec, and 12Snap become saleable is less than the contractual price (between $0.3839 and $0.3956), NeoMedia is obligated to compensate the sellers in cash for the difference between the price at the time the shares become saleable and the relevant contractual price. Assuming a stock price at the time the shares become saleable of $0.10, which was the last sale price on October 23, 2006, NeoMedia would have a cash liability of $32.7 million relating to the guarantees.

- During the nine months ended September 30, 2006, NeoMedia made cash payments totaling $2.1 million to silent partners of 12Snap, as partial payment under silent partner agreements entered into by 12Snap prior to the acquisition of 12Snap by NeoMedia. The agreements call for additional cash payments of approximately $2.5 million on or before December 31, 2006.

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

During August 2006, NeoMedia announced its intent to sell its Micro Paint Repair business unit. NeoMedia expects to receive cash proceeds from the sale of the division, which will be used to fund the operations and growth of the NeoMedia Mobile and NeoMedia Telecom Services businesses.

Should these financing sources fail to materialize, management would seek alternate funding sources such as the sale of common and/or preferred stock, the issuance of debt, or the sale of its marketable assets. Management's plan is to secure adequate funding to bridge the profitability from the NeoMedia Mobile and NeoMedia Telecom Services businesses.

Nature of Business Operations

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

NCIS is the original business line upon which the Company was founded. This unit resells client-server equipment and related software, and general and specialized consulting services. Because of decreased demand for systems integration products, and increased consolidation and competition in the industry in general, during 2005 resources allocated to the NCIS business unit were increasingly used in sales and business development efforts associated with the NISS business unit. During February 2006, NeoMedia's Board of Directors elected to formally wind down the NCIS business unit. As a result, during February 2006, NeoMedia closed its Lisle, Illinois facility out of which the NCIS business unit was based. NeoMedia does, however, plan to continue servicing existing contracts and customers.

During the first quarter of 2006, following the completion of the acquisitions of 12Snap AG (“12Snap”), Sponge Ltd. (“Sponge”), Gavitec AG (“Gavitec”), Mobot, Inc. (“Mobot”), and BSD Software, Inc. (“BSD”), as well as the winding down of the NCIS business unit, NeoMedia restructured into the following three business units:

- NeoMedia Mobile (NMM) - encompassing NeoMedia's physical-world-to-internet and mobile marketing technologies branded under Qode®, 12Snap, Sponge, Gavitec and Mobot. During the second quarter of 2006, NeoMedia rebranded its PaperClick suite of products under the brand name Qode®.

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

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

On August 30, 2006, NeoMedia signed a non-binding letter of intent to sell its Micro Paint Repair business unit to Jose Sada, a technology partner of NeoMedia Micro Paint Repair, backed by Global Emerging Markets Group of New York City. The letter of intent calls for completion of the transaction on or before November 24, 2006.

Reclassifications

Certain amounts in the 2005 condensed consolidated financial statements have been reclassified to conform to the 2006 presentation, most notably, “License revenue” and “Resales of software and technology equipment and service fees”, which were formerly reported as separate line items on NeoMedia's consolidated statement of operations, are now condensed into the category entitled, “Technology license, service & products.” This is primarily due to the winding down of the former NCIS business unit and consolidation of revenues relating to the NCIS unit into the NMM unit, as well as the addition of new revenue streams from Mobot, Sponge, Gavitec, 12Snap, and BSD that fall into the same general category.

In addition, due to the pending sale of the Micro Paint Repair business unit, results of operations from this unit have been reclassified to restate into the caption “Net loss from Micro Paint business to be sold” for all periods shown, and assets and liabilities relating to this unit are combined into the captions “Assets held for sale” and “Liabilities held for sale,” respectively. Additionally, the statement of cash flows for the nine months ended September 30, 2005 has been restated to exclude the cash flows of the discontinued Micro Paint Repair business unit.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

As a result of the addition of the operations of Mobot, Sponge, Gavitec, 12Snap and BSD, and the issuance of the Series C convertible preferred stock and a convertible debenture during the nine months ended September 30, 2006, NeoMedia is presenting certain significant accounting policies that were not applicable as of the filing of its last annual report for the year ended December 31, 2005.

Stock-based Compensation

Beginning January 1, 2006, NeoMedia began to account for stock-based compensation in accordance with SFAS No. 123(R), *Share-Based Payment* . Under the fair value recognition provisions of this statement, share-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of share-based awards at the grant date requires judgment, including estimating expected dividends. In addition, judgment is also required in estimating the amount of share-based awards that are expected to be forfeited. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could be materially impacted. Stock-based compensation expense is calculated using the Black-Scholes-Merton option pricing model on the date of grant. This option valuation model requires input of highly subjective assumptions. Because NeoMedia'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.

Fair Value of Derivatives

The Company generally does not use derivative financial instruments to hedge exposures to cash-flow risks or market-risks that may affect the fair values of its financial instruments. However, certain other financial instruments, such as warrants and embedded conversion features that are indexed to the Company's common stock, are classified as liabilities when either (a) the holder possesses rights to net-cash settlement or (b) physical or net-share settlement is not within the control of the Company. In such instances, net-cash settlement is assumed for financial accounting and reporting, even when the terms of the underlying contracts do not provide for net-cash settlement. Such financial instruments are initially recorded at fair value and subsequently adjusted to fair value through a change to earnings at the close of each reporting period.

The caption “Derivative Financial Instruments” consists of (i) the fair values associated with derivative features embedded in the Series C convertible preferred stock, (ii) the fair values of the detachable warrants that were issued in connection with the preferred stock and the convertible debenture financing arrangements, and (iii) the fair value of detachable warrants that were outstanding prior to the issuance of the preferred stock and the convertible debenture financing arrangements.

Sales Taxes Payable

Sales taxes payable represents amounts collected on behalf of specific regulatory agencies that require remittance on a specified date. These amounts are collected at the time of sales and are detailed on invoices provided to customers. At September 30, 2006 sales taxes payable were $1,178,000, of which $851,000 were delinquent sales taxes assumed by NeoMedia in connection with its acquisitions, certain of which are subject to payment plans. In compliance with the Emerging Issues Task Force consensus on issue number 06-03, NeoMedia accounts for sales taxes on a net basis.

Revenue Recognition

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

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

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

(3) Technology service also includes mobile marketing services to its customers which mobile marketing projects are recognized after the completion of the project and accepted by the customer. All response and messaging based revenues are recognized at the time such responses are received and processed and the Company recognizes its premium messaging revenues on a net basis based on guidance provided in Emerging Issues Task Force Issues No. 99-19 (EITF 99-19), "Reporting Revenue Gross as Principal or Net as an Agent" and No. 01-09 (EITF 01-09), "Accounting for Consideration Given by a Vendor to a Customer." Consulting and management revenues and revenues for periodic services are recognized as services are performed. NeoMedia uses stand-alone pricing to determine an element's vendor specific objective evidence ("VSOE") in order to allocate an arrangement fee amongst various pieces of a multi-element contract. The Company's subsidiaries 12Snap and Sponge (sold during 2006) follow this policy. Telecom revenues from NeoMedia's subsidiary BSD are recognized at the time that calls are accepted by the clearinghouse for billing to customers on a net basis, based on guidance in EITF 99-19. The Company defers revenue related to mobile marketing service fees for which amounts have been invoiced and/or collected but for which revenue has not been recognized. Revenue is then recognized over the matching service period.

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

3. ACQUISITIONS

During the nine months ended September 30, 2006, NeoMedia completed acquisitions of Mobot, Sponge, Gavitec, 12Snap, and BSD.

Acquisition of Mobot

On February 9, 2006, NeoMedia and Mobot signed a definitive merger agreement, subject to closing conditions, under which NeoMedia acquired all of the outstanding shares of Mobot in exchange for $3,500,000 cash and 16,931,493 shares of NeoMedia common stock (2,604,845 of which are being held in escrow for a period of one year from the closing date for the purpose of securing the indemnification obligations outlined in the purchase agreement). On February 17, 2006, NeoMedia and Mobot completed the closing requirements and the acquisition became effective. In addition to cash and stock, at closing NeoMedia forgave notes payable totaling $1,500,000 due from Mobot. This amount is considered other additional consideration in the purchase price allocation. Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock that were issued as stock consideration was calculated using a share price of $0.3839, which was the volume-weighted average closing price of NeoMedia common stock for the ten days up to and including February 8, 2006. The merger agreement between NeoMedia and Mobot also contained a provision that, in the event that NeoMedia's stock price at the time the consideration shares become saleable is less than $0.3839, NeoMedia would be obligated to compensate Mobot shareholders in cash for the difference between the price at the time the shares become saleable and $0.3839. Assuming a stock price at the time the shares become saleable of $0.10, which was the last sale price on October 23, 2006, NeoMedia would have had a cash liability of $4.8 million resulting from this clause.

