NEOMEDIA TECHNOLOGIES INC
Form 10-Q
August 12, 2011
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10 - Q

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

For the quarterly period ended June 30, 2011

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

For the transition period from __________ to ____________

Commission File Number 0-21743

NeoMedia Technologies, Inc.
(Exact Name of Issuer as Specified In Its Charter)

Delaware	36-3680347
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Two Concourse Parkway, Suite 500, Atlanta, GA 30328
(Address, including zip code, of principal executive offices)

678-638-0460
(Registrants' telephone number, including area code)

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

Indicate by check mark whether the registrant 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files.
Yes o No o

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 o Accelerated filer o Non-accelerated filer o Smaller Reporting Company x

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

The number of outstanding shares of the registrant’s Common Stock on August 8, 2011 was 219,257,318.

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PART I — FINANCIAL INFORMATION

ITEM 1. Financial Statements

NeoMedia Technologies, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(in thousands, except share and per share data)

	June 30, 2011 (unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 68	$ 80
Trade accounts receivable, net of allowance of $5 and $0	246	345
Inventories, net of allowance of $122 and $114	145	112
Prepaid expenses and other current assets	211	151
Total current assets	670	688
Property and equipment, net	83	96
Goodwill	3,418	3,418
Proprietary software, net	1,085	1,414
Patents and other intangible assets, net	1,905	2,048
Cash surrender value of life insurance policies	740	738
Other long-term assets	171	171
Total assets	$ 8,072	$ 8,573
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 311	$ 435
Taxes payable	38	126
Accrued expenses	10,381	9,413
Deferred revenues and customer prepayments	1,927	1,417
Note payable	15	69
Accrued purchase price guarantee	4,535	4,535
Deferred tax liability	706	706
Derivative financial instruments - warrants	973	2,213
Derivative financial instruments - Series C and D preferred stock and debentures payable	56,947	28,092
Debentures payable - carried at amortized cost	15,140	14,560
Debentures payable - carried at fair value	38,755	27,484
Total current liabilities	129,728	89,050
Commitments and contingencies (Note 6)		
Series C convertible preferred stock, $0.01 par value, 27,000 shares authorized, 6,104 and 8,336 shares issued and outstanding, liquidation value of $6,104 and $8,336	6,104	8,336
Series D convertible preferred stock, $0.01 par value, 25,000 shares authorized, 25,000 and 25,000 shares issued and outstanding, liquidation value of $2,500 and $2,500	2,500	2,500

Shareholders' deficit:						
Common stock, $0.001 par value, 5,000,000,000 shares authorized, 183,478,429 and 25,695,392 shares issued and 183,462,016 and 25,678,978 shares outstanding as of June 30, 2011 and December 31, 2010, respectively		183			26	
Additional paid-in capital		161,954			153,974	
Accumulated deficit		(291,466	)		(244,395	)
Accumulated other comprehensive loss		(152	)		(139	)
Treasury stock, at cost, 2,012 shares of common stock		(779	)		(779	)
Total shareholders' deficit		(130,260	)		(91,313	)
Total liabilities and shareholders' deficit	$	8,072		$	8,573	

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

NeoMedia Technologies, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations (Unaudited)
(in thousands, except share and per share data)

	Three Months Ended June 30, 2011	June 30, 2010
Revenues	$767	$221
Cost of revenues	237	255
Gross profit	530	(34)
Sales and marketing expenses	305	262
General and administrative expenses	827	1,041
Research and development costs	429	418
Operating loss	(1,031)	(1,755)
Loss on extinguishment of debt	-	(363)
Gain (loss) from change in fair value of hybrid financial instruments	(15,899)	1,180
Gain (loss) from change in fair value of derivative liability - warrants	(87)	4,305
Gain (loss) from change in fair value of derivative liability - Series C and D preferred stock and debentures	(37,941)	6,645
Interest expense related to convertible debt	(904)	(510)
Net Income (loss)	(55,862)	9,502
Net Income (loss) attributable to common shareholders	(55,862)	9,502
Comprehensive income (loss):		
Net income (loss)	(55,862)	9,502
Other comprehensive loss - foreign currency translation adjustment	(4)	(26)
Comprehensive Income (loss)	$(55,866)	$9,476
Net income (loss) per share, basic and diluted:		
Basic	$(0.41)	$0.42
Fully diluted	$(0.41)	$(0.01)
Weighted average number of common shares:		
Basic	137,692,460	22,675,678
Fully diluted	137,692,460	302,104,430

