

Neonode, Inc
Form 10-K
March 11, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2015

or

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

For the transition period from _____ to _____

Commission File No. 1-35526

NEONODE INC.

(Exact name of Registrant as specified in its charter)

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

Storgatan 23C, 114 55 Stockholm, Sweden

(Address of Principal Executive Office and Zip Code)

+46 (0) 8 667 17 17

(Registrant's Telephone Number, including Area Code)

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

| Title of Each Class | Name of Each Exchange on Which Registered |
|--|--|
| Common Stock, par value \$0.001 per share | The NASDAQ Stock Market LLC |

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

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

The approximate aggregate market value of voting and non-voting common equity held by non-affiliates of the registrant, based on the closing price for the registrant's common stock on June 30, 2015 (the last business day of the registrant's most recently completed second fiscal quarter) as reported on the NASDAQ Stock Market, was \$101,549,947.

The number of shares of the registrant's common stock outstanding as of March 1, 2016 was 43,817,151.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive proxy statement for the registrant's 2016 Annual Meeting of Stockholders are incorporated by reference as set forth in Part III of this Annual Report. The registrant intends to file such definitive proxy statement with the Securities and Exchange Commission within 120 days of the registrant's fiscal year ended December 31, 2015.

NEONODE INC.

2015 ANNUAL REPORT ON FORM 10-K

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SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

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

PART I

ITEM 1. BUSINESS

Neonode Inc. (collectively with its subsidiaries, is referred to in this Annual Report as “Neonode”, “we”, “us”, “our”, “registrant”, or “Company”) develops and licenses user interfaces and optical interactive touch solutions. Our patented technology offers multiple features including the ability to sense an object’s size, depth, velocity, pressure, and proximity to any type of surface. We license our multi-touch technology to Original Equipment Manufacturers (“OEMs”) and Original Design Manufacturers (“ODMs”) who incorporate it into devices that they develop, manufacture and sell. In addition, in 2016, we expect to begin manufacturing and selling touch modules to OEMs, distributors and directly to end users.

Our Company

Neonode Inc., formerly known as SBE, Inc., was incorporated in the State of Delaware on September 4, 1997. SBE’s name was changed to Neonode Inc. upon the completion of a merger on August 10, 2007 between SBE and the parent company of Neonode AB, a company founded in February 2004 and incorporated in Sweden. As a result of the merger, the business and operations of Neonode AB became the primary business and operations of Neonode Inc. Our principal executive office is located in Stockholm, Sweden. Our office in the United States is located in San Jose, California.

In 2008, we established a wholly owned subsidiary Neonode Technologies AB (Sweden) to develop and license touchscreen technology. In 2013, we established additional wholly owned subsidiaries: Neonode Japan Inc., (Japan); Neno User Interface Solutions AB (Sweden); NEON Technology Inc. (U.S.); and Neonode Americas Inc. (U.S.). In 2014, we established one additional wholly owned subsidiary: Neonode Korea Ltd. (South Korea). In 2015, we established one additional wholly owned subsidiary: Neonode Taiwan Ltd (Taiwan). In 2015, we established a 51% majority owned consolidated subsidiary: Pronode Technologies AB (Sweden).

Trademarks

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

Our Touch Solution

We develop and license user interface and touch technology. We also are developing, and intend to manufacture and sell, hardware solutions incorporating our interface and touch technology.

We offer a patented family of optical touch solutions under the zForce and MultiSensing brands . Our optical touch technology is capable of projecting a full plane of light beams in free air or over any flat touch surface. Our technology can also send light into a fluid or a glass to achieve a flush design without a bezel. An object touching the touch surface obstructs a portion of the projected light beams. This small variance of signal is detected with sensitive light sensors connected to our touch controllers that process the analog signals and produce touch object coordinates.

Licensing Solutions

As of December 31, 2015, we had forty technology license agreements with global OEMs and ODMs. Sixteen of our customers are currently shipping products and we anticipate other customers will initiate product shipments as they complete their final product development and release cycle throughout 2016 and onwards. In addition, we are currently developing prototype products and are engaged in product engineering design discussions with numerous global OEMs and ODMs who are in the process of qualifying our touch technology for incorporation in various

products. The development and release cycle for these products typically takes six to thirty-six months.

Consumers experience our technology in products such as laptop computers, all-in-one computers and stand-alone monitors running on Microsoft Windows and Google Chrome operating systems, printer products, GPS devices, e-readers, tablets, touch panels for automobiles, household appliances, mobile phones, wearable electronics, games and toys. In addition to traditional screens, our technology can make any surface – including water and air – touch functional.

For OEMs and ODMs, our solution offers industrial design flexibility, low power consumption, and cost-effective manufacturing. OEMS and ODMs can incorporate our touch technology into a wide range of devices such as tablets and e-readers, printers, computers, mobile phones, wearables, toys and gaming consoles, and advanced automotive infotainment systems.

We also offer engineering consulting services to our OEM and ODM customers on a flat rate or hourly rate basis.

Hardware Solutions

In 2015, we announced the development of AirBar. Through a simple USB connection, the AirBar hardware module will enable touch functionality for non-touch PCs. The AirBar “Plug-and-Touch” solution is based on our zForce AIR sensing platform.

We expect to begin manufacturing and selling AirBar in 2016. Initially, we intend to offer AirBar for notebook PCs. We expect to market AirBar through consumer electronics retailers, online stores, and resellers to the education and enterprise customers. We have signed agreements with Ingram Micro to act as our direct customer and distribution channel.

Beyond direct purchasers of AirBar, we anticipate demand from PC OEMs to bundle AirBar with their non-touch notebooks to add greater value and functionality to their low to mid-end notebooks.

Touch Technologies

Background

There are various technologies for touchscreen and touch-enabled surfaces available in the market with differing profiles, power consumption, level of maturity, and cost:

Optical touch technology uses light beams that are broken, reflected by a finger or other non-conductive object to detect a touch.

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

Resistive touchscreens use conductive and resistive layers separated by thin space.

Acoustic pulse recognition touch technology uses piezoelectric transducers located at positions of the screen to turn the mechanical energy of a touch vibration into an electronic signal.

Surface acoustic wave touchscreens use ultrasonic waves that pass over the screen.

In-cell optical touch technology embeds photo sensors or conductive sensors directly into a Liquid Crystal Display (“LCD”) glass to act like a low-resolution camera to “see” the shadow of the finger.

Dispersive signal touch technology uses sensors to detect the mechanical energy in the glass occurring due to a touch.

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

Optical Touch Advantages

Our optical technology projects light across the touch surface or detection area without any need for an extra physical layer to be added. It can be used with thick gloves or any other object. Our optical touch technology also can be fully waterproofed and will provide touch functionality even when fully submerged. In addition to traditional touch interaction on the screen, our optional touch technology can be used in the free space around the screen or product using proximity sensing.

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

Our optical technology does not require additional layers that may dilute the image quality of the display or cause unwanted reflections and glare making reading the display difficult;

Our optical technology is more responsive than capacitive sensor technology and, as a result, is quicker and less prone to misread;

Our optical technology requires no downward pressure on the touch surface in order to select or move items on the touch surface in stark contrast to resistive touch screens;

Our optical technology is cost-efficient due to the lower cost of materials and simple and high yield manufacturing process;

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

Our optical technology works in all climates and environments and does not require any special properties from the object used; and

Our optical technology does not require any black space or borders on the sides of the display and can therefore enable a slimmer design around a display leading to smaller and better looking devices.

Unlike competing technologies, our optical touch screen technology does not require glass. The removal of the glass reduces glare, enhances image clarity, optimizes power consumption, lightens weight, and lowers cost. In contrast, other touch technologies such as capacitive and resistive require a physical touch sensor layer, typically covering the display, in order to detect touches. Layering technology required to activate the capacitive and resistive sensors can be very costly. Glass or plastic layers used in capacitive touch may also increase the friction of the touch surface giving a less enjoyable feel.

Our Market

Automotive

Touch interface displays are becoming standard equipment in vehicles. Display sizes are increasing and curved displays are appearing on the market. Our touch technology is able to support size and shape in a cost-effective manner. We develop our touch technology to meet stringent operating requirements for automotive environments, including electrical, temperature, moisture and vibration standards. Unlike competing technologies such as resistive and projected capacitive, our optical touch solutions does not require an additional layer to be placed in front of the screen which otherwise would reduce the readability of the screen and causes glare and reflections. We believe our technology delivers the highest performance and the highest reliability in the market.

In 2015, our ten automotive OEM customers had a total of twenty automobile models in the market. The majority of these are in China and include SUVs (Boojun 560 and Haval H6) and the two top-selling sedans (Chevrolet Cruze and Buick Excelle). In the fourth quarter of 2014, Volvo launched their new XC90 incorporating a 9.7 inch display using our touch technology. In the fourth quarter of 2014, the new MG GT was launched also using our technology.

We believe that our optical touch solutions are positioned to make further inroads in the global automotive market by providing brighter, more readable displays, with a full operating temperature range that are easily usable while wearing gloves. The Volvo XC90 and S90 infotainment systems have received awards citing properties such as responsiveness and gloved operation. These properties are based upon our zForce touch technology.

In addition to infotainment displays, our zForce AIR technology is adaptable to other automobile components:

our zForce DRIVE technology enables high fidelity detection of hands and fingers positions on the steering wheel. This helps create a safer and more natural interaction with the automobile's systems and the driver's smart phone to decrease driver distraction. In 2015, we entered into an agreement with Autoliv Development AB, a leading supplier of safety products for the automotive industry, to explore and industrialize our zForce technology for the steering wheel.

our zForce AIR technology is being deployed in door handles and other exterior parts of the automobile to enable keyless entry and automation of door functions. We estimate that the first systems will be available in early 2017.

We currently are engaged with several global automotive OEMs and their tier one suppliers developing automotive Human Machine Interface ("HMI") infotainment and entry systems. These projects typically have long development cycles that can take as long as four to five years before any meaningful production and license fee generation will occur.

Printers and Office Equipment

Photo printers and printers combining printer/scanner/fax functions typically require feature-rich menus and settings to deliver the best user experience, and printer OEMs are increasingly replacing mechanical buttons with interactive displays. We have signed agreements with five of the leading global printers and office equipment OEMs including Hewlett Packard (“HP”) and Samsung. HP started shipping the first consumer printer with our touch technology integrated in early 2014 and today the majority of their printer models with interactive displays are using our technology. Lexmark released seven new models of next generation color printers with a touch interface in January 2016. Samsung and two other customers are currently finalizing their development phase and are expected to have printers and office equipment ready for retail rollouts throughout 2016 and 2017.

E-Readers and Tablets

Our touch technology is widely used in e-readers and tablets. Since 2011, over 23 million e-reader and tablet units have been shipped containing our touch technology by customers such as Amazon, Kobo, Deutsche Telekom, Barnes & Noble and Sony. Sony is currently shipping a 13.3 inch writing tablet named “Digital Paper” that integrates our technology. Customers such as LeapFrog Enterprises and LG are shipping tablets with our technology.

Computers and Monitors

Our touch technology is suitable for laptops, all-in-one computers and stand-alone monitors. Our technology provides for a state of the art modern looking industrial design with no bezels and a flush edge to edge design optimized for the new generation of LCD panels with only a few millimeters of black frame. Because it does not require any expensive and brittle glass in front of the LCD to carry the touch sensors, our touch solution can result in more reduction in the cost to implement touch functionality, and in a glare free product with less weight and more usage time on the same battery. In addition, our technology scales over different display sizes and can handle curved displays as well as large transparent displays. We have technology license agreements and are in product design phase with tier one computer and monitor OEMs that we expect will begin shipping products in 2016. We are also in the process of attaining Microsoft Windows 10 certification on top of our already received Windows 8.1 certification.

Distribution, Sales and Marketing

In our licensing business, we consider OEMs and ODMs to be our primary customers. OEMs and ODMs determine the design requirements and make the overall decision regarding the use of our user interface and touch technology in

their products. The use and pricing of our user interface and touch technology are governed by a technology licensing agreement.

Our sales staff solicits prospective customers and receives substantial technical assistance and support from our internal engineering resources because of the highly technical nature of our product solutions. We expect that sales will frequently result from our sales efforts that involve executive/senior management, design engineers, and our sales personnel interacting with our potential customers' decision-makers throughout the product development and order process.

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

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

We intend initially to produce AirBar through partners in Sweden in a highly automated manufacturing process. From this production facility we will ship to distributors such as Ingram Micro in various global locations. Ingram Micro will fulfill retailer, online stores, and reseller customer orders. Ingram Micro also will be the fulfillment partner for all online sales which take place through www.air.bar.

Controller Chips

Under our licensing model, our OEM and ODM customers may use customized single optical controller chips developed in collaboration with Texas Instruments or STMicroelectronics designed specifically for our optical touch technology. These controller chips can only be sold to customers who have a technology license agreement with Neonode.

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

The NN1002, the second generation optical controller chip, was developed pursuant to an Analog Device Development Agreement between Neonode and Texas Instruments entered into on April 25, 2013 effective December 6, 2012. The NN1002 began sampling to customers in May 2014.

The NN1003 is the third generation controller chip and is currently in development with STMicroelectronics. The NN1003 is designed for large screen applications.

The NN1001, NN1002, and NN1003 controller chips are designed to simplify integration, reduce cost, and increase performance.

The NN1001 and NN1002 have scanning speeds of 1000 Hz (latency down to 1ms).

The NN1002 is designed to support advanced power management and enables touch detection even when the device is in sleep or off mode.

The NN1002 is designed to consume less than 1mW at 100Hz.

The NN1002 and NN1003 are designed to be synchronized to touch enabled larger areas by using multiple chips.

The NN1002 and NN1003 are designed to support simultaneous scanning leading to significantly higher scanning speeds and reduced power consumption.

Technology License Agreements

As of December 31, 2015, we have entered into forty technology license agreements compared to thirty-five and thirty-three license agreements as of December 31, 2014 and 2013, respectively. The products related to these license agreements include e-readers, tablets, mobile phones, commercial and consumer printers, automotive consoles, home appliances, toys and games and GPS devices.

We are dependent on a limited number of OEM and ODM customers and the loss of any one of these customers could have a material adverse effect on our future revenue stream. In the short term, we anticipate that we remain dependent on a limited number of customers for substantially all of our future license revenues. Failure to anticipate or respond adequately to technological developments in our industry, changes in customer or supplier requirements or changes in regulatory requirements or industry standards, or any significant delays in the development or introduction of products or services could have a material adverse effect on our business, operating results and cash flows.

Our customers are located in the United States of America (“U.S.”), Europe and Asia.

As of December 31, 2015 three customers represented approximately 78% of our consolidated accounts receivable.

As of December 31, 2014 three customers represented approximately 87% of our consolidated accounts receivable.

Our net revenues for the year ended December 31, 2015 were earned from thirty-five customers. Customers who accounted for 10% or more of our net revenues during the year ended December 31, 2015 are as follows.

Hewlett-Packard Company – 25%

Autoliv – 21%

Amazon – 14%

Our net revenues for the year ended December 31, 2014 were earned from thirty-two customers. Customers who accounted for 10% or more of our net revenues during the year ended December 31, 2014 are as follows.

Hewlett-Packard Company – 24%

KOBO Inc. – 10%

Leap Frog Enterprises Inc. – 11%

Sony Corporation – 10%

Our revenues for the year ended December 31, 2013 were earned from twenty-nine customers. Customers who accounted for 10% or more of our net revenues during the year ended December 31, 2013 are as follows.

KOBO Inc. – 28%
 Netronix Inc. – 18%
 Leap Frog Enterprises Inc. – 12%
 Sony Corporation – 11%

Geographical Data

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

| | 2015 | 2014 | 2013 |
|-------------|-------|-------|-------|
| U.S. | 56 % | 60 % | 51 % |
| Sweden | 21 % | 1 % | 9 % |
| Japan | 8 % | 11 % | 12 % |
| China | 5 % | 11 % | 9 % |
| Germany | 4 % | - | - |
| Taiwan | 3 % | 8 % | 18 % |
| South-Korea | 1 % | 4 % | - |
| Italy | - | 3 % | - |
| Other | 2 % | 2 % | 1 % |
| Total | 100 % | 100 % | 100 % |

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

| | 2015 | 2014 | 2013 |
|--------|---------|---------|----------|
| U.S. | \$4,341 | \$7,314 | \$10,280 |
| Sweden | 1,308 | 1,231 | 1,161 |
| Asia | 278 | 57 | 30 |
| Total | \$5,927 | \$8,602 | \$11,471 |

Competition

The touch technologies market is intensely competitive and characterized by rapidly changing technology, evolving standards and new product releases by our competitors. Implementation of resistive touch technologies in consumer devices is exponentially declining due to limitations regarding sweep gestures, limitations on industrial design, and the negative impact on screen clarity due to film overlays.