Mobot is a pioneer in visual search and recognition technology designed to make marketing effective and innovative using mobile devices. Launched in 2004 to help companies cultivate rewarding relationships with mobile phone users, Mobot gives marketers, content providers and carriers the tools to make it easy for any consumer with a camera phone to interact with their offerings. Mobot's customers include, amongst others, ELLEgirl magazine, for which Mobot “turned on” advertisements throughout the magazine that linked to content and customer loyalty promotions on the mobile Internet; The Light Agency, who distributes Mobot's visual search and recognition technology to the U.K. grocery sector through its award-winning mobile phone-based loyalty program with the Sainsburys-owned convenience store chain Jackson's; and Warner Music Group's U.S. sales and retail marketing company WEA Corp., running a snap-and-enter contest in music stores for music fans to win tailored offers, samples and discounts.

NeoMedia completed the acquisitions of Mobot, Sponge, Gavitec, and 12Snap in an effort to gain entry into the rapidly evolving global mobile marketing industry.

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

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

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

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

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

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

Goodwill was not assigned a life and will be tested for impairment as defined by Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

The accompanying consolidated statement of operations presented herein for the nine months ended September 30, 2006, contains the results of operations for Mobot for the period from February 18, 2006, through September 30, 2006. The accompanying consolidated statement of operations presented herein for the three months ended September 30, 2006, contains the results of operations for Mobot for the entire nine month period. Pro-forma results of operations for the three and nine months ended September 30, 2006 and 2005 are presented at the end of this Note 3.

Acquisition of Sponge

On February 20, 2006, NeoMedia and Sponge signed a definitive share purchase agreement, subject to closing conditions, under which NeoMedia acquired all of the outstanding shares of Sponge in exchange for $6,141,000 cash and 33,097,135 shares of NeoMedia common stock (3,400,490 of which are being held in escrow for a period of one year from the closing date for the purpose of securing the indemnification obligations outlined in the purchase agreement). The agreement also calls for Sponge to earn an additional £2,500,000 (approximately $4.4 million) in the form of NeoMedia common stock if, during the two-year period beginning at closing, the Sponge business earns in excess of £1,300,000 (approximately $2.3 million) in net profits. On February 23, 2006, NeoMedia and Sponge completed the closing requirements and the acquisition became effective. Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock to be issued as consideration was calculated using a share price of $0.384, which was the volume-weighted average closing price of NeoMedia common stock for the ten days up to and including February 8, 2006. In the event that NeoMedia's stock price (at the time the consideration shares are saleable) is less than $0.384, NeoMedia is obligated to compensate Sponge shareholders in cash for the difference between the price at the time the shares become saleable and $0.384. Assuming a stock price at the time the shares become saleable of $0.10, which was the last sale price on October 23, 2006, NeoMedia would have a cash liability of $9.4 million resulting from this clause.

Founded in 2001, Sponge has grown to become a U.K. market leader in providing mobile applications to agencies and media groups, and gain recognition as one of Europe's top independent developers of mobile applications and content. Today, Sponge counts more than 40 agencies, including WPP, Aegis and BBH, as clients, and supplies services for over 100 world-class brands, including Coca Cola® , Heineken® and Diageo. Sponge also supplies a range of mobile services to media groups, including News International, Trinity Mirror, Endemol and IPC. For Walker's (Frito-Lay) potato chips, Sponge enabled a promotion that offered consumers of Walker's — the U.K.'s largest snack brand — to win an iPod every 5 minutes for 4 weeks, by texting a unique code found on-pack into the Sponge platform. More than 5% of the total U.K. population participated in the campaign, which has been expanded to Belgium and the Netherlands on the basis of its success in the U.K. A total of 23% of the U.K. population interacted with Sponge applications in 2005.

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NeoMedia completed the acquisitions of Mobot, Sponge, Gavitec, and 12Snap in an effort to gain entry into the rapidly evolving global mobile marketing industry.

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

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

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

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

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

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

Goodwill was not assigned a life and will be tested for impairment as defined by Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

The purchase agreement calls for the management of Sponge to earn an additional £2,500,000 (approximately $4.4 million) in the form of NeoMedia common stock if, during the two-year period beginning on February 23, 2006, the Sponge business earns in excess of £1,300,000 (approximately $2.3 million) in net profits, plus £1 of NeoMedia common stock for each £1 that earnings exceed £1,300,000 during the two-year period. No shares are to be issued pro rata if the earnings target is not met.

At the end of the two-year measurement period (February 22, 2008), if the earnings target is met, the financial impact on NeoMedia of the issuance of additional shares would be a proportionate increase of approximately $4.4 million in the long-term assets acquired from Sponge, with a corresponding increase in depreciation expense from the point of issuance forward. If the earnings target is not met, no additional shares would be issued and there would be no financial impact to NeoMedia. Pursuant to SFAS 141, NeoMedia has not allocated a value to the contingent consideration in the initial purchase price. Accordingly the final purchase price will not be determined until the conclusion of this contingency.

The accompanying consolidated statement of operations presented herein for the nine months ended September 30, 2006, contains the results of operations for Sponge for the period from February 24, 2006, through September 30, 2006. The accompanying consolidated statement of operations presented herein for the three months ended September 30, 2006, contains the results of operations for Sponge for the entire three month period. Pro-forma results of operations for the three and nine months ended September 30, 2006 and 2005 are presented at the end of this Note 3.

Acquisition of Gavitec

On February 17, 2006, NeoMedia and Gavitec signed a definitive sale and purchase agreement, subject to closing conditions, under which NeoMedia acquired all of the outstanding shares of Gavitec in exchange for $1,800,000 cash and 13,660,511 shares of NeoMedia common stock (1,366,051 of which are being held in escrow until December 31, 2006 for the purpose of securing the indemnification obligations outlined in the purchase agreement). Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock to be issued as consideration was calculated using a share price of $0.389, which was the volume-weighted average closing price of NeoMedia common stock for the ten days up to and including February 16, 2006. On February 23, 2006, NeoMedia and Gavitec completed the closing requirements and the acquisition became effective. In the event that NeoMedia's stock price (at the time the consideration shares are saleable) is less than $0.389, NeoMedia is obligated to compensate Gavitec shareholders in cash for the difference between the price at the time the shares become saleable and $0.389. Assuming a stock price at the time the shares become saleable of $0.10, which was the last sale price on October 23, 2006, NeoMedia would have a cash liability of $3.9 million resulting from this clause.

Gavitec was founded in 1997 as a specialized provider and manufacturer of products and solutions for mobile marketing and mobile information technology. As a technology leader in code-reading systems and software for mobile applications, Gavitec offers its clients standardized or individual solutions in the areas of mobile marketing, mobile ticketing, mobile couponing, and mobile payment systems. Gavitec has run an in-market pilot program in Switzerland for its mobile macro-payment system with the leading Swiss retail bank PostFinance, Unisys, seven selected retailers including Migros, CoOp and McDonald's and approximately a thousand consumers. Participants receive a personal Data Matrix code via text message to their mobile phone. Then to complete a purchase, participants hold their cell phone over Gavitec's EXIO code reader and enter their PIN code to debit their PostFinance account. Gavitec has also run trials with “Coast Mobile” in conjunction with the British Broadcasting Corporation (BBC) and News International's The Times newspaper, along with a number of other interactive mobile campaigns.

NeoMedia completed the acquisitions of Mobot, Sponge, Gavitec, and 12Snap in an effort to gain entry into the rapidly evolving global mobile marketing industry.

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

		(Dollars in Thousands)
Value of 13,660,511 shares issued at $0.386 per share[1]	$	5,273
Cash paid		1,800
Direct costs of acquisition		114
Total Fair Value of Purchase Price		7,187
Assets Purchased:		
Cash and cash equivalents	$	74
Accounts receivable		173
Inventory		106
Other current assets		53
Property, plant & equipment		15
Intangible assets		3
Capitalized software platform		4,600
Copyrighted materials		50
Goodwill		2,611
Total Assets Purchased		7,685
Less Liabilities Assumed:		
Accounts payable	$	113
Accrued liabilities		24
Deferred revenue		117
Other current liabilities		244
Total Liabilities Assumed		498

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

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

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

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

Goodwill was not assigned a life and will be tested for impairment as defined by Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

The accompanying consolidated statement of operations presented herein for the nine months ended September 30, 2006, contains the results of operations for Gavitec for the period from February 24, 2006, through September 30, 2006. The accompanying consolidated statement of operations presented herein for the three months ended September 30, 2006, contains the results of operations for Gavitec for the entire three month period. Pro-forma results of operations for the three and nine months ended September 30, 2006 and 2005 are presented at the end of this Note 3.