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

NeoMedia Technologies, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations (Unaudited)
(in thousands, except share and per share data)

	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Revenues	$1,136	$576
Cost of revenues	475	594
Gross profit	661	(18)
Sales and marketing expenses	621	581
General and administrative expenses	1,621	2,136
Research and development costs	830	701
Operating loss	(2,411)	(3,436)
Loss on extinguishment of debt	-	(6,006)
Gain (loss) from change in fair value of hybrid financial instruments	(13,428)	19,552
Gain from change in fair value of derivative liability - warrants	1,695	10,856
Gain (loss) from change in fair value of derivative liability - Series C and D preferred stock and debentures	(31,270)	46,824
Interest expense related to convertible debt	(1,657)	(956)
Net Income (loss)	(47,071)	66,834
Dividends on convertible preferred stock	-	(2,500)
Net Income (loss) attributable to common shareholders	(47,071)	64,334
Comprehensive income (loss):		
Net income (loss)	(47,071)	66,834
Other comprehensive loss - foreign currency translation adjustment	(13)	(50)
Comprehensive Income (loss)	$(47,084)	$66,784
Net income (loss) per share, basic and diluted:		
Basic	$(1.02)	$2.84
Fully diluted	$(1.02)	$(0.02)
Weighted average number of common shares:		
Basic	46,114,822	22,675,678
Fully diluted	46,114,822	299,092,068

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

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NeoMedia Technologies, Inc. and Subsidiaries
Consolidated Statement of Shareholders' Deficit (Unaudited)
(in thousands, except share data)

	Common Stock Shares	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Treasury Stock Shares	Amount	Total Shareholders' Deficit
Balance, December 31, 2010	25,678,978	$26	$153,974	$ (139)	$ (244,395)	2,012	$(779)	$ (91,313)
Shares issued for acquisition of patent rights	5,000,000	5	345	-	-	-	-	350
Shares issued upon conversions of Series C preferred stock	152,783,038	152	7,583	-	-	-	-	7,735
Stock-based compensation expense	-	-	52	-	-	-	-	52
Comprehensive income - foreign currency translation adjustment	-	-	-	(13)	-	-	-	(13)
Net loss	-	-	-	-	(47,071)	-	-	(47,071)
Balance, June 30, 2011	183,462,016	$183	$161,954	$ (152)	$ (291,466)	2,012	$(779)	$ (130,260)

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

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

	Six Months Ended June 30, 2011	2010
Cash Flows from Operating Activities:		
Net Income (loss)	$(47,071)	$66,834
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	489	497
Loss on extinguishment of debt	-	6,006
(Gain) loss from change in fair value of hybrid financial instruments	13,428	(19,552)
(Gain) loss from change in fair value of derivative liability - warrants	(1,695)	(10,856)
(Gain) loss from change in fair value of derivative liability - Series C and D preferred stock and debentures	31,270	(46,824)
Interest expense related to convertible debt	1,657	956
Interest paid on convertible debt	(1,000)	-
Stock-based compensation expense	52	98
Increase in value of life insurance policies	(2)	47
Changes in operating assets and liabilities		
Trade and other accounts receivable	99	138
Inventories	(33)	24
Prepaid expenses and other assets	(60)	142
Accounts payable and accrued liabilities	(116)	(537)
Deferred revenue and other current liabilities	510	(332)
Net cash used in operating activities	(2,472)	(3,359)
Cash Flows from Investing Activities:		
Acquisition of property and equipment	(5)	(7)
Net cash used in investing activities	(5)	(7)
Cash Flows from Financing Activities:		
Proceeds from issuance of Series D preferred stock	-	2,500
Costs attributed to issuance of Series D convertible preferred stock	-	(100)
Borrowing (repayment) of note payable - YA Global	-	(500)
Borrowings under convertible debt instruments, net	2,460	1,885
Net cash provided by financing activities	2,460	3,785
Effect of exchange rate changes on cash	5	56
Net increase (decrease) in cash and cash equivalents	(12)	475
Cash and cash equivalents, beginning of period	80	198
Cash and cash equivalents, end of period	$68	$673
Supplemental cash flow information:		