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

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

| Company | Technology |
|---------------------|--|
| Synaptics | Capacitive; In-cell |
| ATMEL | Capacitive; In-cell |
| Cypress | Capacitive; In-cell |
| Maxim | Capacitive; In-cell |
| Tyco Electronics | Capacitive; Resistive; Surface acoustic wave |
| Touch International | Resistive; Capacitive |

Intellectual Property

We rely on a combination of intellectual property laws and contractual provisions to establish and protect the proprietary rights in our technology. The number of our issued and pending patents and patents filed in each jurisdiction as of December 31, 2015 is set forth in the following table:

| Jurisdiction | No. of Issued Patents | No. of Patents Pending |
|--------------------------|--------------------------|---------------------------|
| United States | 44 | 38 |
| Europe | 3 | 16 |
| Japan | 12 | 7 |
| China | 5 | 14 |
| South Korea | 8 | 6 |
| Canada | 8 | 8 |
| Australia | 13 | 6 |
| Singapore | 13 | 4 |
| Patent Convention Treaty | Not Applicable | 2 |
| Total: | 106 | 101 |

Our patents cover six main categories: user interfaces, optics, controller integrated circuits, drivers, mechanics and applications. The following table groups our patents into these six categories:

| Patents | UI | Optics | ASICs | Drivers | Mechanical | Applications | Total |
|---------|----|--------|-------|---------|------------|--------------|-------|
| Issued | 22 | 37 | 5 | 10 | 4 | 28 | 106 |
| Pending | 16 | 52 | 2 | 5 | 6 | 20 | 101 |
| Total | 38 | 89 | 7 | 15 | 10 | 48 | 207 |

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

AirBar is powered by Neonode's zForce AIR platform which is protected by a number of granted patents.

Research and Development

In fiscal years 2015, 2014 and 2013, we spent \$6.3 million, \$7.4 million and \$7.2 million, respectively, on research and development activities. Our research and development is predominantly in-house, but is also may be taken in collaboration with external partners and specialists.

Employees

On December 31, 2015, we had sixty employees and seventeen part-time or full-time consultants. There were a total of six employees in our general and administrative group, eight in our sales and marketing group and forty-six in our engineering group. We have employees located in the U.S., Sweden, Israel, Japan, South-Korea and Taiwan. None of our employees are represented by a labor union. We have experienced no work stoppages. We believe our employee relations are positive.

Additional Information

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the “Exchange Act”) and we file or furnish reports, proxy statements, and other information with the Securities and Exchange Commission (“SEC”). The SEC maintains an Internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at www.sec.gov. The reports and other information filed by us with the SEC are available free of charge on the SEC’s website. The public may read and copy any materials we file with the SEC at the SEC’s Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

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

ITEM 1A. RISK FACTORS

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

Risks Related To Our Business

We are dependent on a limited number of customers.

Our net revenues for the year ended December 31, 2015 were earned from thirty-five customers. During the year ended December 31, 2015, three customers represented approximately 60% of our consolidated net revenues.

Our customer concentration may change significantly from period-to-period depending on a customer's product cycle and changes in our industry. The loss of a major customer, a reduction in net revenues of a major customer for any reason, or a failure of a major customer to fulfill its financial or other obligations due to us could have a material adverse effect on our business, financial condition, and future revenue stream.

We are dependent on the ability of our customers to design, manufacture and sell their products that incorporate our touch technology, particularly in markets other than e-readers and tablets.

We generate revenue through technology licensing agreements with companies which must be successful in designing, manufacturing and selling their products that incorporate our touch technology. The majority of our license fees earned in 2015, 2014 and 2013 were from customer shipments of e-reader and tablet products. We expect that customer shipments of e-readers and tablet products will decline in the future. If we are unable to expand our licenses beyond e-readers and tablets or if our customers are not able to design, manufacture or sell their products, or are delayed in producing their products, our revenues, profitability, and liquidity, as well as our brand image, may be adversely affected.

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

The development and release cycle for customer products is lengthy and unpredictable. Our customers often undertake significant evaluation and design in the qualification of our products, which contributes to a lengthy product release cycle. A customer's decision to purchase our technology often requires a lengthy approval process undertaken by several decision makers at the customer. The typical product development and release cycle is six to thirty-six months with new customers while existing customer lead times are typically six to nine months. The development and release cycle may be longer in some cases, particularly for automotive vehicle products. There is no assurance that a customer will adopt our technology after the evaluation or design phase. The lengthy and variable development and release cycle for products may also have a negative impact on the timing of our revenues, causing our revenues and results of operations to vary significantly from quarter to quarter.

Our license customers rely upon component suppliers to sell products containing our technology.

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

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

We operate in a highly competitive, rapidly evolving environment, and our success depends on our ability to develop and introduce new touch technology that our customers and end users choose to buy. If we are unsuccessful at developing new touch technology that are appealing to our customers and end users with acceptable functionality, quality, prices and terms, we will not be able to compete effectively and our ability to generate revenues will suffer. The development of new touch technology is very difficult and requires high levels of innovation and competence. The development process is also lengthy and costly. If we fail to anticipate our end users' needs or technological trends

accurately or if we are unable to complete development in a cost effective and timely fashion, we will be unable to introduce new touch technology into the market or successfully compete with other providers. As we introduce new or enhanced touch technology or integrate new touch technology into new or existing customer products, we face risks including, among other things, disruption in customers' ordering patterns, inability to deliver new touch technology to meet customers' demand, possible product and technology defects, and potentially unfamiliar sales and support environments. Premature announcements or leaks of new products, features, or technologies may exacerbate some of these risks. Our failure to manage the transition to newer touch technology or the integration of newer technology into new or existing customer products could adversely affect our business, results of operations, and financial condition.

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

Our business model in recent years has focused solely on licensing our touch technology. In 2016, we expect to begin manufacturing the AirBar touch module. There is no assurance that this entry into hardware will result in market acceptance or meaningful revenues. The success of AirBar will depend on customer response and our management's ability to execute on a new business offering. Our ability to manufacture AirBar is subject to numerous risks, including:

- quality and reliability of product components that we source from third-party suppliers;
- our inability to secure product components in a timely manner, in sufficient quantities or on commercially reasonable terms;
- our failure to increase production capacity or volumes to meet demand;
- difficulty identifying and qualifying alternative suppliers for components in a timely manner; and
- establishing and maintaining effective distribution channels.

These risks are likely to be exacerbated by our limited experience with AirBar and its manufacturing processes. As demand for our products increases, we will have to invest additional resources to purchase components, hire and train employees and enhance our manufacturing processes. If we fail to increase our production capacity efficiently, our sales may not increase in line with our expectations and our operating margins could fluctuate or decline.

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

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

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

the announcement or introduction of new products or technologies by our competitors;
our ability to upgrade and develop our infrastructure to accommodate growth;
our ability to attract and retain key personnel in a timely and cost effective manner;
technical difficulties;
the amount and timing of operating costs and capital expenditures relating to the expansion of our business, operations, and infrastructure; and
general economic conditions as well as economic conditions specific to the touchscreen industry.

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

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

We have experienced substantial net losses in each fiscal period since our inception. These net losses resulted from a lack of substantial revenues and the significant costs incurred in the development and acceptance of our technology. We may in the future require sources of capital in addition to cash on hand to continue operations and to implement our business plan. We project that we will have sufficient cash to continue operating for at least the next twelve months. However, if our operations do not become cash flow positive, we may be forced to seek credit line facilities from financial institutions, equity investments, or debt arrangements. No assurances can be given that we will be successful in obtaining such additional financing on reasonable terms, or at all. If adequate funds are not available when needed on acceptable terms, or at all, we may be unable to adequately fund our business plan, which could have a negative effect on our business, results of operations, and financial condition.

We must significantly enhance our sales and technology development organizations.

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

personnel, our ability to achieve future revenue may be adversely affected.

We will need to increase the size of our organization, and we may be unable to manage our growth effectively.

Our failure to manage growth effectively could have a material and adverse effect on our business, results of operations and financial condition. We anticipate that expansion of our organization will be required to address internal growth to handle licensing and research activities. This expansion may place a significant strain on management, operational, and financial resources. To manage the expected growth of our operations and personnel, we must both improve our existing operational and financial systems, procedures, and controls, and implement new systems, procedures, and controls. We must also expand our finance, administrative, and operations staff. Our current personnel, systems, procedures, and controls may not adequately support future operations. Management may be unable to hire, train, retain, motivate, and manage the necessary personnel, or to identify, manage and exploit existing and potential strategic relationships and market opportunities.

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

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

We are dependent on the services of our key personnel.

Our senior management team consists of two executive officers. Our Chief Executive Officer is one of the founders of our Company. The unplanned loss of the services of any member of management could have a materially adverse effect on our operations and future prospects.

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

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

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

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

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

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

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

A significant portion of our business is conducted in currencies other than the U.S. dollar (the currency in which our consolidated financial statements are reported), primarily the Swedish Krona and, to a lesser extent, the Euro, Japanese Yen, Korean Won and Taiwan Dollars. For the year ended December 31, 2015, our revenues from North America, Asia, and Europe were 56%, 17%, and 27% respectively. We incur a significant portion of our expenses in Swedish Krona, including a significant portion of our research and development expenses and a substantial portion of our general and administrative expenses. As a result, appreciation of the value of the Swedish Krona relative to the other currencies, particularly the U.S. dollar, could adversely affect operating results. We do not currently undertake hedging transactions to cover our currency exposure, but we may choose to hedge a portion of our currency exposure in the future as it deems appropriate.

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

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

Risks Related to Owning Our Stock

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

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

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

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

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

actual or anticipated fluctuations in our operating results or future prospects;

our announcements or our competitors' announcements of new technology;

the public's reaction to our press releases, our other public announcements, and our filings with the SEC;

strategic actions by us or our competitors, such as acquisitions or restructurings;

new laws or regulations or new interpretations of existing laws or regulations applicable to our business;

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

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

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

our inability to raise additional capital as needed;

concern as to the efficacy of our technology;

changes in financial markets or general economic conditions;

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

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

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

During 2011 and 2013, officers and directors of Neonode sold shares of our common stock in public offerings. In May 2014, Neonode sold to an institutional investor 2,500,000 shares of common stock and a warrant for 2,500,000 shares of common stock. The warrant expired unexercised on November 15, 2015. On October 13, 2015, we sold 3,200,000 shares of common stock to investors. Sales of a substantial number of shares of our common stock in the public market by insiders or large stockholders, or the perception that these sales might occur, could depress the market price of our common stock and could impair our ability to raise capital through the sale of additional equity securities.

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

the trading price of our common stock.

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

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We lease 6,508 square feet of office space located at 2674 North First Street, San Jose, CA 95134 USA. The annual payment for this space equates to approximately \$160,000. This lease was effective on August 1, 2015 and is valid through July 31, 2018.

Our subsidiary Neonode Technologies AB leases 7,007 square feet of office space located at Storgatan 23C, Stockholm, Sweden. The annual payment for this space is approximately \$431,000 per year including property tax (excluding VAT). This lease is valid through November 30, 2017. The lease can be extended on a yearly basis. Neonode Technologies AB's majority-owned subsidiary Pronode Technologies AB leases 9,040 square feet of workshop located at Faktorvägen 17, Kungsbacka, Sweden. The annual payment for this space equates to approximately \$95,000 per year. The lease is valid through December 9, 2017.

Our subsidiary Neonode Japan K.K. leases 430 square feet of office space located at 608 Bureau Shinagawa, 4-1-6 Konan, Minato-ku, 108-0075 Tokyo, Japan. The annual payment for this space equates to approximately \$28,000 per year. The lease is valid through October 31, 2016.

Our subsidiary Neonode Korea Ltd. entered into a lease agreement located at B-1807, Daesung D-Polis. 543-1, Seoul, South Korea in January, 2015. The annual payment for this space equates to approximately \$22,000 per year. The lease is valid through February 13, 2017.

Our subsidiary Neonode Taiwan Ltd. entered into a lease agreement located at Rm. 2406, International Trade Building, Keelung Rd., Sec.1, Taipei, Taiwan. The annual payment for this space equates to approximately \$31,000 per year. The lease is valid through April 30, 2016. The lease is renewed every three months unless termination is notified.

We believe our existing facilities are in good condition and suitable for the conduct of our business.

ITEM 3. LEGAL PROCEEDINGS

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

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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

Our common stock is quoted on the NASDAQ Stock Market under the symbol NEON. Shares of our common stock commenced trading on the NASDAQ Stock Market on May 1, 2012. Set forth below are the high and low sales prices for our common stock for the quarterly periods indicated.

| | Fiscal Quarter Ended | | | |
|-------------|----------------------|--------|-----------|----------|
| | March | June | September | December |
| | 31 | 30 | 30 | 31 |
| Fiscal 2015 | | | | |
| High | \$3.50 | \$4.83 | \$ 3.44 | \$ 2.92 |
| Low | \$2.22 | \$2.89 | \$ 2.21 | \$ 2.05 |
| Fiscal 2014 | | | | |
| High | \$7.80 | \$6.20 | \$ 3.50 | \$ 3.48 |
| Low | \$5.50 | \$2.44 | \$ 1.94 | \$ 1.72 |

Holder

As of March 1, 2016, there were approximately 224 stockholders of record of our common stock. We estimate that there are significantly more stockholder whose shares were held in "street name" by brokers and other institutions on behalf of stockholders of record.

Dividends

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

Stock Performance Graph

| | 12/10 | 12/11 | 12/12 | 12/13 | 12/14 | 12/15 |
|---------------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Neonode Inc. | 100.00 | 271.82 | 278.11 | 361.66 | 193.42 | 144.78 |
| Russell MicroCap | 100.00 | 90.73 | 108.64 | 158.20 | 163.97 | 155.51 |
| S&P Information Technology | 100.00 | 102.41 | 117.59 | 151.03 | 181.40 | 192.15 |

The stock price performance included in this graph is not necessarily indicative of future stock price performance.

The stock performance graph above shall not be deemed incorporated by reference into any filing by us under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, except to the extent that we specifically incorporate such information by reference, and shall not otherwise be deemed filed under such Acts.

ITEM 6. SELECTED FINANCIAL DATA

The following table of selected financial information should be read in conjunction with our consolidated financial statements and related notes thereto included elsewhere in this Annual Report.

| | As of or for the Year Ended December 31, | | | | |
|---|--|-----------|----------|-----------|-----------|
| | 2015 | 2014 | 2013 | 2012 | 2011 |
| | (In thousands, except per share data) | | | | |
| Financial Results: | | | | | |
| Total net revenues | \$11,115 | \$4,740 | \$3,717 | \$7,137 | \$6,067 |
| Net loss attributable to Neonode Inc. | (7,820) | (14,234) | (13,080) | (9,287) | (17,145) |
| Per Share: | | | | | |
| Basic and diluted loss per share | \$(0.19) | \$(0.36) | (0.37) | \$(0.28) | \$(0.64) |
| Weighted average number of shares outstanding | 41,202 | 39,532 | 35,266 | 33,003 | 26,784 |
| Financial Position: | | | | | |
| Total assets | \$5,927 | \$8,602 | \$11,471 | \$12,168 | \$16,627 |
| Total liabilities | 4,094 | 5,332 | 5,123 | 4,068 | 2,954 |

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

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

Overview

Neonode Inc. develops and licenses user interfaces and optical interactive touch solutions. Our patented technology offers multiple features including the ability to sense an object's size, depth, velocity, pressure, and proximity to any type of surface. We license our multi-touch technology to Original Equipment Manufacturers ("OEMs") and Original Design Manufacturers ("ODMs") who incorporate it into devices that they develop, manufacture and sell. As of December 31, 2015, we had forty technology license agreements with global OEMs and ODMs. This compares with thirty-five and thirty-three technology license agreements as of December 31, 2014 and 2013, respectively. During the year ended December 31, 2015, we had sixteen customers using our touch technology in products that were being shipped to their customers. In 2015, we received license fees from customers such as HP (printers), Amazon (e-readers) and Volvo (automotive).

The majority of our license fees earned in 2015, 2014 and 2013 were from customer shipments of printers, automobiles and e-readers. We anticipate that our license fees will continue to increase as other customers initiate product shipments as they complete their final product development and manufacturing cycle throughout 2016 and onwards.

For our licensees, the typical product development and release cycle is six to thirty-six months with new OEMs and ODMs while existing OEM and ODM lead times are typically six to nine months. During the initial cycle, there are three phases: evaluation, design, and commercialization. In the evaluation phase, licensee validates our technology and may produce short runs of prototype products. During the design phase, product development and solution definition begins. This design phase tends to be the longest and delays typically occur which may extend the term of the overall cycle. In the final phase, commercialization, the customer enters into full production mode, ships products to the market and we earn license revenue.

Current and future drivers of the touch technology market include laptop computers, all-in-one and computer monitors running Microsoft Windows 8.1 and 10 and Google Chrome operating systems, printers, mobile phones, automotive features, household appliances, tablets, e-readers, navigation and wearables. The proliferation and mass market acceptance of touch technology have prompted new applications and uses for existing and new offerings, including our AirBar module that we expect to come to market in 2016.

Key Developments

In 2015, we entered into a joint development and cooperation agreement, with Autoliv Development AB (“Autoliv”) to develop a new Human Machine Interface (“HMI”) sensing product for vehicle steering wheel applications. As part of the agreement, we license our zForce DRIVE technology to Autoliv. The agreement requires that Autoliv pay us an initial \$1.5 million and an additional \$1.5 million in three staggered payments subject to and after achievement of project milestones during a twelve-month period. The initial payment of \$1.5 million was initially recorded as deferred revenue and is being amortized to revenue during the twelve-month development period. The additional \$1.5 million will be recognized as revenue as project milestones are completed. During the twelve months ended December 31, 2015, \$1.1 million of the initial payment and \$1.0 million related to completion of project milestones was recognized as revenue.

In 2016, in addition to licensing, we expect to begin manufacturing and selling AirBar touch modules to OEMs, distributors and directly to end users. AirBar is a hardware device that connects through a USB port to enable touch functionality for non-touch PC products.