Acquisition of 12Snap

On February 10, 2006, NeoMedia and 12Snap signed a definitive sale and purchase agreement, subject to closing conditions, under which NeoMedia acquired all of the outstanding shares of 12Snap in exchange for $2,500,000 cash and 49,294,581 shares of NeoMedia common stock. On February 28, 2006, NeoMedia and 12Snap completed the closing requirements and the acquisition became effective. Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock to be issued as consideration was calculated using a share price of $0.3956, which was the volume-weighted average closing price of NeoMedia common stock for the ten days up to and including February 9, 2006. In the event that NeoMedia's stock price (at the time the consideration shares are saleable) is less than $0.3956, NeoMedia is obligated to compensate 12Snap shareholders in cash for the difference between the price at the time the shares become saleable and $0.3956. Assuming a stock price at the time the shares become saleable of $0.10, which was the last sale price on October 23, 2006, NeoMedia would have a cash liability of $14.6 million resulting from this clause.

12snap AG is headquartered in Munich with branches in Düsseldorf, New York, London, Milan, Stockholm and Vienna. As an expert in innovative marketing and entertainment for mobile phones, 12snap combines know-how in mobile applications, mobile loyalty and mobile marketing. In the mobile marketing space, 12snap creates and implements national and pan-European mobile marketing campaigns for international brands; its mobile loyalty business unit offers customer loyalty programs for companies and brands, and its mobile applications business unit is the center for development and software. 12snap sells and licenses a wide spectrum of mobile solutions to satisfy the demands of the current growing market and the new uses of the third mobile phone generation from dynamic video services and multiplayer games to personalized messaging applications. 12snap has 75 employees, and services to companies including McDonald's, MTV® , Coca-Cola, Ferrero, Wella, adidas, Unilever and Gillette® .

NeoMedia completed the acquisitions of Mobot, Sponge, Gavitec, and 12Snap in an effort to gain entry into the rapidly evolving global mobile marketing industry.

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

		(Dollars in Thousands)
Value of 49,294,581 shares issued at $0.394 per share[(1)]	$	19,422
Cash paid		2,500
Direct costs of acquisition		114
Total Fair Value of Purchase Price		22,036
Assets Purchased:		
Cash and cash equivalents	$	465
Investment in marketable securities		951
Accounts receivable		2,683
Other current assets		554
Property, plant & equipment		224
Intangible assets		93
Customer contracts and relationships		400
Capitalized software platform		4,400
Brand name		1,600
Copyrighted materials		50
Goodwill		19,391
Total Assets Purchased		30,811
Less Liabilities Assumed:		
Accounts payable	$	977
Accrued liabilities		1,990
Deferred revenue		1,434
Other current liabilities		225
Notes payable		4,149
Total Liabilities Assumed		8,775

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

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

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

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

Goodwill was not assigned a life and will be tested for impairment as defined by Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

The accompanying consolidated statement of operations presented herein for the nine months ended September 30, 2006, contains the results of operations for 12Snap for the period from March 1, 2006, through September 30, 2006. The accompanying consolidated statement of operations presented herein for the three months ended September 30, 2006, contains the results of operations for 12Snap for the entire three month period. Pro-forma results of operations for the three and nine months ended September 30, 2006 and 2005 are presented at the end of this Note 3.

Acquisition of BSD

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

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

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

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

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

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

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

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

Goodwill was not assigned a life and will be tested for impairment as defined by Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

The accompanying consolidated statement of operations presented herein for the nine months ended September 30, 2006, contains the results of operations for BSD for the period from March 22, 2006, through September 30, 2006. The accompanying consolidated statement of operations presented herein for the three months ended September 30, 2006, contains the results of operations for BSD for the entire three month period. Pro-forma results of operations for the three and nine months ended September 30, 2006 and 2005 are presented at the end of this Note 3.

Pro Forma Financial Information

Pro-forma results of operations as if NeoMedia was combined with Mobot, Sponge, Gavitec, 12Snap and BSD as of January 1, 2006 are as follows:

	Three Months Ended September 30, 2006							
	NeoMedia	**Mobot**	**Sponge**	**Gavitec**	**12Snap**	**BSD**	**Pro Forma Adjust-ments**	**Pro-forma Combined**
Total net sales	$ 3,591	$ 125	$ 265	$ 246	$ 2,226	$ 547	($3,409)(A)	$ 3,591
Net income (loss)	($30,909)	($388)	($420)	($359)	($166)	$ 228	$ 1,105(A)	($30,909)
Net income (loss) per share-basic and diluted	($0.05)						—	($0.05)
Weighted average common shares outstanding	644,720,857						—	644,720,857

	Nine Months Ended September 30, 2006							
	NeoMedia	**Mobot**	**Sponge**	**Gavitec**	**12Snap**	**BSD**	**Pro Forma Adjust-ments**	**Pro-forma Combined**
Total net sales	$ 8,844	$ 344	$ 1,488	$ 953	$ 8,457	$ 1,441	($8,591)(B)	$ 12,936
Net income (loss)	($27,094)	($1,007)	($458)	($428)	($51)	$ 474	$ 1,305(B)	($27,259)
Net income (loss) per share-basic and diluted	($0.04)						$ —(B)(C)	($0.04)
Weighted average common shares outstanding	602,132,555						58,652,190(C)	660,784,745

(A) - Adjustment to back out the operations of each subsidiary, which were included in NeoMedia's consolidated operations for the entire three month period ended September 30, 2006

(B) - Adjustments are to reflect operations of each acquisition from the closing date through September 30, 2006 and amortization of intangible assets for the period January 1, 2006 through the respective closing dates. Results of operations for each acquisition from its respective closing date through September 30, 2006 are included in NeoMedia's operations for the nine months ended September 30, 2006. Closing dates for each acquisition were:

Mobot (February 17, 2006); Sponge and Gavitec (February 23, 2006); 12Snap (February 28, 2006); and BSD (March 21, 2006).

(C) - Adjustment for shares that would have been issued in connection with acquisitions if they had occurred on January 1, 2006. Using the stock price around January 1, 2006, the pro forma number of shares that would have been issued was:

	Mobot	Sponge	Gavitec	12Snap	BSD	Total
Total stock consideration	$ 6,500,000	$ 11,400,000	$ 5,400,000	$ 19,500,000	$ 2,279,263	$ 45,079,263
NeoMedia stock price around January 1, 2006 (measurement date)	$ 0.290	$ 0.290	$ 0.290	$ 0.290	$ 0.290	
Pro forma number of shares of NeoMedia to be issued as purchase price consideration	22,413,793	39,310,345	18,620,690	67,241,379	7,859,528	155,445,735

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The adjustment between the reported and the pro forma number of weighted average shares outstanding is caused by (i) the weighting of the pro forma shares for the entire nine month period ended September 30, 2006, whereas in the reported number the shares were only outstanding from the closing date through September 30, 2006, and (ii) the number of pro forma shares being higher than the actual shares issued due to a lower stock price on the pro forma date of issuance.

Pro-forma results of operations as if NeoMedia was combined with Mobot, Sponge, Gavitec, 12Snap and BSD as of January 1, 2005 are as follows:

Three Months Ended September 30, 2005

	NeoMedia	**Mobot**	**Sponge**	**Gavitec**	**12Snap**	**(B) BSD**	**Pro Forma Adjust- ments**	**Pro-forma Combined**
Total net sales	$ 193	$ 56	$ 609	$ 198	$ 2,114	$ 425	—	$ 3,595
Net income (loss)	($1,950)	($818)	$ 53	($492)	($140)	($134)	($723)(A)	($4,204)
Net income (loss) per share-basic and diluted	($0.00)						($0.01)(A)(B)	($0.01)
Weighted average common shares outstanding	456,695,836						172,717,482(B)	629,413,318

Nine Months Ended September 30, 2005

	NeoMedia	**Mobo**	**Sponge**	**Gavitec**	**12Snap**	**(B) BSD**	**Pro-forma Adjust- ments**	**Pro forma Combined**
Total net sales	$ 762	$ 144	$ 1,544	$ 590	$ 5,600	$ 1,343	—	$ 9,983
Net income (loss)	($5,469)	($918)	$ 172	($747)	($816)	$ 127	($2,170)(A)	($9,821)
Net income (loss) per share-basic and diluted	($0.01)						($0.01)(A)(B)	($0.02)
Weighted average common shares outstanding	451,487,240						172,717,482(B)	624,204,722

(A) - Adjustment for amortization of intangible assets for the periods presented.