Interest paid during the period	$1	$1
Series C preferred stock converted to common stock	$7,736	$-
Deemed dividend on Series D preferred stock issued	$-	$2,500
Shares issued for acquisition of patent rights	$350	$-

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

NeoMedia Technologies, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1 - General

Business – NeoMedia Technologies, Inc., a Delaware corporation (“NeoMedia”, and also referred to herein as “us”, “we” and “our”), is an innovator and a global market leader in 2D mobile barcode technology and solutions that enable the mobile barcode ecosystem world-wide. NeoMedia harnesses the power of the mobile phone with state-of-the art mobile barcode technology. With this technology, mobile phones with cameras become barcode scanners and this enables a range of applications including consumer oriented marketing and advertising, mobile ticketing and couponing, and business-to-business commercial track and trace solutions.

As a technology pioneer in the global mobile barcode industry, our suite of products, services and IP portfolio allows us to offer a comprehensive end-to-end mobile barcode solution. We offer barcode management and infrastructure technology solutions, barcode reader solutions and IP licensing, as well as mobile couponing and ticketing products and services. NeoMedia has been a pioneer in the mobile barcode field since the mid 1990s, and during that time has spearheaded the development of a robust IP portfolio that encompasses many preferred mobile barcode implementations. We have an IP portfolio currently consisting of over sixty issued and pending patents.

Going Concern – We have historically incurred net losses from operations and we expect that we will continue to have negative cash flows as we implement our business plan. There can be no assurance that our continuing efforts to execute our business plan will be successful and that we will be able to continue as a going concern. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“US GAAP”), which contemplates our continuation as a going concern. Net loss for the six months ended June 30, 2011 was $47.1 million and our net income for the six months ended June 30, 2010 was $66.8 million, respectively, of which $43.0 million were net losses, and $71.2 million were net gains related to our financing instruments, respectively. Net cash used by operations during the six months ended June 30, 2011 and 2010 was $2.5 million and $3.4 million, respectively. At June 30, 2011, we have an accumulated deficit of $291.5 million. We also have a working capital deficit of $129.1 million, of which $111.8 million is related to our financing instruments, including $39.7 million related to the fair value of warrants and those debentures that are recorded as hybrid financial instruments, and $72.1 million related to the amortized cost carrying value of certain of our debentures and the fair value of the associated derivative liabilities. We also have a continuing purchase price guarantee obligation of $4.5 million associated with an acquisition of a business in 2006, which we subsequently sold in 2007.

The items discussed above raise substantial doubt about our ability to continue as a going concern.

We currently do not have sufficient cash or commitments for financing, to sustain our operations for the next twelve months and therefore, we will require additional financing in order to execute our operating plan and continue as a going concern. Our management’s plan is to attempt to secure adequate funding to bridge the commercialization of our patent licensing and barcode ecosystem businesses. We cannot predict whether this additional financing will be in the form of equity, debt, or another form and we may not be able to obtain the necessary additional capital on a timely basis, on acceptable terms, or at all. In the event that these financing sources do not materialize, or that we are unsuccessful in increasing our revenues and profits, we may be unable to implement our current plans for expansion, repay our debt obligations as they become due or respond to competitive pressures, any of which circumstances would have a material adverse effect on our business, prospects, financial condition and results of operations. Should our lender, YA Global Investments, L.P. (“YA Global”) choose not to provide us with continued financing, or if we do not find alternative sources of financing to fund our operations or if we are unable to generate significant product revenues, we only have sufficient funds to sustain our current operations through approximately September 1, 2011.

The financial statements do not include any adjustments relating to the recoverability and reclassification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should we be unable to continue as a going concern.

Note 2 - Summary of Significant Accounting Policies

The accompanying unaudited financial statements have been prepared in accordance with US GAAP for interim financial information and Rule 8.03 of Regulation S-X. They do not include all of the information and footnotes required by US GAAP for complete financial statements. In the opinion of management, all adjustments, consisting only of normal recurring adjustments, considered necessary for a fair presentation have been included. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. For further information, refer to our financial statements as of December 31, 2010 and 2009, and for the years then ended, including notes thereto in the Company's Annual Report on Form 10-K, for the year ended December 31, 2010.