Critical Accounting Policies and Estimates

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and include the accounts of Neonode Inc. and its wholly owned subsidiaries, as well as Pronode Technologies AB (Sweden), a 51% majority owned subsidiary of Neonode Technologies AB. The noncontrolling interests are reported below net loss including noncontrolling interests under

the heading “Net loss attributable to noncontrolling interests” in the consolidated statements of operations, below comprehensive loss under the heading “Comprehensive income loss attributable to noncontrolling interests” in the consolidated statements of comprehensive loss and shown as a separate component of stockholders’ equity in the consolidated balance sheets. See “Noncontrolling Interests” for further discussion. All inter-company accounts and transactions have been eliminated in consolidation.

The consolidated statements of operations, comprehensive loss and cash flows for the year ended December 31, 2013 include our accounts and those of our wholly owned subsidiaries, Neonode Technologies AB (Sweden), Neonode Americas Inc. (U.S.), Neonode Japan Inc. (Japan), NEON Technology Inc. (U.S.) and Neno User Interface Solutions AB (Sweden).

The consolidated balance sheet at December 31, 2014 and the consolidated statements of operations, comprehensive loss and cash flows for the year ended December 31, 2014 include our accounts and those of our wholly owned subsidiaries, Neonode Technologies AB (Sweden), Neonode Americas Inc. (U.S.), Neonode Japan Inc. (Japan), NEON Technology Inc. (U.S.), Neno User Interface Solutions AB (Sweden) and Neonode Korea Ltd. (South Korea).

The consolidated balance sheet at December 31, 2015 and the consolidated statements of operations, comprehensive loss and cash flows for the year ended December 31, 2015 include our accounts and those of our wholly owned subsidiaries, Neonode Technologies AB (Sweden), Neonode Americas Inc. (U.S.), Neonode Japan Inc. (Japan), NEON Technology Inc. (U.S.), Neno User Interface Solutions AB (Sweden), Neonode Korea Ltd. (South Korea) and Neonode Taiwan Ltd. (Taiwan), as well as Pronode Technologies AB (Sweden), a 51% majority owned subsidiary of Neonode Technologies AB.

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

Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires making estimates and assumptions that affect, at the date of the consolidated financial statements, the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from these estimates. Significant estimates include, but are not limited to, collectability of accounts receivable, the achievement of substantive milestones and vendor-specific objective evidence (“VSOE”) of fair value for purposes of revenue recognition (or deferral of revenue), recoverability of capitalized project costs and long-lived assets, the valuation allowance related to our deferred tax assets and the fair value of options and warrants issued for stock-based compensation.

Revenue Recognition

Licensing Revenues:

We derive revenue from the licensing of internally developed intellectual property (“IP”). We enter into IP licensing agreements that generally provide licensees the right to incorporate our IP components in their products with terms and conditions that vary by licensee. Fees under these agreements may include license fees relating to our IP and royalties payable following the distribution by our licensees of products incorporating the licensed technology. The license for our IP has standalone value and can be used by the licensee without maintenance and support. We follow U.S. GAAP for revenue recognition as per unit royalty products are distributed or licensed by our customers. For technology license arrangements that do not require significant modification or customization of the underlying technology, we recognize technology license revenue when: (1) we enter into a legally binding arrangement with a customer for the license of technology; (2) the customer distributes or licenses the products; (3) the customer payment is deemed fixed or determinable and free of contingencies or significant uncertainties; and (4) collection is reasonably assured. Our customers report to us the quantities of products distributed or licensed by them after the end of the reporting period stipulated in the contract, generally 30 to 45 days after the end of the month or quarter. Effective October 16, 2013, we determined it was appropriate to recognize licensing revenue in the period in which royalty reports are received, rather than the period in which the products are distributed or to which the license relates.

Explicit return rights are not offered to customers. There were no returns through December 31, 2015.

Engineering Services:

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

Generally, we recognize revenue as the engineering services stipulated under the contract are completed and accepted by our customers. Engineering services are performed under a signed Statement of Work (“SOW”) with a customer. The deliverables and payment terms stipulated under the SOW provide guidance on the project revenue recognition.

Revenues from contracts that are short-term in nature and related costs that are difficult to estimate are accounted for under the completed contract method.

Revenues from contracts with substantive defined milestones that we have determined are reasonable, relevant to all the deliverables and payment terms in the SOW that are commensurate with the efforts required to achieve the milestones are recognized under the milestone recognition method.

Estimated losses on all SOW projects are recognized in full as soon as they become evident. In the year ended December 31, 2015, \$165,000 was recorded as cost of sales due to expected losses related to two SOW projects. In the years ended December 31, 2014 and 2013 no losses related to SOW projects were recorded.

Accounts Receivable and Allowance for Doubtful Accounts

Our accounts receivable are stated at net realizable value. Our policy is to maintain allowances for estimated losses resulting from the inability of our customers to make required payments. Credit limits are established through a process of reviewing the financial history and stability of each customer. Where appropriate, we obtain credit rating reports and financial statements of the customer when determining or modifying its credit limits. We regularly evaluate the collectability of our trade receivable balances based on a combination of factors. When a customer’s account balance becomes past due, we initiate dialogue with the customer to determine the cause. If it is determined that the customer will be unable to meet its financial obligation, such as in the case of a bankruptcy filing, deterioration in the customer’s operating results or financial position or other material events impacting its business, we record a specific allowance to reduce the related receivable to the amount we expect to recover. Should all efforts fail to recover the related receivable, we will write off the account. We also record an allowance for all customers based on certain other factors including the length of time the receivables are past due and historical collection experience with customers.

Projects in Process

Projects in process consist of costs incurred toward the completion of various projects for certain customers. These costs are primarily comprised of direct engineering labor costs and project-specific equipment costs. These costs are capitalized on our balance sheet as an asset and deferred until revenue for each project is recognized in accordance with our revenue recognition policy. Costs capitalized in projects in process were \$158,000, \$200,000 and \$736,000 as of December 31, 2015, 2014 and 2013, respectively.

Property and Equipment

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

Estimated useful lives

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

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

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

Long-lived Assets

We assess any impairment by estimating the future cash flow from the associated asset in accordance with relevant accounting guidance. If the estimated undiscounted future cash flow related to these assets decreases or the useful life is shorter than originally estimated, we may incur charges for impairment of these assets. As of December 31, 2015,

we believe there was no impairment of our long-lived assets. There can be no assurance, however, that market conditions will not change or sufficient demand for our products and services will continue, which could result in impairment of long-lived assets in the future.

Research and Development

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

Stock-Based Compensation Expense

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

We account for equity instruments issued to non-employees at their estimated fair value. The measurement date for the fair estimated value for the equity instruments issued is determined at the earlier of (1) the date at which a commitment for performance by the consultant or vendor is reached, or (2) the date at which the consultant or vendor’s performance is complete. In the case of equity instruments issued to consultants, the estimated fair value of the equity instruments is primarily recognized over the term of the consulting agreement. The estimated fair value of the stock-based compensation is periodically re-measured and income or expense is recognized during the vesting term.

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

Noncontrolling Interests

The Company recognizes noncontrolling interests as equity in the consolidated financial statements separate from the parent company's equity. Noncontrolling interests' partners have less than 50% share of voting rights at any one of the subsidiary level companies. The amount of net income (loss) attributable to noncontrolling interests is included in consolidated net income (loss) on the face of the consolidated statements of operations. Changes in a parent entity's ownership interest in a subsidiary that do not result in deconsolidation are treated as equity transactions if the parent entity retains its controlling financial interest. The Company recognizes a gain or loss in net income (loss) when a subsidiary is deconsolidated. Such gain or loss is measured using the fair value of the noncontrolling equity investment on the deconsolidation date. Additionally, operating losses are allocated to noncontrolling interests even when such allocation creates a deficit balance for the noncontrolling interest partner.

The Company provides either in the consolidated statement of stockholders' equity, if presented, or in the notes to consolidated financial statements, a reconciliation at the beginning and the end of the period of the carrying amount of total equity (net assets), equity (net assets) attributable to the parent, and equity (net assets) attributable to the noncontrolling interest that separately discloses:

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

Foreign Currency Translation and Transaction Gains and Losses

The functional currency of our foreign subsidiaries is the applicable local currency, the Swedish Krona, the Japanese Yen, the South-Korean Won and the Taiwan Dollar. The translation from Swedish Krona, Japanese Yen, South-Korean Won or the Taiwan Dollar to U.S. Dollars is performed for balance sheet accounts using current exchange rates in effect at the balance sheet date and for income statement accounts using a weighted average exchange rate during the period. Gains or (losses) resulting from translation are included as a separate component of accumulated other comprehensive income (loss). Gains or (losses) resulting from foreign currency transactions are included in general and administrative expenses in the accompanying consolidated statements of operations and were \$62,000, (\$37,000) and (\$155,000) during the years ended December 31, 2015, 2014 and 2013, respectively. Foreign currency translation gains or (losses) were (\$103,000), \$138,000 and \$6,000 during the years ended December 31, 2015, 2014 and 2013, respectively.

Net Loss per Share

Net loss per share amounts have been computed based on the weighted-average number of shares of common stock outstanding during the years ended December 31, 2015, 2014 and 2013. Net loss per share, assuming dilution amounts from common stock equivalents, is computed based on the weighted-average number of shares of common stock and potential common stock equivalents outstanding during the period. The weighted-average number of shares of common stock and potential common stock equivalents used in computing the net loss per share for years ended December 31, 2015, 2014 and 2013 exclude the potential common stock equivalents, as the effect would be anti-dilutive (See note 14)

Other Comprehensive Income (Loss)

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

Cash Flow Information

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

| | Years ended December 31, | | |
|------------------|--------------------------|----------|-------|
| | 2015 | 2014 | 2013 |
| Swedish Krona | 8.43 | 6.86 | 6.51 |
| Japanese Yen | 121.03 | 105.84 | 97.58 |
| South Korean Won | 1,130.22 | 1,050.63 | - |
| Taiwan Dollar | 31.73 | - | - |

Exchange rate for the consolidated balance sheets was as follows:

| | Years ended December 31, | |
|------------------|-----------------------------|----------|
| | 2015 | 2014 |
| Swedish Krona | 8.42 | 7.80 |
| Japanese Yen | 120.36 | 119.93 |
| South Korean Won | 1,174.67 | 1,096.73 |
| Taiwan Dollar | 32.84 | - |

Deferred Revenue

We defer license fees until we have met all accounting requirements for revenue recognition as per unit royalty products are distributed and royalty reports are received. Engineering development fee revenues are deferred until such time as the engineering work has been completed and accepted by our customers. As of December 31, 2015 and 2014, we have \$1.1 million and \$3.0 million, respectively, of deferred license fee revenue related to prepayments for future license fees from two and four customers, respectively and a total of \$0.4 million and \$0.4 million, respectively, of deferred engineering development fees from one and five customers, respectively.

New Accounting Pronouncements

In July 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-11, “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists”. ASU 2013-11 provides explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The guidance is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013, with an option for early adoption. We adopted this guidance at the beginning of our first quarter of fiscal year 2014, and did not determine there is any impact on our consolidated financial statements and disclosures.

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, “*Revenue from Contracts with Customers (Topic 606)*” (“ASU 2014-09”). ASU 2014-09 amends the guidance for revenue recognition to replace numerous, industry specific requirements and converges areas under this topic with those of the International Financial Reporting Standards. The ASU implements a five-step process for customer contract revenue recognition that focuses on transfer of control, as opposed to transfer of risk and rewards. The amendment also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenues and cash flows from contracts with customers. Other major provisions include the capitalization and amortization of certain contract costs, ensuring the time value of money is considered in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. On July 9, 2015, the FASB approved amendments deferring the effective date by one year to December 15, 2017 for annual reporting periods beginning after that date and permitting early adoption of the standard, but not before the original effective date or for reporting periods beginning after December 15, 2016. We have not yet selected a transition method and are currently assessing the impact the adoption of ASU 2014-09 will have on our consolidated financial statements and disclosures.

In August 2014, the FASB issued ASU No. 2014-15, “*Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern*”. The amendments in this update provide guidance in U.S. GAAP about management's responsibilities to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The main provision of the amendments are for an entity's management, in connection with the preparation of financial statements, to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. Management's evaluation should be based on relevant conditions and events that are known or reasonably knowable at the date the consolidated financial statements are issued. When management identifies conditions or events that raise substantial doubt about an entity's ability to continue as a going concern, the entity should disclose information that enables users of the consolidated financial statements to understand all of the following: (1) principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern (before consideration of management's plans); (2) management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations; and (3) management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern or management's plans that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern. The amendments in this update are effective for interim and annual reporting periods beginning after December 15, 2016 and early application is permitted. We are currently assessing this guidance for future implementation.

In November 2015, FASB issued ASU 2015-17, *Income Taxes (Topic 740), Balance Sheet Classification of Deferred Taxes* (“ASU 2015-17”), which eliminates the current requirement for an entity to separate deferred income tax liabilities and assets into current and non-current amounts in a classified balance sheet. Instead, the ASU requires deferred tax liabilities, deferred tax assets and valuation allowances be classified as non-current in a classified balance sheet. ASU 2015-17 will be effective for annual reporting periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted. Additionally, this guidance may be applied either prospectively or retrospectively to all periods presented. The Company elected not to early adopt ASU 2015-17 and is evaluating the effect of the adoption of this ASU to its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (“ASU 2016-02”). Under ASU 2016-02, lessees will be required recognize the following for all leases (with the exception of short-term leases) at the commencement date: a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. Lessees must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees may not apply a full retrospective transition approach.

Results of Operations

Net Revenues

Net revenues for the year ended December 31, 2015 were \$11.1 million, compared to \$4.7 million and \$3.7 million for the years ended December 31, 2014 and 2013, respectively. Our net revenues for the year ended December 31, 2015 included \$7.1 million from technology license fees due to product shipments from sixteen customers and \$4.0 million in non-recurring engineering services related to our touch technology from thirteen customers. Our net revenues for the year ended December 31, 2014 included \$3.1 million from technology license fees due to product shipments from sixteen customers and \$1.6 million in non-recurring engineering services related to our touch technology from twenty-two customers. Our net revenues for the year ended December 31, 2013 included \$2.9 million from technology license fees due to product shipments from twelve customers and \$800,000 in non-recurring engineering services related to our touch technology from twenty-two customers.

The increase of 136% in net revenues in 2015 as compared to 2014 is primarily due to an increase in license fees from e-reader, printer and automotive customers, plus non-recurring engineering services revenue.

The license fee revenue distribution per market in 2015 was 48% for e-readers, 38% for printer and 14% for automotive compared to 64% for e-readers, 32% for printers, 1% for automotive and 3% for other markets in 2014.

Customer prepayments are included in deferred revenues and are amortized to net revenues as a customer's products are shipped or distributed. For the years ended December 31, 2015, 2014 and 2013, \$1,188,000, \$596,000 and \$253,000 in license fees related to units licensed or distributed were recognized as revenue, respectively, and as of December 31, 2015, \$1.1 million remained in deferred revenues from customers' license fee prepayments.

As of December 31, 2015, we had forty technology license agreements with global OEMs. This compares with thirty-five and thirty-three technology license agreements with global OEMs as of December 31, 2014 and 2013, respectively. Sixteen of our customers are currently shipping products and we anticipate others will initiate product shipments as they complete their final product development and manufacturing cycle throughout 2016 and onwards.

Gross Margin

Gross margin was \$7.3 million for the year ended December 31, 2015 compared to \$3.2 million and \$2.1 million for the years ended December 31, 2014 and 2013, respectively. Our cost of revenues includes the direct cost of production of certain customer prototypes, costs of engineering personnel and engineering consultants to complete the engineering design contract. Our cost of revenues for 2015 also includes a one-time write-off of \$1.2 million related to cost to develop our zForce CORE platform as we now will use zForce PLUS and AIR in current and future developments. Our gross margin increased in 2015 compared to 2014 due to the increase in our total revenues. The gross margin related to our license fees is 100%. As license fees as a percentage of our total revenue increase, our gross margin will increase.

Research and Development

Product research and development ("R&D") expenses for the year ended December 31, 2015 were \$6.3 million, compared to \$7.4 million and \$7.2 million for the same periods in 2014 and 2013, respectively. The decrease was mainly related to lower costs for personnel due to a favorable currency exchange rate of the SEK compared to the U.S. Dollar. Since May 2014, we have manufactured the majority of prototypes needed in house at our own prototype lab. Previously, we outsourced all the prototype manufacturing process at a higher cost. R&D costs mainly consist of personnel related costs in addition to some external consultancy costs, such as testing, certifying and measurements, along with costs related to developing and building new product prototypes. Included in R&D expenses is approximately \$484,000 of non-cash stock-based compensation expense for the year ended December 31, 2015 compared to approximately \$510,000 and \$267,000 for the same periods in 2014 and 2013, respectively.

Sales and Marketing

Sales and marketing expenses for the year ended December 31, 2015 were \$3.8 million, compared to \$3.3 million and \$2.7 million for the years ended December 31, 2014 and 2013, respectively. Included in sales and marketing expenses is approximately \$296,000 of non-cash stock expense for the year ended December 31, 2015 compared to approximately \$353,000 and \$909,000 for the same periods in 2014 and 2013, respectively. The increase in 2015 as compared to 2014 is primarily related to an increase in sales personnel, marketing and travel expenses in addition to a decrease in non-cash stock-based compensation expense. The increase in 2014 as compared to 2013 is primarily related to an increase in sales personnel, marketing and travel expenses in addition to a decrease in non-cash stock option expense. As of December 31, 2015, our sales and marketing department had eight full-time employees compared to seven full-time employees and nine employees as of December 31, 2014 and 2013, respectively.