(B) - Adjustment for shares that would have been issued in connection with acquisitions if they had occurred on January 1, 2006. Using the stock price around January 1, 2006, the pro forma number of shares that would have been issued was:

	Mobot	Sponge	Gavitec	12Snap	BSD	Total
Total stock consideration	$ 6,500,000	$ 11,400,000	$ 5,400,000	$ 19,500,000	$ 2,279,263	$ 45,079,263
NeoMedia stock price around January 1, 2005 (measurement date)	$ 0.261	$ 0.261	$ 0.261	$ 0.261	$ 0.261	
Pro forma number of shares of NeoMedia to be issued as purchase price consideration	24,904,215	43,678,161	20,689,655	74,712,644	8,732,808	172,717,483

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Tax Implications of Acquisitions

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

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

Intangible Assets

As of September 30, 2006, NeoMedia had intangible assets with a cost as follows:

	12 Snap	Sponge	Gavitec	Mobot	BSD	Other	Total
Customer Contracts	$ 400	$ 400	$ —	$ 440	$ 1,300	$ —	$ 2,540
Proprietary Software	4,516	1,300	4,603	4,210	—	937	15,566
Brand Name	1,600	800	—	5	—	—	2,405
Copyrighted Materials	50	50	50	90	130	—	370
Patents	—	—	—	10	—	4,888	4,898
Goodwill	19,391	16,799	2,712	6,778	4,402	—	50,082
Total	$ 25,957	$ 19,349	$ 7,365	$ 11,533	$ 5,832	$ 5,825	$ 75,861

Accumulated amortization on NeoMedia's intangible assets as of September 30, 2006, was:

	12 Snap	Sponge	Gavitec	Mobot	BSD	Other	Total
Customer Contracts	$ 47	$ 48	$ —	$ 54	$ 152	$ —	$ 301
Proprietary Software	367	112	393	370	—	667	1,909
Brand Name	93	48	—	2	—	—	143
Copyrighted Materials	6	6	6	11	15	—	44
Patents	—	—	—	2	—	1,974	1,976
Goodwill	—	—	—	—	—	—	—
Total	$ 513	$ 214	$ 399	$ 439	$ 167	$ 2,641	$ 4,373

The carrying value of NeoMedia's intangible assets as of September 30, 2006 was:

	12 Snap	Sponge	Gavitec	Mobot	BSD	Other	Total
Customer Contracts	$ 353	$ 352	$ —	$ 386	$ 1,148	$ —	$ 2,239
Proprietary Software	4,149	1,188	4,210	3,839	—	269	13,655
Brand Name	1,507	752	—	3	—	—	2,262
Copyrighted Materials	44	44	44	79	115	—	326
Patents	—	—	—	8	—	2,914	2,922
Goodwill	19,391	16,799	2,712	6,778	4,402	—	50,082
Total	$ 25,444	$ 19,135	$ 6,966	$ 11,093	$ 5,665	$ 3,183	$ 71,486

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

	Customer Contracts	Proprietary Software	Brand Name	Copyrighted Materials	Patents	Goodwill	Total
2006	$ 127	$ 556	$ 60	$ 19	$ 76	$ —	$ 838
2007	508	2,224	241	74	304	—	3,351
2008	508	2,224	182	74	304	—	3,292
2009	508	2,224	182	74	304	—	3,292
2010	356	2,224	182	74	304	—	3,140
Thereafter	232	4,204	1,414	11	1,630	—	7,491
Total	$ 2,239	$ 13,656	$ 2,261	$ 326	$ 2,922	$ —	$ 21,404

It is important to note that actual amortization expense could differ materially from the table due to subjective factors such as changes in assumptions of useful lives or impairment charges.

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The weighted average remaining life for the intangible assets was approximately 6.8 years as of September 30, 2006.

Letter of Intent to Acquire Hip Cricket

On August 24, 2006, NeoMedia terminated a non-binding letter of intent to acquire HipCricket, Inc. (“HipCricket”), due to an inability of the parties to come to terms on a definitive purchase price. On February 16, 2006, NeoMedia and Hip Cricket signed the letter of intent, under which NeoMedia intended to acquire all of the outstanding shares of Hip Cricket in exchange for $500,000 cash and $4,000,000 of NeoMedia common stock, subject to due diligence and signing of a mutually agreeable definitive purchase agreement by both parties.

In addition to signing the letter of intent, NeoMedia loaned HipCricket the principal amount of $500,000 in the form of a) a promissory note, dated February 16, 2006, in the amount of $250,000 and (b) that certain promissory note, dated March 20, 2006, in the amount of $250,000. The notes accrue interest at a rate of 8% per annum. The notes were to be applied toward the cash portion of the purchase price upon signing of a definitive purchase agreement for the acquisition of all of the outstanding shares of HipCricket by NeoMedia, as contemplated in the letter of intent. Due to the termination of the letter of intent, and pursuant to the terms of the notes, the face amount of the notes, plus any and all interest accrued thereon, will become payable and due on November 22, 2006. In the event the Notes are not repaid by November 22, 2006, the notes will convert into shares of HipCricket common stock using a valuation of $4.5 million for HipCricket.

4. DISCONTINUED OPERATIONS AND ASSETS AND LIABILITIES HELD FOR SALE - MICRO PAINT REPAIR BUSINESS UNIT

On August 30, 2006, NeoMedia signed a non-binding letter of intent to sell its Micro Paint Repair business unit to Jose Sada, a technology partner of NeoMedia Micro Paint Repair, backed by Global Emerging Markets Group of New York City. The letter of intent calls for completion of the transaction on or before November 24, 2006.

The letter of intent contained the following material terms:

- the letter of intent is subject to completion of due diligence review by the buyers,
- the letter of intent is subject to negotiation of material terms of the transaction,
- the letter of intent is subject to negotiation of a sales price of the business unit,
- the letter of intent is subject to ability of the buyers to obtain funding,
- the letter of intent can be terminated by either party without cause with written notice,
- NeoMedia cannot shop the business unit to other buyers while the letter of intent is in effect, with the exception of specifically named alternate potential buyers.

SFAS 144 governs the accounting over this transaction. NeoMedia has analyzed the pertinent facts of the proposed transaction with respect to the criteria outlined in SFAS 144, and has determined that all of the criteria have been met. Accordingly NeoMedia is reporting the operating results of the MPR business unit as Discontinued Operations, and the assets and liabilities as Held for Sale. The amounts reported as discontinued operations and assets and liabilities held for sale have been appropriately reclassified and reported in the financial statements presented in this filing.

The operating results of the MPR business unit classified as discontinued operations are indicated in the following table.

	Three Months Ended September 30, 2006	2005	Nine Months Ended September 30, 2006	2005
Net sales	$ 368	$ 244	$ 1,145	$ 960
Cost of sales	605	220	1,592	795
Gross profit	(237)	24	(447)	165
Sales and marketing expenses	207	216	801	1,019
General and administrative expenses	777	68	706	230
Research and development costs	236	121	386	223
Stock-based compensation expense	163	—	485	—
Loss from discontinued operations	$ (1,620)	$ (381)	$ (2,826)	$ (1,307)

The assets and liabilities of the MPR business unit classified as held for sale are as follows.

	September 30, 2006 Unaudited	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 200	$ 587
Trade accounts receivable, net	462	211
Inventories, net of allowance for obsolete & slow-moving inventory of $0	148	421
Prepaid expenses and other current assets	36	30
Total current assets	846	1,249
Leasehold improvements & property and equipment, net	135	126
Goodwill	1,099	1,099
Other intangible assets, net	1,371	1,556
Other long-term assets	—	28
Total assets held for sale	$ 3,451	$ 4,058
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 16	$ 72
Taxes payable	9	—
Accrued expenses	74	6
Deferred revenues and other	651	591
Total liabilities held for sale	$ 750	$ 669

Inventory included in the assets held for sale are as follows.

	September 30, 2006	December 31, 2005
Raw materials	$ 38	$ 33
Work-in-process	—	—
Finished goods	11	388
Total	$ 49	$ 421

There is no tax expense or benefit related to this transaction due to NeoMedia's net operating loss carry forward tax position.