Basis of Presentation – The consolidated financial statements include the accounts of NeoMedia Technologies, Inc. and our wholly-owned subsidiaries. We operate as one reportable segment. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates – The preparation of consolidated financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Changes in facts and circumstances may result in revised estimates, which are recorded in the period in which they become known.

Stock-Based Compensation - FASB ASC 718, Stock Compensation, requires that all stock-based compensation be recognized as an expense in the financial statements and that such cost be measured at the grant date fair value of the award. We account for modifications of terms of existing option grants as exchanges of the existing equity instruments for new instruments. The fair value of the modified option at the grant date is compared with the value at that date of the original option immediately before its terms are modified. Any excess fair value of the modified option over the original option is recognized as additional compensation expense.

Basic and Diluted Net Income (Loss) Per Share – Basic net income (loss) per share is computed by dividing net income (loss) attributable to common shareholders by the weighted average number of shares of common stock outstanding during the period. During the three and six months ended June 30, 2011, we reported a net loss per share, and as such, basic and diluted loss per share were equivalent. During the three and six months ended June 30, 2010, we reported net income per share and included dilutive instruments in the fully diluted net income per share calculation.

The following is a reconciliation of the numerator and denominator of the basic and diluted net income (loss) per share calculations for each period:

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
	(in thousands except share and per share data)			
Numerator:				
Net income (loss)	$(55,862)	$9,502	$(47,071)	$66,834
Adjustments to reconcile net income to income (loss) applicable to common stockholders:				
Accretion of Series D Preferred stock	-	-	-	(2,500)
Numerator for basic earnings per share - income available to common stockholders	(55,862)	9,502	(47,071)	64,334
Effect of dilutive securities:				
Adjustment for change in fair value of derivative liability-Series C and D preferred stock and debentures	-	(6,645)	-	(46,824)
Adjustment for change in fair value of derivative liability- warrants	-	(4,305)	-	(10,856)
Adjustment for change in fair value of hybrid financial instruments	-	(1,180)	-	(19,552)
Adjustment for dividends on convertible preferred stock	-	-	-	-
Adjustment for interest expense related to convertible debt	-	478	-	927
	-	(11,652)	-	(70,662)
Numerator for diluted earnings per share- income available for common stockholders after assumed conversions of debentures and exercise of warrants	$(55,814)	$(2,150)	$(47,071)	$(6,328)
Denominator:				
Weighted average shares used to compute basic EPS	137,692,460	22,675,678	46,114,822	22,675,678
Effect of dilutive securities:				
Employee stock options	-	76,319	-	118,522
Derivative warrants	-	-	-	-
Convertible debentures	-	202,777,415	-	200,102,566
Convertible preferred stock	-	76,575,018	-	76,195,302
Dilutive potential common shares	-	279,428,752	-	276,416,389
Denominator for diluted earnings per share- adjusted weighted average shares and assumed conversions	137,692,460	302,104,430	46,114,822	299,092,067
Basic earning per share	$(0.41)	$0.42	$(1.02)	$2.84
Diluted earnings per share	$(0.41)	$(0.01)	$(1.02)	$(0.02)

The above table includes only dilutive instruments and their effects on earnings per common share.

The following outstanding stock options, warrants, convertible debt and convertible preferred securities for the three and six months ended June 30, 2011 and 2010, are anti-dilutive and therefore have been excluded from diluted net income (loss) per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Stock options	1,289,481	839,830	1,289,481	872,662
Warrants	28,595,000	13,465,035	28,595,000	12,459,085
Convertible debt	2,571,618,911	-	2,523,689,224	-
Convertible preferred stock	656,768,321	-	656,768,321	-
	3,258,271,713	14,304,865	3,210,342,026	13,331,747

Inventories – Inventories are stated at the lower of cost or market and are comprised of barcode-reading equipment at our NeoMedia Europe location. Cost is determined using the first-in, first-out method.