Our sales activities focus primarily on OEM customers who will integrate our touch technology into their products. Our OEM customers will then sell and market their products incorporating our technology to their customers.

General and Administrative

General and administrative (“G&A”) expenses for the year ended December 31, 2015 were \$5.0 million compared to \$6.8 million and \$5.1 million for the years ended December 31, 2014 and 2013, respectively. This overall decrease in 2015 as compared to 2014 was primarily related to payroll expenses, professional fees related to patent filings and a decrease in non-cash stock option expense in 2015 related to stock options issued to employees and members of our Board of Directors. As of December 31, 2015, we had six full-time employees in our G&A department fulfilling management and accounting responsibilities compared to seven full-time employees and eight full-time employees as of December 31, 2014 and 2013. Included in G&A expenses are approximately \$295,000 million of non-cash stock-based compensation expense for the year ended December 31, 2015 compared to approximately \$0.9 million and \$1.5 million for the same periods in 2014 and 2013, respectively.

Interest Expense

Interest expense for the year ended December 31, 2015 was \$18,000. The interest expense was mainly related to a capital lease. Interest expense for the year ended December 31, 2014 was \$14,000. We did not have any interest expense for the year ended December 31, 2013.

Foreign Currency Translation and Transaction Gains and Losses

The functional currency of our foreign subsidiaries is the applicable local currency, the Swedish Krona, the Japanese Yen, the South Korean Won and the Taiwan Dollar. The translation from Swedish Krona, Japanese Yen, South Korean Won or Taiwan Dollar to U.S. Dollars is performed for balance sheet accounts using current exchange rates in effect at the balance sheet date and for income statement accounts using a weighted-average exchange rate during the period. Gains or (losses) resulting from translation are included as a separate component of accumulated other comprehensive income (loss). Gains or (losses) resulting from foreign currency transactions are included in general and administrative expenses in the accompanying consolidated statements of operations and were \$62,000, (\$37,000) and (\$155,000) during the years ended December 31, 2015, 2014 and 2013, respectively. Foreign currency translation gains or (losses) were (\$103,000), \$138,000 and \$6,000 during the years ended December 31, 2015, 2014 and 2013, respectively.

Income Taxes

Our effective tax rate was (1)% in the year ended December 31, 2015 and (1)% and (1%) in the years ended 2014 and 2013, respectively. We recorded valuation allowances in 2015, 2014 and 2013 for deferred tax assets related to net operating losses due to the uncertainty of realization.

Net Loss

As a result of the factors discussed above, we recorded a net loss of \$7.8 million for the year ended December 31, 2015, compared to a net loss of \$14.2 million and \$13.1 million for the years ended December 31, 2014 and 2013, respectively.

Contractual Obligation and Off-Balance Sheet Arrangements

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

A summary of future minimum payments under non-cancellable lease commitments as of December 31, 2015 is as follows (in thousands):

| | Total | Less than 1 year | 1-3 years | 3-5 years | More than 5 years |
|-----------------------------|---------|------------------|-----------|-----------|-------------------|
| Operating lease obligations | \$1,480 | \$741 | \$739 | \$ - | \$ - |
| Capital lease | 382 | 72 | 216 | 94 | - |
| Total | \$1,862 | \$813 | \$955 | \$ 94 | \$ - |

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

Operating Leases

On March 22, 2012, we entered into a three year lease for 3,185 square feet of office space located at 2350 Mission College Blvd, Suite 190, Santa Clara, CA 95054 USA. The initial lease payment was \$7,007 per month, increasing to \$7,657 per month over the term of the lease. This lease was valid through July 31, 2015. The annual payment for this space equated to approximately \$86,000 per year. On May 28, 2015, we entered into a three year lease for 6,508 square feet of office space located at 2674 North First Street, San Jose, CA 95134 USA. The annual payment for this space is \$160,000. This lease is effective on August 1, 2015 and is valid through July 31, 2018.

On October 12, 2012, we entered into a two year lease for office space located at 608 Bureau Shinagawa, 4-1-6 Konan, Minato-ku, 108-0075 Tokyo, Japan. The lease payment is approximately \$2,300 per month. This lease was valid through October 12, 2014. The lease was extended for two years and is valid until October 31, 2016 under the same terms and conditions. The annual payment for this space equates to approximately \$28,000 per year.

On July 1, 2013, NTAB entered into a lease for 5,900 square feet of office space located at Storgatan 23C, Stockholm, Sweden for approximately \$38,000 per month including property tax (excluding VAT). The annual payment for this space equated to approximately \$458,000 per year including property tax (excluding VAT). This lease was valid through June 30, 2014. On July 1, 2014, the lease was extended and is valid through November 30, 2017. As from November 1, 2015 we lease 7,007 square feet for approximately \$431,000 per year. It is lower now compared to 2013 due to exchange rate differences. The lease can be extended on a yearly basis with three months written notice. On December 1 2015, Neonode Technologies AB's majority-owned subsidiary Pronode Technologies AB entered into a lease agreement for 9,040 square feet of workshop located at Faktorvägen 17, Kungsbacka, Sweden for approximately \$8,000 per month. The annual payment for this space equates to approximately \$95,000 per year. The lease is valid through December 9, 2017.

In January 2015, our subsidiary Neonode Korea Ltd. entered into a lease agreement located at B-1807, Daesung D-Polis. 543-1, Seoul, South Korea. The annual payment for this space equates to approximately \$22,000 per year. The lease is valid through February 13, 2017.

In May 2015, our subsidiary Neonode Taiwan Ltd. entered into a lease agreement located at 16F, No. 89 Songren Rd, Taipei, Taiwan. This lease is valid through May 24, 2016 but was terminated on November 30, 2015. The annual payment for this space equated to approximately \$46,000 per year. On December 1, 2015, Neonode Taiwan Ltd. entered into a lease agreement located at Rm. 2406, International Trade Building, Keelung Rd., Sec.1, Taipei, Taiwan. This lease is valid through April 30, 2016. The lease is renewed every three months unless termination is notified. The annual payment for this space equates to approximately \$31,000 per year.

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For the years ended December 31, 2015, 2014 and 2013, we recorded approximately \$641,000, \$633,000 and \$556,000, respectively, for rent expense.

A summary of future minimum payments under non-cancellable operating lease commitments as of December 31, 2015 is as follows (in thousands):

| <u>Years ending December 31,</u> | Total |
|----------------------------------|---------|
| 2016 | \$741 |
| 2017 | 646 |
| 2018 | 93 |
| | \$1,480 |

Equipment Subject to Capital Lease

In April 2014, we entered into a lease for certain specialized milling equipment. Under the terms of the lease agreement we are obligated to purchase the equipment at the end of the original 6 year lease term for 10% of the original purchase price of the equipment. In accordance with relevant accounting guidance the lease is classified as a capital lease. The lease payments and depreciation period began on July 1, 2014 when the equipment went into service. The interest rate of the lease is 4% per annum.

Non-Recurring Engineering Development Costs

On February 4, 2011, we entered into an Analog Device Development Agreement with an effective date of January 24, 2010 (the “NN1001 Agreement”) with Texas Instruments pursuant to which Texas Instruments integrated Neonode’s intellectual property into an Application Specific Integrated Circuit (“ASIC”). The NN1001 ASIC only can be sold by Texas Instruments exclusively to licensees of Neonode. Under the terms of the NN1001 Agreement, we have reimbursed Texas Instruments \$500,000 of non-recurring engineering development costs based on shipments of the NN1001. Under the terms of the NN1001 Agreement, we have reimbursed Texas Instruments a non-recurring engineering fee of \$0.08 per unit for each of the first one million units sold and \$0.05 for the next eight million units sold. During the years ended December 31, 2015 and 2014, approximately \$20,000 and \$93,000, respectively of non-recurring engineering expense related to the NN1001 Agreement is included in research and development in the consolidated statements of operations. Through December 31, 2015, all payments under the NN1001 Agreement have been made.

On April 25, 2013, we entered into an additional Analog Device Development Agreement with an effective date of December 6, 2012 (the “NN1002 Agreement”) with Texas Instruments pursuant to which Texas Instruments will integrate Neonode’s intellectual property into an ASIC. The NN1002 ASIC only can be sold by Texas Instruments exclusively to licensees of Neonode. Under the terms of the NN1002 Agreement, we will reimburse Texas Instruments up to \$500,000 of non-recurring engineering costs based on shipments of the NN1002. Under the terms of the NN1002 Agreement we will reimburse Texas Instruments a non-recurring engineering fee of \$0.25 per unit for each of the first two million units sold. The NN1002 began sampling to customers in May 2014. As of December 31, 2015, we had made no payments under the NN1002 Agreement.

On December 4, 2014, we entered into an additional Analog Device Development Agreement (the “NN1003 Agreement”) with STMicroelectronics International N.V pursuant to which STMicroelectronics will integrate Neonode’s intellectual property into an ASIC. The NN1003 ASIC only can be sold by STMicroelectronics exclusively to licensees of Neonode. Under the terms of the NN1003 Agreement, we will reimburse STMicroelectronics up to \$885,000 of non-recurring engineering costs as follows:

\$235,000 at the feasibility review and contract signature (paid on January 20, 2015)
\$300,000 on completion of tape-out (paid on October 31, 2015)
\$300,000 on completion on product validation (not completed)

Under the terms of the NN1003 Agreement, we also will reimburse STMicroelectronics a non-recurring engineering fee of \$5.00 per each of the first 10,000 units sold. As of December 31, 2015, we had made no payments under the NN1003 Agreement.

Liquidity and Capital Resources

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

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

As of December 31, 2015, we had cash of \$3.1 million, as compared to \$6.1 million as of December 31, 2014.

Working capital (current assets less current liabilities) was \$1.5 million as of December 31, 2015, compared to working capital of \$3.0 million as of December 31, 2014.

Net cash used in operating activities for the year ended December 31, 2015 of \$8.1 million was primarily the result of (1) a net loss including noncontrolling interests of approximately \$7.8 million and (2) approximately \$1.5 million in net cash provided by changes in operating assets and liabilities, primarily accounts receivable, projects in process, accounts payable, accrued expenses and deferred revenue. Cash used to fund net losses is reduced by approximately \$1.3 million in non-cash operating expenses, mainly comprised of depreciation and amortization and stock-based compensation.

Accounts receivable increased approximately \$0.2 million as of December 31, 2015 compared with December 31, 2014, primarily as a result of net revenues of approximately \$3.0 million in the fourth quarter of 2015 compared to approximately \$1.8 million in the fourth quarter of 2014. During 2015 and 2014, we were successful in collecting cash from sales to our customers substantially in accordance with our standard payment terms to those customers.

Deferred revenue decreased approximately \$1.9 million during 2015 mainly related to finalization of development projects and net increase in revenue recognition of prepaid license fees and non-recurring engineering fees during 2015 as compared to 2014.

Net cash used in operating activities for the year ended December 31, 2014 of \$11.8 million was primarily the result of (1) a net loss of approximately \$14.2 million and (2) approximately \$0.3 million in net cash provided by changes in

operating assets and liabilities, primarily accounts receivable, projects in process, accounts payable, accrued expenses and deferred revenue. Cash used to fund net losses is reduced by approximately \$2.1 million in non-cash operating expenses, mainly comprised of depreciation and amortization and stock-based compensation.

Accounts receivable increased approximately \$0.3 million as of December 31, 2014 compared with December 31, 2013, primarily as a result of net revenues of approximately \$1.8 million in the fourth quarter of 2014 compared to approximately \$1.0 million in the fourth quarter of 2013. During 2014 and 2013, we were successful in collecting cash from sales to our customers substantially in accordance with our standard payment terms to those customers.

Deferred revenue decreased approximately \$0.2 million during 2014 mainly related to finalization of development projects and net increase in revenue recognition of prepaid license fees and non-recurring engineering fees during 2014 as compared to 2013.

Net cash used in operating activities for the year ended December 31, 2013 of \$8.8 million was primarily the result of (1) a net loss of approximately \$13.1 million and (2) approximately \$1.5 million in net cash provided by changes in operating assets and liabilities, primarily accounts receivable and deferred revenue. Cash used to fund net losses is reduced by approximately \$2.8 million in non-cash operating expenses, mainly comprised of depreciation and amortization and stock-based compensation.

Accounts receivable decreased approximately \$1.2 million as of December 31, 2013 compared with December 31, 2012, primarily as a result of net revenues of approximately \$1.7 million in the fourth quarter of 2013 compared to approximately \$2.3 million in the fourth quarter of 2012. During 2013 and 2012, we were successful in collecting cash from sales to our customers substantially in accordance with our standard payment terms to those customers.

Deferred revenue increased approximately \$0.9 million during 2013 primarily as a result of additional license technology agreements and engineering projects entered into during 2013 as compared to 2012.

In the years ended December 31, 2015, 2014 and 2013, we purchased \$198,000, \$115,000 and \$155,000, respectively of fixed assets, consisting primarily of computer software, computers and engineering equipment.

Net cash provided by financing activities during the year ended December 31, 2015 was the result of net proceeds of approximately \$5.4 million from the sale of our common stock. This increase was offset by repayments of \$57,000 on our capital lease obligation during the year ended December 31, 2015.

Net cash provided by financing activities during the year ended December 31, 2014 was the result of net proceeds of approximately \$9.3 million from the sale of our common stock and \$36,000 received in connection with the exercise of warrants to purchase 11,500 shares of our common stock. These increases were offset by repayments of \$34,000 on our capital lease obligations during the year ended December 31, 2014.

Net cash provided by financing activities for the year ended December 31, 2013 was \$8.7 million and was due to net proceeds of \$1.8 million received in connection with the exercise of stock options and warrants for shares of our common stock. In addition, we issued 1,168,939 shares of our common stock to investors in connection with an equity financing transaction in which we raised approximately \$7.7 million and received approximately \$6.9 million in cash, net of commissions, direct selling costs including legal, audit and other regulatory costs of approximately \$0.8 million.

We believe that, based upon our current operating plan, our existing cash and cash provided by operations will be sufficient to meet our anticipated cash needs for at least the next twelve months. We expect that our revenues from license fees and non-recurring engineering fees will enable us to reduce, or eliminate, our operating losses in 2016. We also have undertaken steps to reduce operating expenses, including (i) termination of consulting contracts associated with our research and development operations, and (ii) improving overall cost efficiency of our operations. Depending on our cash flow, we intend to continue to implement various measures to improve our financial condition, such as reducing further expenses to conserve cash and pursuing strategic transactions and relationships with third parties. While there is no assurance that the Company can meet its projected cash flows, management anticipates that it can continue operations for at least the next twelve months.

In June 2014, we filed a shelf registration statement with the SEC that became effective on June 12, 2014. We may from time to time issue shares of our common stock under our shelf registration in amounts, at prices, and on terms to be announced when and if the securities are offered. The specifics of any future offerings, along with the use of proceeds of any securities offered, will be described in a prospectus supplement and any other offering materials, at the time of the offering. Our shelf registration statement will expire on June 12, 2017.

On October 13, 2015, we issued 3,200,000 shares of our common stock from our shelf registration statement to investors in connection with an equity financing transaction. We sold the stock at \$1.90 per share and raised approximately \$6.1 million gross and received approximately \$5.4 million in cash, net of direct offering costs including underwriting discounts and legal, audit and other regulatory costs of approximately \$0.6 million.

As of December 31, 2015, there were 1,800,000 shares remaining for issuance under our shelf registration statement.

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

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The functional currency of our foreign subsidiaries is the applicable local currency, the Swedish Krona, the Japanese Yen, the South Korean Won and the Taiwan Dollar and is subject to foreign currency exchange rate risk. Any increase or decrease in the exchange rate of the U.S. Dollar compared to the Swedish Krona, Japanese Yen or South Korean Won will impact our future operating results. 100% of our consolidated net revenues are denominated in US Dollars and approximately 66% of our consolidated operating costs are denominated in Swedish Krona, Japanese Yen, South-Korean Won and Taiwanese Dollar. We do not currently enter into forward-exchange contracts to hedge exposure denominated in foreign currencies or any other derivative financial instruments for trading or speculative purposes. In the future, if our operations change and we determine that our foreign exchange exposure has increased, we may consider entering into hedging transactions to mitigate such risk.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

| | |
|---|------|
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| <u>Consolidated Balance Sheets as of December 31, 2015 and 2014</u> | 37 |
| <u>Consolidated Statements of Operations for the years ended December 31, 2015, 2014 and 2013</u> | 38 |
| <u>Consolidated Statements of Comprehensive Loss for the years ended December 31, 2015, 2014 and 2013</u> | 39 |
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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Neonode Inc.