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5. FINANCING

Series C Convertible Preferred Stock

The Company entered into a Securities Purchase Agreement, dated February 17, 2006 (the “Agreement”) with Cornell Capital Partners LP, an accredited investor (the “Purchasers”). Pursuant to the Agreement, the Purchasers agreed to purchase 8% cumulative Series C convertible preferred stock to be fully converted three (3) years from the date of issuance in the aggregate amount of $22,000,000. Net consideration from this arrangement amounted to $17,854,000, comprised of cash of $14,066,000, marketable securities with a calculated fair value of $579,000 and a purchase value of $2,000,000, and the extinguishment of $3,209,000 of preexisting indebtedness. In addition, the Purchaser withheld $2,725,000 commitment and structuring fees from the gross proceeds. The Agreement also provided for the issuance to the Purchasers, at no additional cost to the purchasers, warrants to purchase shares of the Company's common stock. The Agreement also called for the purchasers to acquire an additional $5,000,000 of Series C convertible preferred stock on the date a registration statement filed by the Company was declared effective by the U.S. Securities and Exchange Commission. In connection with the Agreement, the Company also entered into a registration rights agreement with the Purchasers that requires the Company to (i) file a registration statement with the SEC registering the resale of the shares of common stock issuable upon conversion of the preferred stock and the exercise of the warrants, (ii) achieve effectiveness by December 1, 2006 and (iii) maintain effectiveness of the registration statement. Failure to meet these requirements will require the Company to incur liquidating damages amounting to 1% of the outstanding amount of Series C preferred stock per month, but in no event shall consideration paid as liquidating damages exceed $1,200,000.

On February 17, 2006, the Company issued the Purchasers $22,000,000 in aggregate amount of such 8% cumulative Series C convertible preferred stock. At any time from the closing date until February 17, 2009, the Purchasers have the right to convert the preferred stock, in whole or in part, into common stock of the Company at the then effective conversion price, which varies relative to the Company's trading stock price, as follows: $0.50 per share, or 97% of the lowest closing bid price (as reported by Bloomberg) of the common stock for the 30 trading days immediately preceding the conversion date. The conversions are limited such that the holder cannot exceed 4.99% ownership, unless the holders waive their right to such limitation. The limitation will terminate under any event of default.

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

Under the Agreement, the Purchasers also received “A” warrants, “B” warrants and “C” warrants to purchase an aggregate of up to 75,000,000 shares of common stock. The warrants were exercisable in three separate traunches at a price of $0.50, $0.40 and $0.35 respectively per share, subject to adjustment, included under anti-dilution protection similar to that described above. As an inducement to enter into subsequent financing arrangements related to Cornell Debentures, the warrants were repriced on August 24, 2006 to $0.10, $0.15, and $0.10 respectively subject to all the original terms and conditions of the agreement. The warrants have a five-year contractual life. NeoMedia can force exercise of the warrants if the closing bid price of NeoMedia stock is more than $0.10 greater than the exercise price of any of the warrants for 15 consecutive trading days.

At February 17, 2006, a summary of the allocation of the components of the transaction is as follows:

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

(1) The discount to the face value of the 8% cumulative Series C convertible preferred stock that resulted from the allocation along with deferred costs is being accreted through periodic charges to additional paid-in capital using the effective interest method. Accretion of the deferred costs amounted to $604,000 and $0 during the three months ended September 30, 2006 and 2005, respectively, and $1,220,000 and $0 during the nine months ended September 30, 2006 and 2005, respectively.

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

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

The carrying value of the 8% cumulative Series C convertible preferred stock amounted to $2,931,000, net of unaccreted deferred cost of $24,349,000, at September 30, 2006. Face value of Series C convertible preferred stock at September 30, 2006 is $22,000,000. Derivative financial instruments arising from the issuance of Series C convertible preferred stock are initially recorded and continuously carried at fair values. Upon conversion of any derivative financial instrument, the change in fair value from the previous reporting date to the date of conversion is recorded to income (loss), and then the carrying value is recorded to paid-in capital, provided all other criteria for equity classification are met. The following tabular presentation reflects the components of derivative financial instruments on the Company's balance sheet at September 30, 2006:

(Assets) Liabilities:		September 30, 2006
Common stock warrants	$	4,625,000
Embedded conversion features		1,515,000
Other warrants[1]		2,126,000
	$	8,266,000

(1) The fair values of certain other derivative financial instruments (warrants) that existed at the time of the issuance of Series C convertible preferred stock were reclassified from stockholders' equity to liabilities when, in connection with the issuance of Series C convertible preferred stock, the Company no longer controlled its ability to share-settle these instruments. These derivative financial instruments had fair values of $13,883,000 and $2,072,000 on February 17, 2006 and September 30, 2006, respectively. The decrease in fair value of these other derivative financial instruments resulted from a decrease in NeoMedia's share price between February 17, 2006 and September 30, 2006. The change in fair value is reported as “Change in fair value from revaluation of warrants and embedded conversion features” in the accompanying condensed consolidated statement of operations. These warrants will be reclassified to stockholders' equity when the Company reacquires the ability to share-settle the

instruments.

The following tabular presentation reflects the number of common shares into which the aforementioned derivative financial instruments are indexed at September 30, 2006:

	Shares of common stock
Common stock warrants	75,000,000
Embedded conversion feature(1)	216,494,845
Other warrants	33,325,000
	324,819,845

(1) The terms of the embedded conversion features (ECF) in the Series C convertible preferred stock provide for variable conversion rates that are indexed to the Company's trading common stock price. As a result, the number of indexed shares is subject to continuous fluctuation. For presentation purposes, the number of shares of common stock into which the ECF was convertible as of September 30, 2006 was calculated as the face value of $22,000,000 plus assumed dividends of $1,220,000 if declared, divided by 97% of the lowest closing bid price for the 30 trading days preceding September 30, 2006 which was $0.111 per share.

Derivative income associated with adjustments recorded to reflect the aforementioned derivatives at fair value amounted to $19,934,000 and $0 for the nine months ended September 30, 2006 and 2005, respectively, and $4,161,000 and $0 for the three months ended September 30, 2006 and 2005, respectively. These amounts are reported as "Change in fair value from revaluation of warrants and embedded conversion features" in the accompanying condensed consolidated statement of operations.

Fair value considerations for derivative financial instruments:

Freestanding derivative instruments, consisting of warrants that arose from the financing and those reclassified as described above are valued using the Black-Scholes-Merton valuation methodology because that model embodies all of the relevant assumptions that address the features underlying these instruments. Significant assumptions included in this model as of September 30, 2006 are as follows:

Holder	Cornell Capital Partners	Other
Instrument	Warrants	Warrants
Exercise price	$0.10 - $0.15	$0.01 - $3.45
Term (years)	5.0	1.0 - 5.0
Volatility	59.32%	47.55%-59.32%
Risk-free rate	3.65%	3.65%

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

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

Instrument	**Features**
Conversion prices	$0.95 - $1.29
Remaining terms (years)	1 - 5
Equivalent volatility	47.55% - 48.69%
Equivalent interest-risk adjusted rate	8.17% - 8.58%
Equivalent credit-risk adjusted yield rate	14.50%

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

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

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

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

- Any cessation in the eligibility of the Company's stock to be quoted on a trading market;
- Failure to timely file the registration statement covering the shares related to the conversion option, or failure to make the registration statement effective timely.
- Any lapse in the effectiveness of the registration statement covering the shares related to the conversion option, the warrants as described and transacted in the securities purchase agreement and accompanying documents;
- Any failure to deliver certificates within the specified time; and
- Any failure, by the Company, to pay in full the amount of cash due pursuant to a buy-in or failure to pay any amounts owed on account on account of an event of default within 10 days of the date due.

Other provisions included in the Agreement include the following:

- The 8% cumulative Series C convertible preferred stock is convertible into common stock, at the option of the Purchaser, at any time after the effective date.
- Conversions can be made in increments and from time to time.
- The 8% cumulative Series C convertible preferred stock has voting rights on an “as converted” basis, meaning the Purchaser is entitled to vote the number of shares of common stock into which the 8% cumulative Series C convertible preferred stock was convertible as of the record date for a meeting of shareholders
- As promptly as practicable after any conversion date, the Company shall cause its transfer agent to deliver a certificate representing the converted shares, free of any legends and trading restrictions for the number of shares converted;
- The Company will reserve and keep available authorized and unissued registered shares available to be issued upon conversion;
- Purchaser will not be responsible for any transfer taxes relative to issuance of shares;
- If the Company offers, sells or grants stock at an effective per share price less than the then Conversion Price, then the Conversion Price shall be reduced to equal the effective conversion, exchange or purchase price for such common stock or common stock equivalents;

NeoMedia filed the registration statement covering the shares related to the conversion option beyond the date stipulated in the investor registration rights agreement. As such, NeoMedia has accrued $161,000 of liquidated damages relating to the Series C convertible stock.

Secured Convertible Debenture

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

On August 24, 2006, the Company issued the Purchasers $5,000,000 in aggregate principal amount of such convertible debentures. At any time from the closing date until August 24, 2008, the Purchasers have the right to convert the convertible debenture into common stock of the Company at the then effective conversion price, which varies relative to the Company's trading stock price, as follows: $0.15 per share, or 90% of the lowest closing bid price (as reported by Bloomberg) of the common stock for the 30 trading days immediately preceding the conversion date. The conversion is limited such that the holder cannot exceed 4.99% ownership, unless the holders waive their right to such limitation. The limitation will terminate under any event of default.