Recent Accounting Pronouncements - The following Accounting Standards Codification Updates have recently been issued:

Pronouncement	Issued	Title
ASU No. 2011-02	April 2011	Receivables (Topic 310): A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring
ASU No. 2011-03	April 2011	Update No. 2011-03—Transfers and Servicing (Topic 860): Reconsideration of Effective Control for Repurchase Agreements
ASU No. 2011-04	May 2011	Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs
ASU No. 2011-05	June 2011	Comprehensive Income (Topic 220): Presentation of Comprehensive Income
ASU No. 2011-06	July 2011	Other Expenses (Topic 720): Fees Paid to the Federal Government by Health Insurers (a consensus of the FASB Emerging Issues Task Force)
ASU No. 2011-07	July 2011	Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities (a consensus of the FASB Emerging Issues Task Force)

To the extent appropriate, the guidance in the above Accounting Standards Codification Updates is already reflected in our consolidated financial statements and management does not anticipate that these accounting pronouncements will have any material future effect on our consolidated financial statements.

Note 3 – Financing

At June 30, 2011, our financing transactions with YA Global, an accredited investor, included shares of our Series C preferred stock issued in February 2006, Series D preferred stock issued in January 2010, a series of twenty five secured convertible debentures issued between August 2006 and June 2011 and various warrants to purchase shares of our common stock. All of our assets are pledged to secure our obligations under these securities. At various times YA Global has assigned or distributed portions of its holdings of these securities to other holders, including persons who are officers of YA Global and its related entities, as well as to other holders who are investors in YA Global's funds. As of June 30, 2011, approximately $826,000 has been assigned or distributed by YA Global to other holders which represents approximately 2% of YA Global's holdings.

Conversions – Our preferred stock and convertible debentures are convertible into shares of our common stock. However, the conversion of each of these securities is limited such that the holder cannot exceed 9.99% beneficial ownership of our common stock, unless the holder waives their right to such limitation. Cumulatively, as of June 30, 2011, the holders of our Series C preferred stock have converted 15,896 shares of the original 22,000 shares of Series C preferred stock into 151,826,899 shares of common stock. YA Global has converted $888,000 of principal and accrued interest of those debentures into 1,317,747 shares of our common stock. Holders, other than YA Global, converted $197,000 of principal and accrued interest of debentures into 15,798,675 shares of common stock.

Debenture Interest Payments– On December 23, 2010 and again on February 18, 2011, we made payments to YA Global of $1.0 million each of accrued interest related to the March 27, 2007 debenture.

Secured Debentures - The underlying agreements for each of the twenty five debentures issued to YA Global are essentially the same, except in regard to the interest rate, varying conversion prices per share, and the number of warrants that were issued in conjunction with each of the debentures. The debentures are convertible into our common stock, at the option of the holder, at the lower of a fixed conversion price per share or a percentage of the lowest volume-weighted average price ("VWAP") for a specified number of days prior to the conversion (the "look-back period"). The conversion is limited such that the holder cannot exceed 9.99% ownership, unless the holder waives their right to such limitation. All of the debentures are secured according to the terms of a Security Pledge Agreement dated August 23, 2006, which was entered into in connection with the first convertible debenture issued to YA Global and which provides YA Global with a security interest in substantially all of our assets. The debentures are also secured by a Patent Security Agreement dated July 29, 2008. On August 13, 2010 our wholly owned subsidiary, NeoMedia Europe AG, became a guarantor of all outstanding financing transactions between us and YA Global, through pledges of their intellectual property and other movable assets. As security for our obligations to YA Global, all of our Pledged Property, Patent Collateral and other collateral is affirmed through the several successive Ratification Agreements which have been executed in connection with each of the 2010 and 2011 financings.