We have audited the accompanying consolidated balance sheets of Neonode Inc. (a Delaware corporation) and subsidiaries (the “Company”) as of December 31, 2015 and 2014, and the related consolidated statements of operations, comprehensive loss, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2015. Our audits also included the financial statement schedule appearing under Item 15(a)(2). These consolidated financial statements and the financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Neonode Inc. and subsidiaries as of December 31, 2015 and 2014, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2015, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the related financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 10, 2016 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

/s/ KMJ Corbin & Company LLP

Costa Mesa, California

March 10, 2016

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NEONODE INC.**CONSOLIDATED BALANCE SHEETS**

(In thousands, except share and per share amounts)

| | As of December 31, 2015 | As of December 31, 2014 |
|--|-------------------------------|-------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 3,082 | \$ 6,129 |
| Accounts receivable, net | 1,346 | 1,106 |
| Projects in process | 158 | 200 |
| Prepaid expenses and other current assets | 747 | 513 |
| Total current assets | 5,333 | 7,948 |
| Property and equipment, net | 594 | 654 |
| Total assets | \$ 5,927 | \$ 8,602 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 965 | \$ 566 |
| Accrued expenses | 1,314 | 935 |
| Deferred revenues | 1,475 | 3,403 |
| Current portion of capital lease obligations | 57 | 61 |
| Total current liabilities | 3,811 | 4,965 |
| Capital lease obligation, net of current portion | 283 | 367 |
| Total liabilities | 4,094 | 5,332 |
| Commitments and contingencies | | |
| Stockholders' equity | | |
| Series B Preferred stock, 54,425 shares authorized with par value of \$0.001; 83 shares issued and outstanding at December 31, 2015 and 2014, respectively. (In the event of dissolution, each share of Series B Preferred stock has a liquidation preference equal to par value of \$0.001 over the shares of common stock) | - | - |
| Common stock, 70,000,000 shares authorized at December 31, 2015 and 2014, respectively, with par value of \$0.001; 43,805,586 and 40,455,352 shares issued and outstanding at December 31, 2015 and 2014, respectively | 44 | 40 |
| Additional paid-in capital | 175,504 | 169,010 |
| Accumulated other comprehensive income | 46 | 149 |
| Accumulated deficit | (173,749) | (165,929) |
| Total Neonode Inc. stockholders' equity | 1,845 | 3,270 |
| Noncontrolling interests | (12) | - |

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| | | |
|--|----------|----------|
| Total stockholders' equity | 1,833 | 3,270 |
| Total liabilities and stockholders' equity | \$ 5,927 | \$ 8,602 |

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

NEONODE INC.**CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share amounts)

| | Years Ended December 31, | | |
|--|--------------------------|------------|------------|
| | 2015 | 2014 | 2013 |
| Net revenues | \$11,115 | \$4,740 | \$3,717 |
| Cost of revenues | 3,780 | 1,509 | 1,642 |
| Gross margin | 7,335 | 3,231 | 2,075 |
| Operating expenses: | | | |
| Research and development | 6,279 | 7,373 | 7,235 |
| Sales and marketing | 3,753 | 3,250 | 2,732 |
| General and administrative | 4,999 | 6,799 | 5,079 |
| Total operating expenses | 15,031 | 17,422 | 15,046 |
| Operating loss | (7,696) | (14,191) | (12,971) |
| Other expense: | | | |
| Interest expense | (18) | (14) | - |
| Other expense, net | (28) | (16) | - |
| Total other expense | (46) | (30) | - |
| Loss before provision for income taxes | (7,742) | (14,221) | (12,971) |
| Provision for income taxes | 93 | 13 | 109 |
| Net loss including noncontrolling interests | (7,835) | (14,234) | (13,080) |
| Less: Net loss attributable to noncontrolling interests | 15 | - | - |
| Net loss attributable to Neonode Inc. | \$(7,820) | \$(14,234) | \$(13,080) |
| Loss per common share: | | | |
| Basic and diluted loss per share | \$(0.19) | \$(0.36) | \$(0.37) |
| Basic and diluted – weighted average number of common shares outstanding | 41,202 | 39,532 | 35,266 |

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

NEONODE INC.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

| | Years ended December 31, | | |
|---|--------------------------|-------------|-------------|
| | 2015 | 2014 | 2013 |
| Net loss including noncontrolling interests | \$ (7,835) | \$ (14,234) | \$ (13,080) |
| Other comprehensive income (loss): | | | |
| Foreign currency translation adjustments | (103) | 138 | 6 |
| Comprehensive loss | (7,938) | (14,096) | (13,074) |
| Less: Comprehensive loss attributable to noncontrolling interests | (15) | - | - |
| Comprehensive loss attributable to Neonode Inc. | \$ (7,953) | \$ (14,096) | \$ (13,074) |

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

NEONODE INC

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

| | Series A Preferred Stock Shares Issued | Series B Preferred Stock Shares Issued | Series C Preferred Stock Shares Issued | Common Stock Shares Issued | Common Stock Amount | Additional Paid-in Capital | Accumulated Other Comprehensive Income | Accumulated Deficit | Total Neonode Inc. Stockholders' Equity | Noncontrolling Interests | Total Stockholders' Equity | |
|--|--|--|--|----------------------------|---------------------|----------------------------|--|---------------------|---|--------------------------|----------------------------|----------|
| Balances, January 1, 2013 | - | \$- | - | \$- | 33,331 | \$33 | \$146,677 | \$5 | \$(138,615) | \$8,100 | \$- | \$8,100 |
| Stock option and warrant compensation expense to employees | - | - | - | - | - | 2,656 | - | - | 2,656 | - | - | 2,656 |
| Proceeds from sale of common stock, net of offering costs | - | - | - | 1,169 | 2 | 6,890 | - | - | 6,892 | - | - | 6,892 |
| Common stock issued upon exercise of common stock warrants | - | - | - | 3,152 | 3 | 711 | - | - | 714 | - | - | 714 |
| Common stock issued upon exercise of common stock options | - | - | - | 241 | - | 1,060 | - | - | 1,060 | - | - | 1,060 |
| Exchange of Series A preferred stock for common stock | - | - | - | 40 | - | - | - | - | - | - | - | - |
| Exchange of Series B preferred stock for common stock | - | - | - | 1 | - | - | - | - | - | - | - | - |
| Foreign currency translation adjustment | - | - | - | - | - | - | 6 | - | 6 | - | - | 6 |
| Net loss | - | - | - | - | - | - | - | (13,080) | (13,080) | - | - | (13,080) |
| Balances, December 31, 2013 | - | \$- | - | \$- | 37,934 | \$38 | \$157,994 | \$11 | \$(151,695) | \$6,348 | \$- | \$6,348 |
| | - | - | - | - | - | 1,729 | - | - | 1,729 | - | - | 1,729 |

Stock option and warrant
 compensation expense to
 employees, directors and
 vendors

| | | | | | | | | | | | | |
|--|---|---|---|---|-------|---|-------|---|---|-------|---|-------|
| Proceeds from sale of common stock, net of offering costs | - | - | - | - | 2,500 | 2 | 9,251 | - | - | 9,253 | - | 9,253 |
|--|---|---|---|---|-------|---|-------|---|---|-------|---|-------|

| | | | | | | | | | | | | |
|--|---|---|---|---|----|---|----|---|---|----|---|----|
| Common stock issued upon exercise of common stock warrants | - | - | - | - | 21 | - | 36 | - | - | 36 | - | 36 |
|--|---|---|---|---|----|---|----|---|---|----|---|----|

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| | Series A Preferred Stock Shares Issued | Series B Preferred Stock Shares Issued | Series B Preferred Stock Shares Issued | Common Stock Shares Issued | Common Stock Amount | Additional Paid-in Capital | Accumulated Other Comprehensive Income | Accumulated Deficit | Total Neonode Inc. Stockholders Equity | Noncontrolling Interests | Total Stockholders Equity | |
|---|--|--|--|----------------------------|---------------------|----------------------------|--|---------------------|--|--------------------------|---------------------------|---------|
| Foreign currency translation adjustment | - | - | - | - | - | - | 138 | - | 138 | - | 138 | |
| Net loss | - | - | - | - | - | - | - | (14,234) | (14,234) | - | (14,234) | |
| Balances, December 31, 2014 | - | \$- | - | \$- | 40,455 | \$40 | \$169,010 | \$149 | \$(165,929) | \$3,270 | \$- | \$3,270 |
| Stock option and warrant compensation expense to employees, directors and vendors | - | - | - | - | - | 1,075 | - | - | 1,075 | - | 1,075 | |
| Proceeds from sale of common stock, net of offering costs | - | - | - | - | 3,200 | 3 | 5,419 | - | - | 5,422 | - | 5,422 |
| Common stock issued upon exercise of common stock warrants | - | - | - | - | 151 | 1 | - | - | - | 1 | - | 1 |
| Foreign currency translation adjustment | - | - | - | - | - | - | (103) | - | (103) | - | (103) | |
| Noncontrolling interests Pronode – initial contribution | - | - | - | - | - | - | - | - | - | 3 | 3 | |
| Net loss | - | - | - | - | - | - | - | (7,820) | (7,820) | (15) | (7,835) | |
| Balances, December 31, 2015 | - | \$- | 83 | \$- | 43,806 | \$44 | \$175,504 | \$46 | \$(173,749) | \$1,845 | \$(12) | \$1,833 |

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

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

(In thousands)

| | Years Ended December 31, | | |
|---|--------------------------|------------|------------|
| | 2015 | 2014 | 2013 |
| Cash flows from operating activities: | | | |
| Net loss (including noncontrolling interests) | \$(7,835) | \$(14,234) | \$(13,080) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | | |
| Stock-based compensation | 1,075 | 1,729 | 2,656 |
| Bad debt expense | - | 167 | - |
| Depreciation and amortization | 187 | 202 | 144 |
| Loss on disposal of property and equipment | 28 | 16 | 8 |
| Changes in operating assets and liabilities: | | | |
| Accounts receivable | (239) | (304) | 1,155 |
| Projects in process | 38 | 530 | (736) |
| Prepaid expenses and other current assets | (263) | (60) | 95 |
| Accounts payable and accrued expenses | 871 | 363 | 19 |
| Deferred revenues | (1,925) | (233) | 938 |
| Net cash used in operating activities | (8,063) | (11,824) | (8,801) |
| Cash flows from investing activities: | | | |
| Purchase of property and equipment | (198) | (115) | (155) |
| Proceeds from sale of property and equipment | - | 7 | - |
| Net cash used in investing activities | (198) | (108) | (155) |
| Cash flow from financing activities: | | | |
| Proceeds from exercise of stock options | - | - | 1,060 |
| Proceeds from exercise of warrants | - | 36 | 714 |
| Proceeds from issuance of common stock, net of offering costs | 5,422 | 9,253 | 6,892 |
| Contributions from noncontrolling interests | 3 | - | - |
| Principal payments on capital lease obligations | (57) | (34) | - |
| Net cash provided by financing activities | 5,368 | 9,255 | 8,666 |
| Effect of exchange rates on cash | (154) | (9) | 8 |
| Net decrease in cash | (3,047) | (2,686) | (282) |
| Cash at beginning of year | 6,129 | 8,815 | 9,097 |
| Cash at end of year | \$3,082 | \$6,129 | \$8,815 |

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Supplemental disclosure of cash flow information:

| | | | |
|----------------------------|-------|-------|--------|
| Cash paid for interest | \$ 18 | \$ 14 | \$ - |
| Cash paid for income taxes | \$ 93 | \$ 5 | \$ 109 |

Supplemental disclosure of non-cash investing and financing activities:

| | | | |
|---|------|--------|------|
| Purchase of equipment with capital lease obligation | \$ - | \$ 530 | \$ - |
|---|------|--------|------|

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

NEONODE INC.

Notes to the Consolidated Financial Statements

1. Nature of the Business and Operations

Background and Organization

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

Operations

Neonode Inc., collectively with its subsidiaries, is referred to as “Neonode”, develops and licenses user interfaces and optical touch technology to Original Equipment Manufacturers (“OEMs”) and Original Design Manufacturers (“ODMs”) who embed the Neonode technology into devices that they produce and sell.

Reclassifications

Interest expense for the year ended December 31, 2014 is now reported under its own caption, separate from other expense, in the accompanying consolidated statement of operations, in order to conform to the current period presentation.

Liquidity

We incurred net losses of approximately \$7.8 million, \$14.2 million and \$13.1 million for the years ended December 31, 2015, 2014 and 2013, respectively and had an accumulated deficit of approximately \$173.7 million as of December 31, 2015. In addition, we used cash in operating activities of approximately \$8.1 million, \$11.8 million and \$8.8 million for the years ended December 31, 2015, 2014 and 2013, respectively.

In June 2014, we filed a shelf registration statement with the SEC that became effective on June 12, 2014. We may from time to time issue shares of our common stock under our shelf registration in amounts, at prices, and on terms to be announced when and if the securities are offered. The specifics of any future offerings, along with the use of proceeds of any securities offered, will be described in a prospectus supplement and any other offering materials, at the time of the offering. Our shelf registration statement will expire on June 12, 2017.

On October 13, 2015, we issued 3,200,000 shares of our common stock from our shelf registration statement to investors in connection with an equity financing transaction. We sold the stock at \$1.90 per share and raised approximately \$6.1 million gross and received approximately \$5.4 million in cash, net of direct offering costs including underwriting discounts and legal, audit and other regulatory costs of approximately \$0.7 million.

As of December 31, 2015, there were 1,800,000 shares remaining for issuance under our existing shelf registration statement.

We believe that, based upon our current operating plan, our existing cash and cash provided by operations will be sufficient to meet our anticipated cash needs for at least the next twelve months. We expect that our revenues from license fees and non-recurring engineering fees will enable us to reduce, or eliminate, our operating losses in 2016. We also have undertaken steps to reduce operating expenses, including (i) termination of consulting contracts associated with our research and development operations, and (ii) improving overall cost efficiency of our operations. Depending on our cash flow, we intend to continue to implement various measures to improve our financial condition, such as reducing further expenses to conserve cash and pursuing strategic transactions and relationships with third parties. While there is no assurance that the Company can meet its projected cash flows, management anticipates that it can continue operations for at least the next twelve months.

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

2. Summary of Significant Accounting policies

Principles of Consolidation

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

The consolidated statements of operations, comprehensive loss and cash flows for the year ended December 31, 2013 include our accounts and those of our wholly owned subsidiaries, Neonode Technologies AB (Sweden), Neonode Americas Inc. (U.S.), Neonode Japan Inc. (Japan), NEON Technology Inc. (U.S.) and Neno User Interface Solutions AB (Sweden).

The consolidated balance sheet at December 31, 2014 and the consolidated statements of operations, comprehensive loss and cash flows for the year ended December 31, 2014 include our accounts and those of our wholly owned subsidiaries, Neonode Technologies AB (Sweden), Neonode Americas Inc. (U.S.), Neonode Japan Inc. (Japan), NEON Technology Inc. (U.S.), Neno User Interface Solutions AB (Sweden) and Neonode Korea Ltd. (South Korea).

The consolidated balance sheet at December 31, 2015 and the consolidated statements of operations, comprehensive loss and cash flows for the year ended December 31, 2015 include our accounts and those of our wholly owned subsidiaries, Neonode Technologies AB (Sweden), Neonode Americas Inc. (U.S.), Neonode Japan Inc. (Japan), NEON Technology Inc. (U.S.), Neno User Interface Solutions AB (Sweden), Neonode Korea Ltd. (South Korea) and Neonode Taiwan Ltd. (Taiwan), and the majority-owned subsidiary of Neonode Technologies AB, Pronode Technologies AB.

Estimates

The preparation of financial statements in conformity with U.S. GAAP requires making estimates and assumptions that affect, at the date of the financial statements, the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from these estimates. Significant estimates include, but are not limited to, collectability of accounts receivable, the achievement of substantive milestones and vendor-specific objective evidence (“VSOE”) of fair value for purposes of

revenue recognition (or deferral of revenue), recoverability of capitalized project costs and long-lived assets, the valuation allowance related to our deferred tax assets, and the fair value of options and warrants issued for stock-based compensation.

Cash

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

Concentration of Cash Balance Risks

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

Accounts Receivable and Allowance for Doubtful Accounts

Our accounts receivable are stated at net realizable value. Our policy is to maintain allowances for estimated losses resulting from the inability of our customers to make required payments. Credit limits are established through a process of reviewing the financial history and stability of each customer. Where appropriate, we obtain credit rating reports and financial statements of the customer when determining or modifying its credit limits. We regularly evaluate the collectability of our trade receivable balances based on a combination of factors. When a customer's account balance becomes past due, we initiate dialogue with the customer to determine the cause. If it is determined that the customer will be unable to meet its financial obligation, such as in the case of a bankruptcy filing, deterioration in the customer's operating results or financial position or other material events impacting its business, we record a specific allowance to reduce the related receivable to the amount we expect to recover. Should all efforts fail to recover the related receivable, we will write-off the account. We also record an allowance for all customers based on certain other factors including the length of time the receivables are past due and historical collection experience with customers. Our allowance for doubtful accounts was approximately \$167,000 as of December 31, 2015 and 2014.

Projects in Process

Projects in process consist of costs incurred toward the completion of various projects for certain customers. These costs are primarily comprised of direct engineering labor costs and project-specific equipment costs. These costs are capitalized on our balance sheet as an asset and deferred until revenue for each project is recognized in accordance with our revenue recognition policy. Costs capitalized in projects in process were \$158,000 and \$200,000 as of December 31, 2015 and 2014, respectively.

Property and Equipment

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

Estimated useful lives

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

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

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

Long-Lived Assets

We assess any impairment by estimating the future cash flow from the associated asset in accordance with relevant accounting guidance. If the estimated undiscounted future cash flow related to these assets decreases or the useful life is shorter than originally estimated, we may incur charges for impairment of these assets. As of December 31, 2015, we believe there was no impairment of our long-lived assets. There can be no assurance, however, that market conditions will not change or sufficient demand for our products and services will continue, which could result in impairment of long-lived assets in the future.