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

Under the Agreement, the Purchasers also received "A" warrants, "B" warrants, "C" warrants and "D" warrants to purchase 25,000,000, 50,000,000, 50,000,000, and 50,000,000 shares of common stock respectively. The warrants are exercisable in four separate traunches at a price of $0.15, $0.25, $0.20 and $0.05 respectively per share, subject to adjustment, included under anti-dilution protection similar to that described above. The warrants have a five-year contractual life. NeoMedia can force exercise of the warrants if the closing bid price of NeoMedia stock is more than $0.10 greater than the exercise price of any of the warrants for 15 consecutive trading days.

At August 24, 2006, a summary of the allocation of the components of the transaction is as follows:

Instrument:		
Convertible debenture(1)	$	—
Common stock warrants(2)		18,507,000
Embedded conversion feature		970,000
Derivative loss		(14,477,000)
Total gross proceeds	$	5,000,000

(1) There were insufficient proceeds to allocate amounts to the host debentures. Accordingly, for purposes of application of the effective interest method, the company applied the 1% convention which provides for recognition of 1% of the future value as amortization. Amortization of debt discount amounted to $73,000

at September 30, 2006. Unamortized debt discount at September 30, 2006 was $4,927,000.

(2) The Company issued warrants to purchase aggregate 175,000,000 shares of common stock in connection with the convertible debenture, as described above.

The carrying value of the convertible debenture amounted to $73,000 net of unamortized debt discount $4,927,000 at September 30, 2006. The face value of convertible debenture at September 30, 2006 is $5,000,000. The discount recorded at inception of the debenture was equal to the $5,000,000 face value and $1,000,000 of contractual interest at the stated rate of 10% over the term of the debenture was included in the computation of the effective interest rate. Derivative financial instruments arising from the issuance of convertible debenture are initially recorded and continuously carried at fair values. Upon conversion of any derivative financial instrument, the change in fair value from the previous reporting date to the date of conversion is recorded to income (loss), and then the carrying value is recorded to paid-in capital, provided all other criteria for equity classification are met. The following tabular presentation reflects the components of derivative financial instruments related to convertible debentures on the Company's balance sheet at September 30, 2006:

(Assets) Liabilities:		**September 30, 2006**
Common stock warrants	$	17,567,000
Embedded conversion features		864,000
	$	18,431,000

The following tabular presentation reflects the number of common shares into which the aforementioned derivative financial instruments are indexed at September 30, 2006:

	Shares of common stock
Common stock warrants	175,000,000
Embedded conversion feature[1]	50,505,051
	225,505,051

(1) The terms of the embedded conversion features (ECF) in the convertible debenture provide for variable conversion rates that are indexed to the Company's trading common stock price. As a result, the number of indexed shares is subject to continuous fluctuation. For presentation purposes, the number of shares of common stock into which the ECF was convertible as of September 30, 2006 was calculated as the face value of $5,000,000 plus assumed interest of $51,000 due at maturity, divided by 90% of the lowest closing bid price for the 30 trading days preceding September 30, 2006.

Derivative loss for the three and nine months ended September 30, 2006 and 2005 associated with adjustments recorded to reflect the aforementioned derivatives at fair value amounted to $13,431,000 and $0, respectively, and is reported as “Change in fair value from revaluation of warrants and embeddded conversion features” in the accompanying condensed consolidated statement of operations.

<u>Fair value considerations for derivative financial instruments</u>:

Freestanding derivative instruments, consisting of warrants that arose from the financing are valued using the Black-Scholes-Merton valuation methodology because that model embodies all of the relevant assumptions that address the features underlying these instruments. Significant assumptions included in this model as of September 30, 2006 are as follows:

Holder	Cornell Capital Partners
Instrument	Warrants
Exercise price	$0.05 - $0.25
Term (years)	5.0
Volatility	67.62%

Risk-free rate	4.78%

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

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

Instrument:	**Features**
Conversion prices	$0.099
Remaining terms (years)	2
Equivalent volatility	56.03% - 58.00%
Equivalent interest-risk adjusted rate	%
Equivalent credit-risk adjusted yield rate	15.25%

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

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

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

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

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

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

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

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

Other provisions included in the Agreement include the following:

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

- As promptly as practicable after any conversion date, the Company shall cause its transfer agent to deliver a certificate representing the converted shares, free of any legends and trading restrictions for the number of shares converted;

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

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

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

- Pursuant to the terms of the convertible debenture agreement between NeoMedia and Cornell signed in connection with the convertible debenture sale, without Cornell's consent NeoMedia cannot

  - (i) issue or sell any shares of Common Stock or preferred stock without consideration or for consideration per share less than the closing bid price immediately prior to its issuance,

  - (ii) issue or sell any preferred stock, warrant, option, right, contract, call, or other security or instrument granting the holder thereof the right to acquire common stock for consideration per share less than the closing bid price immediately prior to its issuance,

  - (iii) enter into any security instrument granting the holder a security interest in any of its assets of, or

  - (iv) file any registration statements on Form S-8.

- In addition, pursuant to a security agreement between NeoMedia and Cornell signed in connection with the convertible debenture, Cornell has a security interest in all of NeoMedia's assets.

Standby Equity Distribution Agreements with Cornell

On October 27, 2003, NeoMedia and Cornell entered into a $20 million Standby Equity Distribution Agreement (the “2003 SEDA”). The agreement provided for a maximum “draw” of $280,000 per week, not to exceed $840,000 in any 30-day period, and Cornell was obligated to purchase up to $20 million of the Company's common stock over a two-year period. The SEDA became effective during January 2004, and expired after a two-year term in January 2006. During the nine months ended September 30, 2006 and 2005, NeoMedia sold 751,880 and 19,337,119 shares of its common stock to Cornell pursuant to the 2003 SEDA. The following table summarizes funding received from Cornell during the nine months ended September 30, 2006 and 2005:

	2006							
		First Quarter		Second Quarter		Third Quarter		Nine Months Ended September 30
Number of shares sold to Cornell		751,880		—		—		751,880
Gross Proceeds from sale of shares	$	234,000	$	—	$	—	$	234,000
Less: discounts and fees*		(24,000)		—		—		(24,000)
Net Proceeds from sale of shares	$	210,000	$	—	$	—	$	210,000

	2005							
		First Quarter		Second Quarter		Third Quarter		Nine Months Ended September 30
Number of shares sold to Cornell		6,998,931		7,258,094		5,080,094		19,337,119
Gross Proceeds from sale of shares	$	1,709,000	$	3,219,000	$	2,130,000	$	7,058,000
Less: discounts and fees*		(204,000)		(489,000)		(170,000)		(863,000)
Net Proceeds from sale of shares	$	1,505,000	$	2,730,000	$	1,960,000	$	6,195,000

* Pursuant to the terms of the 2003 SEDA, stock was valued at 98% of the lowest closing bid price during the week it was sold.

On March 30, 2005, NeoMedia and Cornell entered into a Standby Equity Distribution Agreement (the “2005 SEDA”) under which Cornell agreed to purchase up to $100 million of NeoMedia common stock over a two-year period, with the timing and amount of the purchase at NeoMedia's discretion. The maximum amount of each purchase would be $2,000,000 with a minimum of five business days between advances. The shares would be valued at 98% of the lowest closing bid price during the five-day period following the delivery of a notice of purchase by NeoMedia, and NeoMedia would pay 5% of the gross proceeds of each purchase to Cornell. Based on NeoMedia's current market capitalization and other outstanding securities, NeoMedia does not believe that the 2005 SEDA is currently a viable source of financing.

As a commitment fee for Cornell to enter into the 2005 SEDA, NeoMedia issued 50 million warrants to Cornell with an exercise price of $0.20 per share for a term of three (3) years, and also paid a cash commitment fee of $1 million.

During the nine months ended September 30, 2006, Cornell exercised 40 million of the warrants, generating cash proceeds of $8 million to NeoMedia. During August 2006, in connection with the Convertible Debenture, NeoMedia repriced the remaining 2 million warrants to an exercise price of $0.10 per share. NeoMedia also issued 4 million warrants with an exercise price of $0.227 to a consultant as a fee in connection with the 2005 SEDA, which have not been exercised. NeoMedia recorded the $13,256,000 fair value of the warrants to "Deferred equity financing costs" at inception. This amount was written off during the three months ended September 30, 2006 because the Company believes that it can no longer consider the SEDA a viable financing source due to the requirements of the preferred stock financing and the debenture financing.