2011 Financing Transactions - On January 10, 2011, February 8, 2011, March 11, 2011, April 13, 2011, May 31, 2011 and June 28, 2011, we entered into Securities Purchase Agreements to issue and sell debentures to YA Global in the principal amounts of $450,000, $650,000, $450,000, $450,000, $450,000 and $250,000, respectively. On June 28, 2011, we entered into a Securities Purchase agreement to issue and sell secured debentures to YA Global that combined will have an aggregate principal amount of $1,050,000 upon their issuance. As noted above, the first debenture in the principal amount of $250,000 was issued on June 28, 2011, a second convertible debenture in the amount of $450,000 was issued on July 13, 2011 and in accordance with the terms of the agreement, a third convertible debenture with a principal amount of $350,000 will be issued on or before August 15, 2011. The debentures are convertible, at the option of the holder, at a conversion price equal to the lesser of (i) $0.10 or (ii) 95% of the lowest closing bid price of our common stock for the 60 trading days preceding the date of conversion. The debentures bear interest at 14% and mature on July 29, 2012. The six debentures issued prior to June 30, 2011, provided net proceeds of $2,460,000 after payment of $240,000 in fees. These financing fees included a prepayment of $75,000 related to the debenture issued on July 13, 2011, and the debenture to be issued on or before August 15, 2011. We have the right to redeem a portion or all amounts outstanding under the debentures at a redemption premium of 10%, plus accrued interest. In connection with the six debentures issued prior to June 30, 2011, we also issued warrants to YA Global to purchase 1,250,000, 1,250,000, 1,000,000, 1,000,000, 1,000,000 and 3,000,000 shares of common stock, respectively. The warrants issued from January 2011 through April 2011 have an exercise price of $0.10 per share, and the warrants issued subsequently have an exercise price of $0.15 per share. All warrants issued during 2011 have a term of five years.

At inception, a summary of the allocation of the components of the new debentures and warrants issued this quarter was as follows:

	April 13, 2011 debenture (in thousands)	May 31, 2011 debenture	June 28, 2011 debenture
Gross proceeds	$ 450	$ 450	$ 250
Structuring and due diligence fee	(25)	(25)	(25)
	$ 425	$ 425	$ 225
Derivative liabilities:			
Investor warrants	$ (18)	$ (90)	$ (105)
Compound derivative	(284)	(310)	(525)
Total derivative liabilities	(302)	(400)	(630)

Day one derivative loss		-			-			405	
Convertible debenture-initial carrying								
value		(123	)		(25	)		-
	$	(425	)	$	(425	)	$	(225	)

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The compound derivatives were valued using the Monte Carlo Simulation valuation method. Significant assumptions used to value the compound derivatives as of inception of the financings included exercise estimates/behaviors and the following significant estimates:

	April 13, 2011 Financing	May 31, 2011 Financing	June 28, 2011 Financing
Conversion price	$ 0.0152	$ 0.0688	$ 0.0128
Equivalent volatility	127 %	122 %	190 %
Equivalent interest risk	14.00 %	14.00 %	14.00 %
Equivalent credit risk	7.40 %	7.54 %	7.40%

The warrants are valued using a binomial option valuation methodology. Significant assumptions used to value the warrants as of their inception included the following significant estimates:

	April 13, 2011	May 31, 2011	June 28, 2011
Exercise price	$0.02	$0.11	$0.04
Expected life	5 years	5 years	5 years
Estimated volatility	254 %	278 %	271 %
Risk free rate of return	0.92 %	0.64 %	0.63 %
Dividend yield	—	—	—

For the risk-free rates of return, we use the published yields on zero-coupon Treasury Securities with maturities consistent with the term of the warrants and volatility is based upon our expected stock price volatility over the term of the warrants.

The table below summarizes the significant terms of each of the debentures as of June 30, 2011:

					Conversion Price – Lower of Fixed Price or Percentage of VWAP for Preceding Period			
Debenture Issue Date	Face Amount	Maturity	Interest Rate	Default Interest Rate	Fixed Price	%	Default %	Preceding Period
August 24, 2006	$ 5,000,000	7/29/2012	10 %	n/a	$ 2.00	90 %	n/a	125 Days
December 29, 2006	$ 2,500,000	7/29/2012	10 %	n/a	$ 2.00	90 %	n/a	125 Days
March 27, 2007	$ 7,458,651	7/29/2012	13 %	n/a	$ 2.00	90 %	n/a	125 Days
August 24, 2007	$ 1,775,000	7/29/2012	14 %	n/a	$ 2.00	80 %	n/a	125 Days
April 11, 2008	$ 390,000	7/29/2012	15 %	24 %	$ 1.50	80 %	75 %	125 Days
May 16, 2008	$ 500,000	7/29/2012	15 %	24 %	$ 1.50	80 %	50 %	125 Days
May 29, 2008	$ 790,000	7/29/2012	15 %	24 %	$ 1.00	80 %	50 %	125 Days
July 10, 2008	$ 137,750	7/29/2012	15 %	24 %	$ 1.00	80 %	50 %	125 Days
July 29, 2008	$ 2,325,000	7/29/2012	14 %	24 %	$ 2.00	95 %	50 %	125 Days
October 28, 2008	$ 2,325,000	7/29/2012	14 %	20 %	$ 2.00	95 %	50 %	125 Days
May 1, 2009	$ 258,037	7/29/2012	14 %	20 %	$ 2.00	95 %	50 %	125 Days
June 5, 2009	$ 715,000	7/29/2012	14 %	20 %	$ 2.00	95 %	50 %	125 Days
July 15, 2009	$ 535,000	7/29/2012	14 %	20 %	$ 2.00	95 %	50 %	125 Days
August 14, 2009	$ 475,000	7/29/2012	14 %	20 %	$ 2.00	95 %	50 %	125 Days
May 27, 2010	$ 2,006,137	7/29/2012	14 %	20 %	$ 0.30	95 %	50 %	60 Days
August 13, 2010	$ 550,000	7/29/2012	14 %	20 %	$ 0.20	95 %	50 %	60 Days
September 29, 2010	$ 475,000	7/29/2012	14 %	20 %	$ 0.20	95 %	50 %	60 Days
October 28, 2010	$ 400,000	7/29/2012	14 %	20 %	$ 0.20	95 %	50 %	60 Days
December 15, 2010	$ 450,000	7/29/2012	14 %	20 %	$ 0.10	95 %	50 %	60 Days
January 10, 2011	$ 450,000	7/29/2012	14 %	20 %	$ 0.10	95 %	50 %	60 Days
February 8, 2011	$ 650,000	7/29/2012	14 %	20 %	$ 0.10	95 %	50 %	60 Days
March 11, 2011	$ 450,000	7/29/2012	14 %	20 %	$ 0.10	95 %	50 %	60 Days
April 13, 2011	$ 450,000	7/29/2012	14 %	20 %	$ 0.10	95 %	50 %	60 Days
May 31, 2011	$ 450,000	7/29/2012	14 %	20 %	$ 0.10	95 %	50 %	60 Days
June 28, 2011	$ 250,000	7/29/2012	14 %	20 %	$ 0.10	95 %	50 %	60 Days

All debentures with YA Global contain provisions for acceleration of principal and interest upon default. Certain debentures also contain default interest rates and conversion prices, as reflected in the table above.

In our evaluation of these financing transactions, we concluded that the conversion features were not afforded the exemption for conventional convertible instruments due to the variable conversion rate, and they did not otherwise meet the conditions set forth in current accounting standards for equity classification. Because equity classification was not available for the conversion features, we elected to bifurcate the compound derivatives, and carry them as derivative liabilities, at fair value. Each compound derivative consists of (i) the embedded conversion feature, (ii) down-round anti-dilution protection features, and (iii) default, non-delivery and buy-in puts which were combined into one compound instrument that is carried as a component of derivative liabilities.

Fair Value Considerations - In accordance with FASB ASC 815, Derivatives and Hedging, we determined that the conversion features of the Series C and Series D preferred stock, and the August 2006, December 2006, July 2008, October 2008, April 2009, May 2009, June 2009, July 2009, August 2009, May 2010, August 2010, September 2010, October 2010, December 2010, January 2011, February 2011, March 2011, April 2011, May 2011 and June 2011 Debentures met the criteria of embedded derivatives and that the conversion features of these instruments required bifurcation and accounting as derivative instrument liabilities. Changes in the fair value of the compound derivative liability, including the embedded conversion option, are charged or credited to income each period. As permitted by FASB ASC 815-15-25, Recognition of Embedded Derivatives, we elected not to bifurcate the embedded derivatives in the March 2007, August 2007, April 2008 or May 2008 Debentures and accordingly, these convertible instruments are being carried in their entirety at their fair values, with the changes in the fair value of the debentures charged or credited to income each period.