Foreign Currency Translation and Transaction Gains and Losses

The functional currency of our foreign subsidiaries is the applicable local currency, the Swedish Krona, the Japanese Yen, the South Korean Won and the Taiwan Dollar. The translation from Swedish Krona, Japanese Yen, South-Korean Won or the Taiwan Dollar to U.S. Dollars is performed for balance sheet accounts using current exchange rates in effect at the balance sheet date and for income statement accounts using a weighted average exchange rate during the period. Gains or (losses) resulting from translation are included as a separate component of accumulated other comprehensive income (loss). Gains or (losses) resulting from foreign currency transactions are included in general and administrative expenses in the accompanying consolidated statements of operations and were \$62,000, (\$37,000) and (\$155,000) during the years ended December 31, 2015, 2014 and 2013, respectively. Foreign currency translation gains or (losses) were (\$103,000), \$138,000 and \$6,000 during the years ended December 31, 2015, 2014 and 2013, respectively.

Concentration of Credit and Business Risks

Our customers are located in U.S., Europe and Asia.

As of December 31, 2015, three customers represented approximately 78% of our consolidated accounts receivable.

As of December 31, 2014, three customers represented approximately 87% of our consolidated accounts receivable.

Our net revenues for the year ended December 31, 2015 were earned from thirty-five customers. Customers who accounted for 10% or more of our net revenues during the year ended December 31, 2015 are as follows.

Hewlett-Packard Company – 25%

Autoliv – 21%

Amazon – 14%

Our net revenues for the year ended December 31, 2014 were earned from thirty-two customers. Customers who accounted for 10% or more of our net revenues during the year ended December 31, 2014 are as follows.

Hewlett-Packard Company – 24%
KOBO Inc. – 10%
Leap Frog Enterprises Inc. – 11%
Sony Corporation – 10%

Our revenues for the year ended December 31, 2013 were earned from twenty-nine customers. Customers who accounted for 10% or more of our net revenues during the year ended December 31, 2013 are as follows.

KOBO Inc. – 28%
Netronix Inc. – 18%
Leap Frog Enterprises Inc. – 12%
Sony Corporation – 11%

The Company conducts business in the U.S., Europe and Asia. At December 31, 2015, the Company maintained approximately \$2,533,000, (\$909,000) and \$209,000 of its net assets (liabilities) in the U.S., Europe and Asia, respectively. At December 31, 2014, the Company maintained approximately \$3,713,000, (\$461,000) and \$18,000 of its net assets (liabilities) in the U.S., Europe and Asia, respectively.

Revenue Recognition

Licensing Revenues:

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

Explicit return rights are not offered to customers. There have been no returns through December 31, 2015.

Engineering Services:

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

Generally, we recognize revenue as the engineering services stipulated under the contract are completed and accepted by our customers. Engineering services are performed under a signed Statement of Work (“SOW”) with a customer. The deliverables and payment terms stipulated under the SOW provide guidance on the project revenue recognition.

Revenues from contracts that are short-term in nature and related costs that are difficult to estimate are accounted for under the completed contract method.

Revenues from contracts with substantive defined milestones that we have determined are reasonable, relevant to all the deliverables and payment terms in the SOW that are commensurate with the efforts required to achieve the milestones are recognized under the milestone recognition method.

Estimated losses on all SOW projects are recognized in full as soon as they become evident. In the year ended December 31, 2015, \$165,000 was recorded as cost of sales due to expected losses related to two SOW projects. In the years ended December 31, 2014 and 2013 no losses related to SOW projects were recorded.

Deferred Revenues

We defer license fees until we have met all accounting requirements for revenue recognition as per unit royalty products are distributed and royalty reports are received. Engineering development fee revenues are deferred until such time as the engineering work has been completed and accepted by our customers. As of December 31, 2015 and

2014, we have \$1.1 million and \$3.0 million, respectively, of deferred license fee revenue related to prepayments for future license fees from two and four customers, respectively and a total of \$0.4 million and \$0.4 million, respectively, of deferred engineering development fees from one and five customers, respectively.

Advertising

Advertising costs are expensed as incurred. Advertising costs amounted to approximately \$328,000, \$172,000 and \$141,000 for the years ended December 31, 2015, 2014 and 2013, respectively.

Research and Development

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

Stock-Based Compensation Expense

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

We account for equity instruments issued to non-employees at their estimated fair value. The measurement date for the estimated fair value for the equity instruments issued is determined at the earlier of (1) the date at which a commitment for performance by the consultant or vendor is reached, or (2) the date at which the consultant or vendor's performance is complete. In the case of equity instruments issued to consultants, the estimated fair value of the equity instruments is primarily recognized over the term of the consulting agreement. The estimated fair value of the stock-based compensation is periodically re-measured and income or expense is recognized during the vesting term.

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

Noncontrolling Interests

The Company recognizes noncontrolling interests as equity in the consolidated financial statements separate from the parent company's equity. Noncontrolling interests' partners have less than 50% share of voting rights at any one of the subsidiary level companies. The amount of net income (loss) attributable to noncontrolling interests is included in consolidated net income (loss) on the face of the consolidated statements of operations. Changes in a parent entity's ownership interest in a subsidiary that do not result in deconsolidation are treated as equity transactions if the parent entity retains its controlling financial interest. The Company recognizes a gain or loss in net income (loss) when a subsidiary is deconsolidated. Such gain or loss is measured using the fair value of the noncontrolling equity investment on the deconsolidation date. Additionally, operating losses are allocated to noncontrolling interests even when such allocation creates a deficit balance for the noncontrolling interest partner.

The Company provides either in the consolidated statement of stockholders' equity, if presented, or in the notes to consolidated financial statements, a reconciliation at the beginning and the end of the period of the carrying amount of total equity (net assets), equity (net assets) attributable to the parent, and equity (net assets) attributable to the noncontrolling interest that separately discloses:

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

Income Taxes

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

Based on the uncertainty of future pre-tax income, we fully reserved our net deferred tax assets as of December 31, 2015 and 2014. In the event we were to determine that we would be able to realize our deferred tax assets in the future, an adjustment to the deferred tax asset would increase income in the period such determination was made. The provision for income taxes represents the net change in deferred tax amounts, plus income taxes payable for the current period.

We follow U.S. GAAP related to uncertain tax positions, which provisions include a two-step approach to recognizing, de-recognizing and measuring uncertain tax positions. As a result, we did not recognize a liability for unrecognized tax benefits. As of December 31, 2015 and 2014, we had no unrecognized tax benefits.

Net Loss per Share

Net loss per share amounts have been computed based on the weighted-average number of shares of common stock outstanding during the years ended December 31, 2015, 2014 and 2013. Net loss per share, assuming dilution amounts from common stock equivalents, is computed based on the weighted-average number of shares of common stock and potential common stock equivalents outstanding during the period. The weighted-average number of shares of common stock and potential common stock equivalents used in computing the net loss per share for years ended December 31, 2015, 2014 and 2013 exclude the potential common stock equivalents, as the effect would be anti-dilutive (see Note 14).

Other Comprehensive Income (Loss)

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

Cash Flow Information

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

| | Years ended December 31, | | |
|------------------|--------------------------|----------|-------|
| | 2015 | 2014 | 2013 |
| Swedish Krona | 8.43 | 6.86 | 6.51 |
| Japanese Yen | 121.03 | 105.84 | 97.58 |
| South Korean Won | 1,130.22 | 1,050.63 | - |
| Taiwan Dollar | 31.73 | - | - |

Exchange rate for the consolidated balance sheets was as follows:

Years ended
December 31,

| | 2015 | 2014 |
|------------------|----------|----------|
| Swedish Krona | 8.42 | 7.80 |
| Japanese Yen | 120.36 | 119.93 |
| South Korean Won | 1,174.67 | 1,096.73 |
| Taiwan Dollar | 32.84 | - |

Fair Value of Financial Instruments

We disclose the estimated fair values for all financial instruments for which it is practicable to estimate fair value. Financial instruments including cash, accounts receivable, accounts payable and accrued expenses and are deemed to approximate fair value due to their short maturities.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, “*Revenue from Contracts with Customers (Topic 606)*” (“ASU 2014-09”). ASU 2014-09 amends the guidance for revenue recognition to replace numerous, industry specific requirements and converges areas under this topic with those of the International Financial Reporting Standards. The ASU implements a five-step process for customer contract revenue recognition that focuses on transfer of control, as opposed to transfer of risk and rewards. The amendment also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenues and cash flows from contracts with customers. Other major provisions include the capitalization and amortization of certain contract costs, ensuring the time value of money is considered in the transaction price, and allowing estimates of variable consideration to be recognized before contingencies are resolved in certain circumstances. Entities can transition to the standard either retrospectively or as a cumulative-effect adjustment as of the date of adoption. On July 9, 2015, the FASB approved amendments deferring the effective date by one year to December 15, 2017 for annual reporting periods beginning after that date and permitting early adoption of the standard, but not before the original effective date or for reporting periods beginning after December 15, 2016. We have not yet selected a transition method and are currently assessing the impact the adoption of ASU 2014-09 will have on our consolidated financial statements and disclosures.

In August 2014, the FASB issued ASU No. 2014-15, “*Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern*”. The amendments in this update provide guidance in U.S. GAAP about management's responsibilities to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The main provision of the amendments are for an entity's management, in connection with the preparation of financial statements, to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. Management's evaluation should be based on relevant conditions and events that are known or reasonably knowable at the date the consolidated financial statements are issued. When management identifies conditions or events that raise substantial doubt about an entity's ability to continue as a going concern, the entity should disclose information that enables users of the consolidated financial statements to understand all of the following: (1) principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern (before consideration of management's plans); (2) management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations; and (3) management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern or management's plans that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern. The amendments in this update are effective for interim and annual reporting periods beginning after December 15, 2016 and early application is permitted. We are currently assessing this guidance for future implementation.

In November 2015, FASB issued ASU 2015-17, *Income Taxes (Topic 740), Balance Sheet Classification of Deferred Taxes* (“ASU 2015-17”), which eliminates the current requirement for an entity to separate deferred income tax liabilities and assets into current and non-current amounts in a classified balance sheet. Instead, the ASU requires deferred tax liabilities, deferred tax assets and valuation allowances be classified as non-current in a classified balance sheet. ASU 2015-17 will be effective for annual reporting periods beginning after December 15, 2016 and interim periods within those annual periods. Early adoption is permitted. Additionally, this guidance may be applied either prospectively or retrospectively to all periods presented. The Company elected not to early adopt ASU 2015-17 and is evaluating the effect of the adoption of this ASU to its consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)* (“ASU 2016-02”). Under ASU 2016-02, lessees will be required to recognize the following for all leases (with the exception of short-term leases) at the commencement date: a lease liability, which is a lessee’s obligation to make lease payments arising from a lease, measured on a discounted basis; and a right-of-use asset, which is an asset that represents the lessee’s right to use, or control the use of, a specified asset for the lease term. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application is permitted. Lessees must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees may not apply a full retrospective transition approach. The Company elected not to early adopt ASU 2016-02 and is evaluating the effect of the adoption of this ASU to its consolidated financial statements.

3. Prepaid Expenses and Other Current Assets

Prepaid expense and other current assets consist of the following (in thousands):

| | As of December 31, 2015 2014 | |
|---|---------------------------------------|-------|
| Prepaid insurance | \$119 | \$122 |
| Prepaid rent | 52 | 39 |
| VAT receivable | 337 | 137 |
| Other | 239 | 215 |
| Total prepaid expenses and other current assets | \$747 | \$513 |

4. Property and Equipment

Property and equipment consist of the following (in thousands):

| | As of December 31, 2015 2014 | |
|--|--|-------|
| Computers, software, furniture and fixtures | \$637 | \$546 |
| Equipment under capital lease | 428 | 458 |
| Less accumulated depreciation and amortization | (471) | (350) |
| Property and equipment, net | \$594 | \$654 |

Depreciation and amortization expense was \$187,000, \$202,000 and \$144,000 for the years ended December 31, 2015, 2014 and 2013, respectively.

5. Accrued Expenses

Accrued expenses consist of the following (in thousands):

| | As of December 31, 2015 2014 | |
|--|--|-------|
| Salaries, payroll taxes, vacation and benefits | \$932 | \$686 |
| Accrued consulting fees and other | 382 | 249 |
| Total accrued expenses | \$1,314 | \$935 |

6. Fair Value Measurements

Accounting guidance defines fair value, establishes a framework for measuring fair value, and expands disclosure requirements about fair value measurements. The accounting guidance does not mandate any new fair value measurements and is applicable to assets and liabilities that are required to be recorded at fair value under other accounting pronouncements.

There were no assets or liabilities recorded at fair value on a recurring basis in 2015 and 2014.

The three levels of the fair value hierarchy are described as follows:

Level 1: Applies to assets or liabilities for which there are quoted prices (unadjusted) in active markets for identical assets and liabilities. We had no Level 1 assets or liabilities.

Level 2: Applies to assets or liabilities for which there are inputs other than quoted prices that are included in Level 1 observable, either directly or indirectly. We had no Level 2 assets or liabilities.

Level 3: Applies to assets or liabilities for which there are unobservable inputs to the valuation methodology that are significant to the measurement of the fair value of the assets or liabilities. We had no Level 3 assets or liabilities.

7. Deferred Revenue

We defer the license fees until we have met all accounting requirements for revenue recognition as per unit royalty products are distributed and royalty reports are received. Engineering development fee revenues are deferred until such time as the engineering work has been completed and accepted by our customers. As of December 31, 2015 and 2014, we had \$1.1 million and \$3.0 million, respectively, of deferred license fee revenue related to prepayments for future license fees from two and four customers and a total of \$0.4 million and \$0.4 million, respectively, of deferred engineering development fees from one and five customers, respectively.

8. Stockholders' Equity

Common Stock

During the year ended December 31, 2015, we issued 3,200,000 shares of our common stock to investors in connection with an equity financing transaction. These shares of common stock were a portion of the 5,000,000 shares previously registered in 2014 under a shelf registration statement. We issued the stock at \$1.90 per share and raised approximately \$6.1 million gross and received approximately \$5.4 million in cash, net of direct offering costs including underwriting discounts and legal, audit and other regulatory costs of approximately \$0.7 million. Per Bystedt (Chairman of our Board of Directors), Thomas Eriksson (our Chief Executive Officer and a member of our Board of Directors), and Mats Dahlin (a member of our Board of Directors) purchased an aggregate of 157,893 shares of common stock in the offering at the public offering price per share for an aggregate purchase price of approximately \$300,000.

In addition, warrant holders exercised warrants to purchase 280,000 shares of common stock using the cashless net exercise provision allowed in the warrant and received 150,234 shares of our common stock.

During the year ended December 31, 2014, we sold 2,500,000 shares of our common stock at a price of \$4.00 per share to an accredited institutional investor for an aggregate purchase price of \$10,000,000 in gross proceeds and net proceeds of approximately \$9.3 million after expenses and fees, including a \$600,000 placement agent fee.

In addition, we issued a warrant to purchase up to an aggregate of 2,500,000 shares of our common stock at an exercise price of \$5.09 per share (see Note 9) that expired on November 15, 2015. In addition, we issued to the placement agent a warrant to acquire up to an aggregate of 75,000 shares of our common stock. The agent warrant is subject to the same terms and provisions of the investor warrant described above.

During the year ended December 31, 2014, warrant holders exercised warrants to purchase 17,000 shares of common stock using the cashless net exercise provision allowed in the warrant and received 10,053 shares of our common stock. In addition, warrant holders exercised warrants to purchase 11,500 shares of common stock at an exercise price of \$3.13 per share for total cash proceeds of approximately \$36,000.

During the year ended December 31, 2013, warrant holders exercised warrants to purchase 1,815,368 shares of common stock using the cashless exercise provision allowed in the warrant and received 1,384,719 shares of our common stock. In addition, warrant holders exercised warrants to purchase 429,536 shares of common stock and paid a cash exercise price ranging between \$1.00 and \$3.13 per share for total cash proceeds of approximately \$714,000.

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

On April 4, 2013, we extended a 40,000 stock purchase warrant with an exercise price of \$1.00 per share that expired on January 28, 2013 that was issued to an investor in a previous convertible debt financing. The estimated fair value of the warrant was \$166,000 on the date of grant, using the Black-Scholes option pricing model, which was expensed during the year ended December 31, 2013. The warrant holder exercised the warrant on April 4, 2013 and the Company received cash proceeds of \$40,000 (see Note 9).

On August 12, 2013, Thomas Eriksson, our Chief Executive Officer, exercised warrants to purchase 400,000 shares of common stock using the cashless net exercise provision allowed in the warrant and received 326,608 shares of our common stock.

On August 12, 2013, Per Bystedt, the Chairman of our Board, exercised warrants to purchase 387,773 shares of common stock using the cashless exercise provision allowed in the warrant and received 316,624 shares of our common stock.

On August 12, 2013, Phenning Holdings Ltd, a company controlled by Per Bystedt, the Chairman of our Board, exercised warrants to purchase 227,661 shares of common stock using the cashless net exercise provision allowed in the warrant and received 185,890 shares of our common stock.

On August 12, 2013, Davisa Ltd, a company controlled by Mats Dahlin, a member of our Board, exercised warrants to purchase 215,724 shares of common stock using the cashless net exercise provision allowed in the warrant and received 176,143 shares of our common stock.

On August 12, 2013, John Reardon, a member of our Board, exercised warrants to purchase 80,000 shares of common stock using the cashless net exercise provision allowed in the warrant and received 65,322 shares of our common stock.

On September 16, 2013, we issued 1,168,939 shares of our common stock to investors in connection with an equity financing transaction in which we raised approximately \$7.7 million and received approximately \$6.9 million in cash, net of commissions, direct offering costs including legal, audit and other regulatory costs of approximately \$0.8 million.

Preferred Stock

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

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

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

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

Dividends and Distributions

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

Liquidation Preference

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

Voting

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

Conversion

Initially, each share of Series B Preferred stock was convertible into one share of our common stock. On March 31, 2009, our stockholders approved a resolution to increase the authorized share capital, and to increase the conversion ratio to 132.07 shares of our common stock for each share of Series B Preferred stock.