Promissory Note Payable to Cornell

On March 30, 2005, NeoMedia borrowed from Cornell the principal amount of $10,000,000 before discounts and fees in the form of a secured promissory note. Cornell withheld structuring and escrow fees of $68,000 related to the note. The note was originally scheduled to be repaid at a rate of $1,120,000 per month commencing May 1, 2005, which was subsequently changed to $840,000 per month, continuing until principal and interest were paid in full. The note accrued interest at a rate of 8% per annum on any unpaid principal. In connection with the note, NeoMedia and Cornell entered into a Security Agreement under which the note was secured by all of NeoMedia's assets other than its patents and patent applications. NeoMedia also escrowed 25,000,000 shares of its restricted common stock as security for the note. During the period from March 30, 2005 through January 9, 2006, NeoMedia made payments against the principal totaling $7,210,000. On February 17, 2006, NeoMedia retired the balance of the principal in the amount of $2,790,000, plus accrued interest of $419,000, from the proceeds of the Series C convertible preferred financing arrangement with Cornell. In connection with the payment and issuance of the Series C convertible preferred stock, NeoMedia recognized a loss on extinguishment of debt of $1,964,000 during the nine months ended September 30, 2006.

6. INVESTMENT IN MARKETABLE SECURITIES

On February 25, 2005, NeoMedia invested $250,000 in exchange for 8,333,333 shares of Pickups Plus, Inc ("PUPS") restricted common stock. On February 17, 2006, as a component of net proceeds from the issuance of 8% Series C convertible preferred stock, NeoMedia received marketable securities with a fair value of $579,000, of which, $200,000 represented 20,000,000 shares of PUPS common stock and $379,000 in notes designated as held to maturity. NeoMedia acquired an additional 20,000,000 shares of PUPS common stock for a purchase price equal to $389,000. PUPS is a retail operator and franchiser of retail automotive parts and accessories stores catering to the light truck market, and also provides new vehicle preparation, environmental protection packages, detailing and reconditioning products and services. In accordance with Statements of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities," the investment in PUPS is being recorded as available-for-sale securities and reported at fair value. Accordingly, unrealized gains and losses on the equity securities are reflected in the condensed consolidated statement of operations and comprehensive income (loss).

The investments in marketable securities are summarized as follows:

	Cost	Unrealized Holding Gain	Unrealized Holding Losses	Fair Value Adjustments	Fair Value
Available-for-sale	$ 639,000	$ -	($384,000)	$ -	$ 255,000
Held to maturity	$ 379,000	$ -	$ -	$ 108,000	$ 487,000

Held to maturity securities consist of four notes receivable from PUPS with a face value of $1,611,000 and a fair value of $487,000. The fair value of $487,000 is recorded in other long-term assets on the consolidated balance sheet as of September 30, 2006, and is based upon a risk adjusted anticipated rate of return. The notes are delinquent and accrue interest at rates between 12 - 24%. NeoMedia has not recorded any interest since the Company is using the cost recovery method.

7. FINANCIAL INSTRUMENTS

The carrying amount of the Company's cash equivalents, accounts receivable, prepaid expenses, other current assets, cash surrender value of life insurance policy, accounts payable and accrued expenses, accrued salaries and benefits, and payable to merchants approximates their estimated fair values due to the short-term maturities of those financial instruments.

Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate fair value of existing debt.

It is not practicable to estimate the fair value of the Company's 17% investment in the common stock of i-Point Media Ltd. and its investments of 250,000 shares of preferred stock of Intactis Software, Inc., because of the lack of quoted market prices and the inability to estimate fair value without incurring excessive costs. During the year ended December 31, 2005 NeoMedia took an impairment of the carrying values of its investments in iPoint-media and Intactis of $530,000 and $250,000, respectively. No impairment charge was taken during the nine months ended September 30, 2006. The net carrying value of these investments were $470,000 as of September 30, 2006.

For all available-for-sale investment securities, the carrying values represents fair value of the securities and unrealized gain (losses) that are other than temporary are recognized as other comprehensive income (loss). NeoMedia does not hold these securities for speculative or trading purposes. Also see Note 6.

8. COMPUTATION OF NET INCOME (LOSS) PER SHARE

Basic net loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. During the three and nine month periods ended September 30, 2006 and 2005, the Company reported net loss per share, and as such basic and diluted loss per share were equivalent. The Company has excluded all outstanding stock options and warrants from the calculation of diluted net loss per share because these securities are anti-dilutive for all years presented. The shares excluded from the calculation of diluted net loss per share are detailed in the table below:

	September 30, 2006	**September 30, 2005**
Outstanding Stock Options	117,317,058	77,629,221
Outstanding Warrants	276,325,000	72,775,000

9. STOCK BASED COMPENSATION

Option-based Compensation Expense

At September 30, 2006, NeoMedia has four employee stock option plans (the 1996 Stock Option Plan, the 1998 Stock Option Plan, the 2003 Stock Option Plan, and the 2005 Stock Option Plan) and one employee stock compensation plan (the 2003 Stock Incentive Plan) (collectively, the “Plans”). Prior to January 1, 2006, NeoMedia accounted for those plans under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations, as permitted by FASB Statement No. 123, Accounting for Stock-Based Compensation (“Statement 123(R)”). No stock-based employee compensation cost was recognized in the statement of operations for the fiscal years or interim periods ended prior to December 31, 2005, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2006, NeoMedia adopted the fair value recognition provisions of Statement 123(R), using the modified-prospective-transition method. Under that transition method, compensation cost recognized in 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R). Results for prior periods have not been restated.

As a result of adopting Statement 123(R) on January 1, 2006, NeoMedia's net loss for the three and nine months ended September 30, 2006 is $2,483,000 and $5,433,000 higher (including $163,000 and $485,000 relating to discontinued operations) respectively, than if it had continued to account for share-based compensation under Opinion 25. Basic and diluted loss per share, as well as loss per share attributable to common shareholders, are each higher by less than $0.01 per share for the three months ended September 30, 2006 than they would have been if NeoMedia had not adopted Statement 123(R). Basic and diluted loss per share, as well as loss per share attributable to common shareholders, are each higher by $0.01 per share for the nine months ended September 30, 2006 than they would have been if NeoMedia had not adopted Statement 123(R). Estimated income tax benefits recognized during the three and nine months ended September 30, 2006 were offset by a valuation allowance since realization was not reasonably assured.

Prior to the adoption of Statement 123(R), it was NeoMedia's policy to present all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in its statement of cash flows, however, due to NeoMedia's tax loss carryforward, any such benefits were always fully offset by a valuation allowance. Statement 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. NeoMedia will use this presentation if and when it has exhausted its tax loss carryforward.

The following table illustrates the effect on net loss and loss per share if NeoMedia had applied the fair value recognition provisions of Statement 123(R) to options granted under NeoMedia's stock option plans in 2005. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes option-pricing formula and amortized to expense over the options' vesting periods.

	Three Months Ended September 30, 2005	**Nine Months Ended September 30, 2005**
Net Loss, as reported	($1,950)	($5,469)
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	—	—
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	(1,080)	(2,760)
Pro-forma net loss	($3,030)	($8,229)
Net Loss per share:		
Basic and diluted - as reported	($0.00)	($0.01)
Basic and diluted - pro-forma	($0.01)	($0.02)

Note that the above pro forma disclosures are provided for the three and nine months ended September 30, 2005 because employee stock options were not accounted for using the fair-value method during those periods.

The Plans permit the grant of share options and shares to NeoMedia's employees, board of directors, and outside consultants. NeoMedia believes that such awards better align the interests of its employees with those of its shareholders. Option awards are generally granted with an exercise price equal to the market price of NeoMedia's stock at the date of grant; those option awards generally vest over a period of 3 years and have 10-year contractual terms. Shares granted upon the exercise of stock options are newly issued shares. The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model that uses the assumptions noted in the following table. Because the Black-Scholes valuation model incorporates ranges of assumptions for inputs, those ranges are disclosed. Expected volatilities are based on the expected impact on future stock price of expected future revenue and earnings, historical volatility of NeoMedia's stock, and other factors. NeoMedia uses historical data to estimate option exercise and employee termination within the valuation model. The expected term of options granted represents the period of time that options granted are expected to be outstanding.

	Three and Nine months ended September 30,	
	2006	**2005**
Volatility	56% - 28%	431% - 449%
Expected dividends	—	—
Expected term (in years)	3	3
Risk-free rate	4.35%	4.50%

As of January 1, 2006, NeoMedia reevaluated its volatility calculation to take into consideration the guidance outlined in Statement 123(R). Prior to January 1, 2006, NeoMedia calculated volatility using only historical share price data. Under the provisions of Statement 123(R), from January 1, 2006 onward NeoMedia has considered historical volatility, as well expected future volatility. As a result, NeoMedia's volatility decreased significantly for stock based compensation granted during the nine months ended September 30, 2006 as compared with stock based compensation granted prior to January 1, 2006. NeoMedia will evaluate its volatility on an ongoing basis using the most current information available. NeoMedia expects that, under the guidelines of Statement 123(R), future volatility will more closely resemble 2006 levels than previous years.