Conversion of Preferred Stock Issued to Common Stock

The following table summarizes the amounts as of December 31, 2015:

| | Shares of Preferred Stock Not Exchanged as of December 31, 2015 | Conversion Ratio | Shares of Common Stock after Conversion of all Outstanding Shares of Preferred Stock Not yet Exchanged at December 31, 2015 |
|--------------------------|---|------------------|---|
| Series B Preferred Stock | 83 | 132.07 | 10,962 |

9. Stock-Based Compensation

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

Stock Options

During the year ended 2015, our shareholders approved the Neonode Inc. 2015 Stock Incentive Plan (the “2015 Plan”) which replaces our 2006 Equity Incentive Plan (the “2006 Plan”). Under the 2015 Plan, 2,100,000 shares of common stock have been reserved for awards, including nonqualified stock option grants and restricted stock grants to officers, employees, non-employee directors and consultants. The terms of the awards granted under the 2015 Plan are set by our compensation committee at its discretion. During the year ended December 31 2015, 605,000 stock options were granted under the 2015 Plan.

Accordingly, as of December 31, 2015, we had two equity incentive plans:

The 2006 Equity Incentive Plan (the “2006 Plan”).
 The 2015 Equity Incentive Plan (the “2015 Plan”).

We also had one non-employee director stock option plan as of December 31, 2015:

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

The following table summarizes information with respect to all options to purchase shares of common stock outstanding under the 2006 Plan, the 2015 Plan and the Director Plan at December 31, 2015:

| Options Outstanding | Options Outstanding | | Options Exercisable | Options Exercisable | |
|-------------------------|---------------------|----------|---------------------|---------------------|--|
| Range of Exercise Price | Number | Weighted | Number | Weighted | |
| | Outstanding | Average | Exercisable | Average | |

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| | at 12/31/15 | Remaining Contractual Life (years) | Exercise Price | at 12/31/15 | Exercise Price |
|-------------------|-------------|--|-------------------|-------------|-------------------|
| \$ 2.08 - \$ 3.50 | 296,450 | 6.10 | \$2.98 | 62,717 | \$ 2.95 |
| \$ 3.51 - \$ 5.00 | 1,516,000 | 3.16 | \$4.22 | 1,501,000 | \$ 4.23 |
| \$ 5.01 - \$ 6.50 | 201,667 | 4.53 | \$5.84 | 161,385 | \$ 5.81 |
| \$ 6.51 - \$ 8.21 | 170,000 | 2.80 | \$7.83 | 163,334 | \$ 7.84 |
| | 2,184,117 | 3.65 | \$4.48 | 1,888,436 | \$ 4.63 |

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

| | Options Outstanding | Weighted- Average Remaining Contractual Life (in years) | Aggregate Intrinsic Value |
|--|---------------------|--|---------------------------------|
| | Number of Shares | Weighted- Average Exercise Price | |
| Options outstanding – January 1, 2013 | 1,715,200 | \$ 5.04 | |
| Options granted | 145,000 | 6.06 | |
| Options exercised | (241,361) | 4.39 | |
| Options cancelled or expired | (18,256) | 5.57 | |
| Options outstanding – December 31, 2013 | 1,600,583 | \$ 5.22 | |
| Options granted | 405,200 | 6.31 | |
| Options exercised | - | - | |
| Options cancelled or expired | (296,383) | 5.46 | |
| Options outstanding – December 31, 2014 | 1,709,400 | 4.92 | |
| Options granted | 605,000 | 3.57 | |
| Options exercised | - | - | |
| Options cancelled or expired | (130,283) | 6.03 | |
| Options outstanding – December 31, 2015 | 2,184,117 | \$ 4.48 | 3.65 \$ 10,740 |
| Options exercisable and expected to vest – December 31, 2015 | 1,888,436 | \$ 4.63 | 3.30 \$ 4,006 |

The assumptions used to value stock options granted to directors, employees and consultants during the years ended December 31, 2015, 2014 and 2013 are as follows:

| | |
|-------------------------|---|
| | For the year ended December 31, 2015 |
| Annual dividend yield | - |
| Expected life (years) | 2.97 |
| Risk-free interest rate | 0.47% - 1.41 % |
| Expected volatility | 60.07% - 72.33 % |

For the year ended
December 31,
2014

Annual dividend yield -

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| | |
|-------------------------|-------------------|
| Expected life (years) | 3.5 |
| Risk-free interest rate | 0.28% - 1.47 % |
| Expected volatility | 60.68% - 108.75 % |

For the year
ended
December 31,
2013

| | |
|-------------------------|----------------|
| Annual dividend yield | - |
| Expected life (years) | 4.3 |
| Risk-free interest rate | 0.65% - 2.15 % |
| Expected volatility | 117% - 154 % |

During the years ended December 31, 2015, 2014 and 2013, we recorded \$1.1 million, \$1.7 million and \$2.7 million, respectively, of compensation expense related to the vesting of stock options. The estimated fair value of the stock-based compensation was calculated using the Black-Scholes option pricing model as of the grant date of the stock option.

The 1998 Plan terminated effective June 15, 2008. The last stock options from the 1998 Plan were exercised during the year ended December 31, 2015. Options granted under the Director Plan vest over a one to four-year period, expire five to seven years after the date of grant and have exercise prices reflecting market value of the shares of our common stock on the date of grant. Stock options granted under the 2006 and 2015 Plans are exercisable over a maximum term of ten years from the date of grant, vest in various installments over a one to four-year period and have exercise prices reflecting the market value of the shares of common stock on the date of grant.

During the year ended December 31, 2015, we granted options to purchase 515,000 shares of our common stock to employees and an option to purchase 90,000 shares of our common stock to four members of our board of directors with total grant date estimated fair value of \$0.8 million computed using the Black-Scholes option pricing model. The weighted-average grant date fair value of the options granted during year ended December 31, 2015 was \$1.24 per share.

During the year ended December 31, 2014, we granted options to purchase 395,200 shares of our common stock to employees and an option to purchase 10,000 shares of our common stock to a former member of our board of directors with total grant date estimated fair value of \$1.3 million computed using the Black-Scholes option pricing model. The weighted-average grant date fair value of the options granted during year ended December 31, 2015 was \$3.14 per share.

During the year ended December 31, 2013, we received an aggregate of \$1.1 million from five employees in connection with the exercise of stock options into 241,361 shares of common stock. The intrinsic value of the options exercised was \$502,000 on the date of exercise.

We granted options to purchase 145,000 shares of our common stock to three employees during the year ended December 31, 2013 with an aggregate grant date fair value of approximately \$748,000 computed using the Black-Scholes option pricing model. The options have a 7-year life and 1/3 of the options are vested on the one year anniversary date of grant with the remaining to vest monthly over the next 24-months.

Warrants

During the year ended December 31, 2015 and 2014, certain warrant holders exercised their warrants under the cash and cashless exercise provisions, as defined in the agreements. See Note 8 for details of such exercises and number of common stock shares issued.

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We issued 20,000 three-year stock purchase warrants at an exercise price of \$3.90 per share with a vesting period over 24 months to an employee during the year ended December 31, 2011. The unvested warrant granted to an employee had an estimated fair value on the date of grant of \$75,000. This amount was expensed over the vesting period and \$26,000 of expense related to this warrant is included in research and development expense for the year ended December 31, 2013. The estimated fair value of stock-based compensation related to the issuance of warrants is calculated using the Black-Scholes option pricing model as of the grant date of the underlying warrant.

The stock-based compensation expense for the years ended December 31, 2015, 2014 and 2013 reflects the estimated fair value of the vested portion of options and warrants granted to directors, employees and non-employees.

(In thousands)

| | Years ended December 31, | | |
|----------------------------|-----------------------------|---------|---------|
| | 2015 | 2014 | 2013 |
| Research and development | \$484 | \$510 | \$267 |
| Sales and marketing | 296 | 353 | 909 |
| General and administrative | 295 | 866 | 1,480 |
| Stock compensation expense | \$1,075 | \$1,729 | \$2,656 |

(In thousands)

Remaining
unrecognized
expense at
December 31,
2015

Stock-based compensation \$ 520

The remaining unrecognized expense related to stock options and warrants will be recognized on a straight line basis monthly as compensation expense over the remaining vesting period which approximates 1.6 years.

A summary of all warrant activity is set forth below:

| Outstanding and exercisable | Warrants | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life |
|--|-------------|--|---|
| January 1, 2013 | 4,704,636 | \$ 1.61 | 1.41 |
| Issued | - | - | - |
| Expired/forfeited | - | - | - |
| Exercised | (3,876,063) | 1.45 | - |
| December 31, 2013 | 828,573 | 2.39 | 2.06 |
| Issued | 2,575,000 | 5.09 | - |
| Expired/forfeited | (40,000) | 3.98 | - |
| Exercised | (28,500) | 2.85 | - |
| December 31, 2014 | 3,335,073 | 4.45 | 0.93 |
| Issued | - | - | - |
| Expired/forfeited | (2,591,000) | 5.06 | - |
| Exercised | (280,000) | 1.30 | - |
| Outstanding and exercisable, December 31, 2015 | 464,073 | \$ 3.02 | 0.19 |

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

amount of the stock-based compensation expense reported in future periods.

Outstanding Warrants to Purchase Common Stock as of December 31, 2015:

| Description | Issue Date | Exercise Price | Shares | Expiration Date |
|-------------------------------------|------------|----------------|---------|-----------------|
| February 2011 Legal Advisor Warrant | 2/22/2011 | \$ 2.50 | 80,000 | 2/22/2016 |
| March 2011 Investor Warrants | 3/9/2011 | \$ 3.13 | 349,973 | 3/9/2016 |
| March 2011 Investor Warrants | 4/7/2011 | \$ 3.13 | 34,100 | 4/7/2016 |
| Total Warrants Outstanding | | | 464,073 | |

10. Commitments and Contingencies

Indemnities and Guarantees

Our bylaws require that we indemnify each of our executive officers and directors for certain events or occurrences arising as a result of the officer or director serving in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. However, we have a directors' and officers' liability insurance policy that should enable us to recover a portion of future amounts paid. As a result of our insurance policy coverage, we believe the estimated fair value of these indemnification agreements is minimal and we have no liabilities recorded for these agreements as of December 31, 2015 and 2014.

We enter into indemnification provisions under our agreements with other companies in the ordinary course of business, typically with business partners, contractors, customers and landlords. Under these provisions we generally indemnify and hold harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of our activities or, in some cases, as a result of the indemnified party's activities under the agreement. These indemnification provisions often include indemnifications relating to representations made by us with regard to intellectual property rights. These indemnification provisions generally survive termination of the underlying agreement. The maximum potential amount of future payments we could be required to make under these indemnification provisions is unlimited. We have not incurred material costs to defend lawsuits or settle claims related to these indemnification agreements. As a result, we believe the estimated fair value of these agreements is minimal. Accordingly, we have no liabilities recorded for these indemnification provisions as of December 31, 2015 and 2014.

Non-Recurring Engineering Development Costs

On February 4, 2011, we entered into an Analog Device Development Agreement with an effective date of January 24, 2010 (the "NN1001 Agreement") with Texas Instruments pursuant to which Texas Instruments integrated Neonode's intellectual property into an Application Specific Integrated Circuit ("ASIC"). The NN1001 ASIC only can be sold by Texas Instruments exclusively to licensees of Neonode. Under the terms of the NN1001 Agreement, we have reimbursed Texas Instruments \$500,000 of non-recurring engineering development costs based on shipments of the NN1001. Under the terms of the NN1001 Agreement, we have reimbursed Texas Instruments a non-recurring engineering fee of \$0.08 per unit for each of the first one million units sold and \$0.05 for the next eight million units sold. During the years ended December 31, 2015 and 2014, approximately \$20,000 and \$93,000, respectively of non-recurring engineering expense related to the NN1001 Agreement is included in research and development in the consolidated statements of operations. As of December 31, 2015, all payments under the NN1001 Agreement have been made.

On April 25, 2013, we entered into an additional Analog Device Development Agreement with an effective date of December 6, 2012 (the “NN1002 Agreement”) with Texas Instruments pursuant to which Texas Instruments will integrate Neonode’s intellectual property into an ASIC. The NN1002 ASIC only can be sold by Texas Instruments exclusively to licensees of Neonode. Under the terms of the NN1002 Agreement, we will reimburse Texas Instruments up to \$500,000 of non-recurring engineering costs based on shipments of the NN1002. Under the terms of the NN1002 Agreement we will reimburse Texas Instruments a non-recurring engineering fee of \$0.25 per unit for each of the first two million units sold. The NN1002 began sampling to customers in May 2014. As of December 31, 2015, we had made no payments under the NN1002 Agreement.

On December 4, 2014, we entered into an additional Analog Device Development Agreement (the “NN1003 Agreement”) with STMicroelectronics International N.V pursuant to which STMicroelectronics will integrate Neonode’s intellectual property into an ASIC. The NN1003 ASIC only can be sold by STMicroelectronics exclusively to licensees of Neonode. Under the terms of the NN1003 Agreement, we will reimburse STMicroelectronics up to \$885,000 of non-recurring engineering costs as follows:

\$235,000 at the feasibility review and contract signature (paid on January 20, 2015)

\$300,000 on completion of tape-out (paid on October 31, 2015)

\$300,000 on completion on product validation (not completed)

Under the terms of the NN1003 Agreement, we also will reimburse STMicroelectronics a non-recurring engineering fee of \$5.00 per each of the first 10,000 units sold. As of December 31, 2015, we had made no payments under the NN1003 Agreement.

Operating Leases

We lease 6,508 square feet of office space located at 2674 North First Street, San Jose, CA 95134 USA. The annual payment for this space equates to approximately \$160,000 per year. The lease is valid through July 31, 2018.

Our subsidiary Neonode Technologies AB leases 7,007 square feet of office space located at Storgatan 23C, Stockholm, Sweden. The annual payment for this space equates to approximately \$431,000 per year including property tax (excluding VAT). The lease is valid through November 30, 2017. The lease can be extended on a yearly basis.

Our subsidiary Neonode Japan Inc. leases 430 square feet of office space located at 608 Bureau Shinagawa, 4-1-6 Konan, Minato-ku, 108-0075 Tokyo, Japan. The annual expense for this space is approximately \$28,000 per year. The lease is valid through October 31, 2016.

Our subsidiary Neonode Korea Ltd. leases 112 square feet located at B-1807, Daesung D-Polis. 543-1, Seoul, South Korea. The annual expense for this space is approximately \$22,000 per year. The lease is valid through February 13, 2017.

Our subsidiary Neonode Taiwan Ltd leases office space located at Rm. 2406, International Trade Building, Keelung Rd., Sec.1, Taipei 11012, Taiwan. The annual expense for this space is approximately \$31,000 per year. The lease can be terminated with a three months' notice.

Neonode Technologies AB's majority-owned subsidiary Pronode Technologies AB entered leases agreement 9,040 square feet of workshop located at Faktorvägen 17, Kungsbacka, Sweden for approximately \$95,000 per year. The lease is valid through December 9, 2017.

For the years ended December 31, 2015, 2014 and 2013, we recorded approximately \$641,000, \$633,000 and \$556,000, respectively, for rent expense.

We believe our existing facilities are in good condition and suitable for the conduct of our business.

A summary of future minimum payments under non-cancellable operating lease commitments as of December 31, 2015 is as follows (in thousands):

| <u>Years ending December 31.</u> | Total |
|----------------------------------|---------|
| 2016 | \$741 |
| 2017 | 646 |
| 2018 | 93 |
| | \$1,480 |

Equipment Subject to Capital Lease

In April 2014, we entered into a lease for certain specialized milling equipment. Under the terms of the lease agreement we are obligated to purchase the equipment at the end of the original 6 year lease term for 10% of the original purchase price of the equipment. In accordance with relevant accounting guidance the lease is classified as a capital lease. The lease payments and depreciation period began on July 1, 2014 when the equipment went into service. The equipment is being amortized to research and development expense on a straight line basis over 6 years at

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the rate of approximately \$16,000 per quarter. The interest rate of the lease is 4% per annum.

The following is a schedule of minimum future rentals on the non-cancelable capital lease as of December 31, 2015 (in thousands):

| <u>Year ending December 31,</u> | Total |
|--|-------|
| 2016 | \$72 |
| 2017 | 72 |
| 2018 | 72 |
| 2019 | 72 |
| 2020 | 94 |
| Total minimum payments required: | 382 |
| Less amount representing interest: | (42) |
| Present value of net minimum lease payments: | 340 |
| Less current portion | (57) |
| | \$283 |

| | |
|--------------------------------|-------|
| Equipment under capital lease | \$427 |
| Less: accumulated depreciation | (95) |
| Net book value | \$332 |

11. Segment Information

Our Company has one reportable segment, which is comprised of the touch technology licensing business. All of our sales for the years ended December 31, 2015, 2014 and 2013 were to customers located in the U.S., Europe and Asia.

The following table presents net revenues by geographic region for the years ended December 31, 2015, 2014 and 2013 (dollars in thousands):

| | 2015 | | |
|---|----------|------------|---|
| | Amount | Percentage | |
| Net revenues from customers in the U.S. | \$6,177 | 56 | % |
| Net revenue from customers in Europe | 2,987 | 27 | % |
| Net revenues from customers in Asia | 1,951 | 17 | % |
| Total | \$11,115 | 100 | % |

| | 2014 | | |
|---|---------|------------|---|
| | Amount | Percentage | |
| Net revenues from customers in the U.S. | \$2,833 | 60 | % |
| Net revenues from customers in Europe | 228 | 5 | % |
| Net revenues from customers in Asia | 1,679 | 35 | % |
| Total | \$4,740 | 100 | % |

| | 2013 | | |
|---|---------|------------|---|
| | Amount | Percentage | |
| Net revenues from customers in the U.S. | \$1,896 | 51 | % |
| Net revenues from customers in Europe | 308 | 9 | % |
| Net revenues from customers in Asia | 1,513 | 40 | % |
| Total | \$3,717 | 100 | % |

12. Income Taxes

Loss before income taxes was distributed geographically for the years ended December 31, as follows (in thousands):

| | 2015 | 2014 | 2013 |
|----------|-----------|------------|------------|
| Domestic | \$(7,783) | \$(13,993) | \$(12,877) |
| Foreign | 41 | (228) | (94) |

Total \$(7,742) \$(14,221) \$(12,971)

60

The provision for income taxes is as follows for the years ended December 31 (in thousands):

| | 2015 | 2014 | 2013 |
|-----------------------------|---------|---------|---------|
| Current | | | |
| Federal | \$- | \$- | \$- |
| State | 2 | 3 | 2 |
| Foreign | 91 | 10 | 107 |
| Change in deferred | | | |
| Federal | (2,466) | (4,213) | (3,794) |
| Federal valuation allowance | 2,466 | 4,213 | 3,794 |
| State | (252) | (460) | 129 |
| State valuation allowance | 252 | 460 | (129) |
| Foreign | 6 | 64 | 111 |
| Foreign valuation allowance | (6) | (64) | (111) |
| Total current | \$93 | \$13 | \$109 |

The differences between our effective income tax rate and the U.S. federal statutory federal income tax rate for the years ended December 31, are:

| | 2015 | 2014 | 2013 |
|---|--------|--------|--------|
| Amounts at statutory tax rates | 34 % | 34 % | 34 % |
| Foreign losses taxed at different rates | - % | (1)% | - |
| Stock-based compensation | (1)% | (2)% | (3)% |
| Other | (1)% | (1)% | (1)% |
| Total | 32 % | 30 % | 30 % |
| Valuation allowance | (33)% | (31)% | (31)% |
| Effective tax rate | (1)% | (1)% | (1)% |

Significant components of the deferred tax asset balances at December 31 are as follows (in thousands):

| | 2015 | 2014 |
|----------------------------------|----------|----------|
| Deferred tax assets: | | |
| Accruals | \$1,109 | \$1,053 |
| Stock compensation | 1,352 | 1,210 |
| Net operating losses | 17,190 | 14,681 |
| Basis difference in fixed assets | 7 | 2 |
| Total deferred tax assets | \$19,658 | \$16,946 |
| Valuation allowance | (19,658) | (16,946) |

Total net deferred tax assets \$- \$-

Valuation allowances are recorded to offset certain deferred tax assets due to management's uncertainty of realizing the benefits of these items. Management applies a full valuation allowance for the accumulated losses of Neonode Inc., and its subsidiaries, since it is not determinable using the "more likely than not" criteria that there will be any future benefit of our deferred tax assets. This is mainly due to our history of operating losses. As of December 31, 2015, we had federal, state and foreign net operating losses of \$48.6 million, \$19.8 million and \$0, respectively. The federal loss carryforward begins to expire in 2028, the California loss carryforward begins to expire in 2030 and the foreign loss carryforward is indefinite.

Utilization of the net operating loss and tax credit carryforwards is subject to an annual limitation due to the ownership percentage change limitations provided by Section 382 of the Internal Revenue Code and similar state provisions. The annual limitation may result in the expiration of the net operating losses and tax credit carryforwards before utilization. As of December 31, 2015, we had not completed the determination of the amount to be limited under the provision.

As of December 31, 2015, we did not recognize \$547,000 and \$28,000 of federal and state deferred tax assets relating to excess tax benefits for stock-based compensation deductions. Unrecognized deferred tax benefits will be accounted for as a credit to additional paid-in capital when realized through a reduction in income taxes payable.

We follow the provisions of accounting guidance which includes a two-step approach to recognizing, de-recognizing and measuring uncertain tax positions. There were no unrecognized tax benefits for the years ended December 31, 2015, 2014 and 2013.

We follow the policy to classify accrued interest and penalties as part of the accrued tax liability in the provision for income taxes. For the years ended December 31, 2015, 2014 and 2013 we did not recognize any interest or penalties related to unrecognized tax benefits.

Our continuing practice is to recognize interest and/or penalties related to income tax matters in income tax expense. As of December 31, 2015 and 2014, we had no accrued interest and penalties related to uncertain tax matters.

As of December 31, 2015, we had no uncertain tax positions that would be reduced as a result of a lapse of the applicable statute of limitations.

Payments related to the license agreement with Sony Corporation are net of 10% income tax withholding as required by the Japanese government under the Sweden and Japan international tax treaty. The amounts withheld may be used to offset future payables for income tax in Sweden. In the year ended December 31, 2015, \$80,000 was withheld. In the years ended December 31, 2015, 2014 and 2013, \$0, \$0 and \$42,000 were withheld, respectively.

We file income tax returns in the U.S. federal jurisdiction, California, Sweden, Japan, South Korea and Taiwan. The 1999 through 2014 tax years are open and may be subject to potential examination in one or more jurisdictions. We are not currently under any federal, state or foreign income tax examinations.

13. Employee Benefit Plans

We participate in a number of individual defined contribution pension plans for our employees in Sweden. We contribute five percent (5%) of the employee's annual salary to these pension plans. For the Swedish Management we contribute up to fifteen percent (15%) of the employee's annual salary. Contributions relating to these defined contribution plans for the years ended December 31, 2015, 2014 and 2013 were \$306,000, \$249,000 and \$184,000, respectively. We match U.S. employee contributions to a 401k retirement plan up to a maximum of six percent (6%) of an employee's annual salary. Contributions relating to the matching 401k contributions for the years ended December 31, 2015, 2014 and 2013 were \$89,000, \$81,000 and \$66,000, respectively. In Taiwan, we contribute six percent (6%) of the employee's annual salary to a pension fund which agrees with Taiwan's newly made Labor Pension Act. Contributions relating to the Taiwanese pension fund for the year ended December 31, 2015, were \$10,000.

14. Net Loss per Share

Basic net loss per common share for the years ended December 31, 2015, 2014 and 2013 was computed by dividing the net loss attributable to Neonode Inc. for the relevant period by the weighted average number of shares of common stock outstanding during the year. Diluted loss per common share is computed by dividing net loss attributable to Neonode Inc. for the relevant period by the weighted average number of shares of common stock and common stock equivalents outstanding during the year.

Potential common stock equivalents of approximately 13,000, 0.3 million and 0.8 million outstanding stock warrants, 11,000, 11,000 and 11,000 shares issuable upon conversion of preferred stock, 7,000, 24,000 and 1.6 million stock options are excluded from the diluted earnings per share calculation for the years ended December 31, 2015, 2014 and 2013, respectively, due to their anti-dilutive effect.

| <u>(In thousands, except per share amounts)</u> | Years ended December 31, | | |
|--|--------------------------|------------|------------|
| | 2015 | 2014 | 2013 |
| BASIC AND DILUTED | | | |
| Weighted average number of common shares outstanding | 41,202 | 39,532 | 35,266 |
| Net loss attributable to Neonode Inc. | \$(7,820) | \$(14,234) | \$(13,080) |
| Net loss per shares basic and diluted | \$(0.19) | \$(0.36) | \$(0.37) |

15. Quarterly Financial Information

| | For the Quarter Ended | | | |
|---|---|-------------|------------------|-----------------|
| | March 31, | June 30, | September 30, | December 31, |
| | (unaudited, in thousands except per share amounts) | | | |
| 2015 | | | | |
| Net Revenues | \$2,263 | \$2,776 | \$ 3,113 | \$ 2,963 |
| Cost of revenues | 338 | 737 | 909 | 1,796 |
| Gross margin | 1,925 | 2,039 | 2,204 | 1,167 |
| Net loss attributable to Neonode Inc. | (2,072) | (1,792) | (1,368) | (2,588) |
| Net loss per basic and diluted common share | \$(0.05) | \$(0.04) | \$(0.03) | \$(0.06) |
| 2014 | | | | |
| Net Revenues | \$1,014 | \$865 | \$ 1,126 | \$ 1,735 |
| Cost of revenues | 166 | 452 | 422 | 469 |
| Gross margin | 848 | 413 | 704 | 1,266 |
| Net loss attributable to Neonode Inc. | (4,008) | (3,874) | (3,245) | (3,107) |
| Net loss per basic and diluted common share | \$(0.11) | \$(0.10) | \$(0.08) | \$(0.08) |
| 2013 | | | | |
| Net Revenues | \$548 | \$1,084 | \$ 1,076 | \$ 1,009 |
| Cost of revenues | 16 | 662 | 765 | 199 |
| Gross margin | 532 | 422 | 311 | 810 |
| Net loss attributable to Neonode Inc. | (3,570) | (3,120) | (3,343) | (3,047) |
| Net loss per basic and diluted common share | \$(0.11) | \$(0.09) | \$(0.09) | \$(0.08) |

Quarterly and year-to-date computations of per share amounts are made independently. Therefore, the sum of per share amounts for the quarters may not agree with the per share amounts for the year.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the supervision of and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of December 31, 2015. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

In designing and evaluating disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable, not absolute, assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended December 31, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Management's Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act.

A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our Company have been detected.

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2015. In making their assessment, our management used criteria established in the framework on *Internal Control – Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based upon that assessment, our management concluded that our internal control over financial reporting was effective as of December 31, 2015.

Our management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Pronode Technologies AB. Pronode Technologies AB is included in the consolidated financial statements of Neonode Inc., but constituted less than 2% of consolidated total assets as of December 31, 2015 and none of consolidated net sales for the year then ended.

The effectiveness of our internal control over financial reporting as of December 31, 2015 has been audited by KMJ Corbin & Company LLP, an independent registered public accounting firm, as stated in its report contained on the next page of this Annual Report.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders

Neonode Inc.

We have audited the internal control over financial reporting of Neonode Inc. and subsidiaries (the “Company”) as of December 31, 2015, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company’s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Annual Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on that risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As indicated in the accompanying Management's Annual Report on Internal Control over Financial Reporting, management's assessment of and conclusion on the effectiveness of internal control over financial reporting did not include the internal controls of Pronode Technologies AB, which is included in the consolidated financial statements of Neonode Inc. and constituted less than 2% of consolidated total assets as of December 31, 2015 and had no net revenues for the year then ended. Our audit of internal control over financial reporting of Neonode Inc. also did not include an evaluation of the internal control over financial reporting of Pronode Technologies AB.

In our opinion, Neonode Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Neonode Inc. and subsidiaries as of December 31, 2015 and 2014, and the related consolidated statements of operations, comprehensive loss, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2015 and our report dated March 10, 2016 expressed an unqualified opinion on those consolidated financial statements.

/s/ KMJ Corbin & Company LLP

Costa Mesa, California

March 10, 2016

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The information required by this Item will be included in our definitive proxy statement for the 2016 Annual Meeting of Stockholders and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item will be included in our definitive proxy statement for the 2016 Annual Meeting of Stockholders and is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this Item will be included in our definitive proxy statement for the 2016 Annual Meeting of Stockholders and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

The information required by this Item will be included in our definitive proxy statement for the 2016 Annual Meeting of Stockholders and is incorporated herein by reference.

ITEM 14. Principal Accounting Fees and Services

The information required by this Item will be included in our definitive proxy statement for the 2016 Annual Meeting of Stockholders and is incorporated herein by reference.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES**Financial Statements**

The consolidated financial statements of the registrant are listed in the index to the consolidated financial statements and filed under Item 8 of this Annual Report.

Financial Statement Schedules

All financial statement schedules are omitted because the relevant information is not applicable or not present in amounts sufficient to require submission of the schedule or the required information is shown in the consolidated financial statements and the notes thereto included in this Annual Report.

(2) Schedule II — Valuation and Qualifying Accounts.

SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS

(All dollar amounts expressed in thousands of U.S. dollars)

| | Balance at Beginning of Year | Charged to Costs and Expenses | Charged to Other Accounts | Deductions | Balance at End of Year |
|---|---|--|--------------------------------------|-------------------|-----------------------------------|
| Year ended December 31, 2015 | | | | | |
| Allowance for doubtful accounts | \$ 167 | \$- | \$- | \$- | \$ 167 |
| Deferred tax asset valuation allowance | \$ 16,946 | \$- | \$ 2,712 | \$- | \$ 19,658 |
| Year ended December 31, 2014 | | | | | |
| Allowance for doubtful accounts | \$ | \$ 167 | \$- | \$- | \$ 167 |
| Deferred tax asset valuation allowance | \$ 12,335 | \$- | \$ 4,611 | \$- | \$ 16,946 |

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Year ended
December 31, 2013
Deferred tax asset
valuation allowance

| | | | | |
|---------|-----|---------|-----|----------|
| \$8,302 | \$- | \$4,033 | \$- | \$12,335 |
|---------|-----|---------|-----|----------|

Exhibits

Number Description

- 3.1 Amended and Restated Certificate of Incorporation of Neonode Inc., dated April 17, 2009 (*incorporated by reference to Exhibit 10.22 of the registrant's quarterly report on Form 10-Q filed on August 4, 2009 (file no. 0-08419)*)
- 3.1.1 Certificate of Amendment, dated December 13, 2010 (*incorporated by reference to Exhibit 3.1.1 of the registrant's annual report on Form 10-K filed on March 31, 2011 (file no. 0-08419)*)
- 3.1.2 Certificate of Amendment, dated March 18, 2011 (*incorporated by reference to Exhibit 3.1 of the registrant's current report on Form 8-K filed on March 28, 2011 (file no. 0-08419)*)
- 3.1.3 Certificate of Correction, dated February 28, 2012 (*incorporated by reference to Exhibit 3.1.3 of the registrant's annual report on Form 10-K filed on March 30, 2012 (file no. 0-08419)*)
- 3.2 Bylaws, as amended through December 5, 2007 (*incorporated by reference to Exhibit 3.2 of the registrant's annual report on Form 10-K filed on April 15, 2008 (file no. 0-08419)*)
- 4.1 Certificate of Designations, Preferences and Rights of the Series A and Series B Preferred Stock dated December 29, 2008 (*incorporated by reference to Exhibit 4.1 of the registrant's current report on Form 8-K filed on December 31, 2008 (file no. 0-08419)*)
- 4.2 Certificate of Increase of Designation of Series B Preferred Stock dated January 2, 2009 (*incorporated by reference to Exhibit 4.2 of the registrant's quarterly report on Form 10-Q filed on October 31, 2011 (file no. 0-08419)*)
- 4.3 Certificate of Increase of Designation of Series B Preferred Stock dated January 28, 2009 (*incorporated by reference to Exhibit 4.3 of the registrant's quarterly report on Form 10-Q filed on October 31, 2011 (file no. 0-08419)*)
- 10.1 Form of Common Stock Purchase Warrant (*incorporated by reference to Exhibit 10.20 of the registrant's annual report on Form 10-K filed on March 31, 2011 (file no. 0-08419)*)
- 10.2 Employment Agreement of Thomas Eriksson, dated March 5, 2014 (*incorporated by reference to Exhibit 10.1 of the registrant's current report on Form 8-K filed on March 11, 2014 (file no. 1-35526)*) +
- 10.3 Employment Agreement of Lars Lindqvist, dated August 5, 2014 (*incorporated by reference to Exhibit 10.1 of the registrant's current report on Form 8-K filed on August 6, 2014 (file no. 1-35526)*) +
- 10.4 Neonode Inc. 2015 Stock Incentive Plan
- 10.5 Form of Notice of Grant of Stock Option used in connection with the 2015 Stock Incentive Plan
- 10.6 Form of Notice of Grant of Restricted Stock used in connection with the 2015 Stock Incentive Plan
- 10.7 Form of Notice of Grant of Restricted Stock Units used in connection with the 2015 Stock Incentive Plan
- 10.8 Form of Notice of Grant of Stock Option to Swedish residents used in connection with the 2015 Stock Incentive Plan
- 21 Subsidiaries of the registrant
- 23.1 Consent of Independent Registered Public Accounting Firm
- 31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act Of 2002
- 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act Of 2002
- 32 Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

+ Management contract or compensatory plan or arrangement

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NEONODE INC.
(Registrant)

Date: March 10, 2016 By: /s/ Lars Lindqvist
Lars Lindqvist

Chief Financial Officer,

Vice President, Finance, Treasurer

and Secretary

Pursuant to the requirements for the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacity and dates indicated.

| Name | Title | Date |
|--|--|----------------|
| /s/ Thomas Eriksson Thomas Eriksson | President and Chief Executive Officer, and Director <i>(Principal Executive Officer)</i> | March 10, 2016 |
| /s/ Lars Lindqvist Lars Lindqvist | Chief Financial Officer, Vice President, Finance Treasurer and Secretary <i>(Principal Financial and Accounting Officer)</i> | March 10, 2016 |
| /s/ Per Bystedt Per Bystedt | Chairman of the Board of Directors | March 10, 2016 |
| /s/ John Reardon John Reardon | Director | March 10, 2016 |
| /s/ Mats Dahlin Mats Dahlin | Director | March 10, 2016 |
| /s/ Per Löfgren | Director | March 10, 2016 |

Per Löfgren

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