A summary of option activity under the Plans as of September 30, 2006, and changes during the nine months then ended is presented below:

	Shares (In thousands)		**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term** (in years)		**Aggregate Intrinsic Value** (In thousands)
Outstanding at January 1, 2006	100,041	$	0.18			
Granted	25,660	$	0.36			
Exercised	(2,568)	$	0.14			
Forfeited	(5,816)	$	0.25			
Outstanding at September 30, 2006	117,317	$	0.22	8.6	$	2,871
Vested or expected to vest at September 30, 2006	72,995	$	0.16	8.2	$	2,842

The weighted-average grant-date fair value of options granted during the nine months ended September 30, 2006 was $0.11. The total intrinsic value of options exercised during the nine months ended September 30, 2006 was $425,000. Total cash received from options exercised was $350,000 and $903,000 for the nine months ended September 30, 2006 and 2005, respectively.

A summary of the status of NeoMedia's nonvested shares as of September 30, 2006, and changes during the nine months ended September 30, 2006, is presented below:

Nonvested Shares	**Shares** (in thousands)		**Weighted Average Grant Date Fair Value**
Nonvested at January 1, 2006	44,215	$	0.18
Granted	15,870	$	0.12
Vested	(11,929)	$	0.20
Forfeited	(3,834)	$	0.21
Nonvested at September 30, 2006	44,322	$	0.24

As of September 30, 2006, there was $7,973,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized over a weighted-average period of 1.2 years.

Other Stock-based Compensation Expense

On January 10, 2006, NeoMedia issued 52,632 fully vested shares to an employee as a sign-on bonus. The shares were valued at $0.309 per share, which was the last sale price of NeoMedia common stock on the date of issuance. The aggregate fair value of $16,000 was expensed during the nine months ended September 30, 2006.

On April 5, 2006, NeoMedia issued 115,681 fully vested shares to an employee as a sign-on bonus. The shares were valued at $0.389 per share, which was the last sale price of NeoMedia common stock on the date of issuance. The aggregate fair value of $45,000 was expensed during the nine months ended September 30, 2006.

On May 30, 2006, June 30, 2006, and July 31, 2006, NeoMedia issued 6,977, 6,557, and 36,000 fully vested shares, respectively, to an outside consultant for services rendered. The shares were valued at $0.215, $0.244, and $0.19 per share, respectively, which was the last sale price of NeoMedia common stock on the date of each issuance. The aggregate fair value of $10,000 was expensed during the nine months ended September 30, 2006.

On August 8, 2006, NeoMedia issued 1,098,467 fully vested shares to an outside consultant as prepayment for one year of consulting services. The shares were valued at $0.163 per share, which was the last sale price of NeoMedia common stock on the date of issuance. The aggregate fair value of $179,000 was expensed during the nine months ended September 30, 2006.

On August 29, 2006, NeoMedia issued 161,290 fully vested shares to an employee as a sign-on bonus. The shares were valued at $0.124 per share, which was the last sale price of NeoMedia common stock on the date of issuance. The aggregate fair value of $20,000 was expensed during the nine months ended September 30, 2006.

On August 31, 2006, NeoMedia issued 4,975,000 fully vested shares to an employee in exchange for (i) an extension of the employee's service agreement through December 31, 2007, and (ii) a waiver of certain of the employee's rights to receive additional shares under a previous contract. The shares were valued at $0.132 per share, which was the last sale price of NeoMedia common stock on the date of issuance. The aggregate fair value of $657,000 was expensed during the nine months ended September 30, 2006.

On August 31, 2006, NeoMedia issued 5,400,000 fully vested shares to an employee in exchange for (i) an extension of the employee's service agreement through December 31, 2007, and (ii) a waiver of certain of the employee's rights to receive additional shares under a previous contract. The shares were valued at $0.132 per share, which was the last sale price of NeoMedia common stock on the date of issuance. The aggregate fair value of $713,000 was expensed during the nine months ended September 30, 2006.

On September 12, 2006, NeoMedia issued 96,429 fully vested shares to an outside consultant for services rendered. The shares were valued at $0.14 per share, which was the last sale price of NeoMedia common stock on the date of issuance. The aggregate fair value of $14,000 was expensed during the nine months ended September 30, 2006.

Subsequent Events

On October 4, 2006, NeoMedia issued 94,340 fully vested shares to an employee as a sign-on bonus. The shares were valued at $0.106 per share, which was the last sale price of NeoMedia common stock on the date of issuance. The aggregate fair value of $10,000 will be expensed during the fourth quarter of 2006.

On October 17, 2006, NeoMedia issued 104,167 fully vested shares to an employee as a sign-on bonus. The shares were valued at $0.10 per share, which was the last sale price of NeoMedia common stock on the date of issuance. The aggregate fair value of $10,000 will be expensed during the fourth quarter of 2006.

On October 18, 2006, NeoMedia issued 5,500,000 fully vested shares to an employee in exchange for an extension of the employee's services. The shares were valued at $0.097 per share, which was the last sale price of NeoMedia common stock on the date of issuance. NeoMedia did not recognize any expense relating to this issuance during the three and nine month periods ended September 30, 2006 since the issuance occurred in October. NeoMedia will expense the aggregate fair value of $534,000 during the fourth quarter of 2006.

On October 20, 2006, NeoMedia issued 108,630 fully vested shares to an employee as severance payment. The shares were valued at $0.10 per share, which was the last sale price of NeoMedia common stock on the date of issuance. The aggregate fair value of $10,000 will be expensed during the fourth quarter of 2006.

On October 23, 2006, NeoMedia issued 250,000 fully vested shares to an employee as a sign-on bonus. The shares were valued at $0.10 per share, which was the last sale price of NeoMedia common stock on the date of issuance. The aggregate fair value of $25,000 will be expensed during the fourth quarter of 2006.

10. SEGMENT REPORTING

As of September 30, 2006, NeoMedia was structured and evaluated by its Board of Directors and Management as three distinct business units:

- NeoMedia Mobile (NMM) - encompassing NeoMedia's physical-world-to-internet and mobile marketing technologies branded under qode, 12Snap, Sponge, Gavitec and Mobot

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

- NeoMedia Telecom Services (NTS) - encompassing the billing, clearinghouse and information management services of recently-acquired BSD

NeoMedia's reportable segments are strategic business units that offer different technology and marketing strategies. NMM is headquartered in Ft. Myers, Florida, and operates principally in the United States and in Europe through the recent acquisitions of Sponge (United Kingdom), 12Snap (Germany) and Gavitec (Germany). NMPR is headquartered in Ft. Myers, Florida, and currently sells into Canada, the United States, Australia, New Zealand, Scandinavia, Mexico and China. NTS is headquartered in Calgary, Alberta, Canada and presently primarily operates within Canada.

On August 30, 2006, NeoMedia signed a non-binding letter of intent to sell its NMPR business unit to Jose Sada, a technology partner of NeoMedia Micro Paint Repair, backed by Global Emerging Markets Group of New York City. The letter of intent calls for consummation of the transaction on or before November 24, 2006. As a result of the letter of intent to sell NMPR, results of operations of NMPR are shown under the caption “Net loss from Micro Paint business to be sold” on the accompanying condensed consolidated financial statements, and as such are no longer included in this segment reporting.

Consolidated net sales and net loss from continuing operations for the three and nine month periods ended September 30, 2006 and 2005, and identifiable assets as of September 30, 2006 by geographic area were as follows:

	(in thousands) Three Months Ended September 30,		(in thousands) Nine Months Ended September 30,	
	2006	2005	2006	2005
Net Sales: [2]				
United States	$ 298	$ 193	$ 819	$ 762
Germany	1,424	—	3,713	—
United Kingdom	697	—	1,748	—
Canada	547	—	1,089	—
Italy	597	—	1,179	—
Other	28	—	296	—
	$ 3,591	$ 193	$ 8,844	$ 762
Net Loss From Continuing Operations: [2]				
United States	($28,981)	($1,569)	($23,593)	($4,162)
Germany	(150)	—	(759)	—
United Kingdom	(561)	—	(543)	—
Canada	227	—	463	—
Italy	(271)	—	(41)	—
Other	447	—	205	—
	($29,289)	($1,569)	($24,268)	($4,162)
Identifiable Assets [2]				
United States [1]	$ 80,429			
Germany	1,672			
United Kingdom	676			
Canada	1,594			