Derivative financial instruments arising from the issuance of convertible financial instruments are initially recorded, and continuously carried, at fair value. Upon conversion of any of the convertible financial instruments, the carrying amount of the debt, including any unamortized premium or discount, and the related derivative instrument liability are credited to the capital accounts upon conversion to reflect the stock issued and no gain or loss is recognized.

Embedded Derivative Instruments – Series C and Series D preferred stock and August 2006, December 2006, July 2008, October 2008, April 2009, May 2009, June 2009, July 2009, August 2009, May 2010, August 2010, September 2010, October 2010, December 2010, January 2011, February 2011, March 2011, April 2011, May 2011 and June 2011 Convertible Debentures - Embedded derivative financial instruments arising from the convertible instruments consist of multiple individual features that were embedded in each instrument. For each convertible instrument, we evaluated all significant features and, as required under current accounting standards, aggregated the components into one compound derivative financial instrument for financial reporting purposes. For financings recorded in accordance with FASB ASC 815, the compound embedded derivative instruments are valued using a Monte Carlo Simulation methodology because that model embodies certain relevant assumptions (including, but not limited to, interest rate risk, credit risk, and conversion/redemption privileges) that are necessary to value these complex derivatives.

The conversion price in each of the convertible debentures is subject to adjustment for down-round, anti-dilution protection. Accordingly, if we sell common stock or common share indexed financial instruments below the stated or variable conversion price in the agreement, the conversion price adjusts to that lower amount.

The assumptions included in the calculations are highly subjective and subject to interpretation. Assumptions used as of June 30, 2011 included exercise estimates/behaviors and the following other significant estimates:

	Conversion Prices	Remaining Term (years)	Equivalent Volatility	Equivalent Interest-Risk Adjusted Rate	Equivalent Credit-Risk Adjusted Rate
Series C preferred Stock	$ 0.01	1.08	190 %	8.00 %	7.40 %
Series D preferred Stock	$ 0.01	1.08	190 %	8.00 %	7.40 %
August 24, 2006	$ 0.01	1.08	190 %	10.00 %	7.40 %
December 29, 2006	$ 0.01	1.08	190 %	10.00 %	7.40 %
July 10, 2008	$ 0.01	1.08	190 %	15.00 %	7.40 %
July 29, 2008	$ 0.01	1.08	190 %	14.00 %	7.40 %
October 28, 2008	$ 0.01	1.08	190 %	14.00 %	7.40 %
May 1, 2009	$ 0.01	1.08	190 %	14.00 %	7.40 %
June 5, 2009	$ 0.01	1.08	190 %	14.00 %	7.40 %
July 15, 2009	$ 0.01	1.08	190 %	14.00 %	7.40 %
August 14, 2009	$ 0.01	1.08	190 %	14.00 %	7.40 %
May 27, 2010	$ 0.01	1.08	190 %	14.00 %	7.40 %
August 13, 2010	$ 0.01	1.08	190 %	14.00 %	7.40 %
September 29, 2010	$ 0.01	1.08	190 %	14.00 %	7.40 %
October 28, 2010	$ 0.01	1.08	190 %	14.00 %	7.40 %
December 15, 2010	$ 0.01	1.08	190 %	14.00 %	7.40 %
January 10, 2011	$ 0.01	1.08	190 %	14.00 %	7.40 %
February 8, 2011	$ 0.01	1.08	190 %	14.00 %	7.40 %
March 11, 2011	$ 0.01	1.08	190 %	14.00 %	7.40 %
April 13, 2011	$ 0.01	1.08	190 %	14.00 %	7.40 %
May 31, 2011	$ 0.01	1.08	190 %	14.00 %	7.40 %
June 28, 2011	$ 0.01	1.08	190 %	14.00 %	7.40 %

Equivalent amounts reflect the net results of multiple modeling simulations that the Monte Carlo Simulation methodology applies to underlying assumptions.

Due to the variable component of the conversion price, rapid fluctuations in the trading market price may result in significant variations to the calculated conversion price. For each debenture, we analyze the ratio of the conversion price (as calculated based on the percentage of VWAP for the appropriate look back period) to the trading market price for a period of time equal to the term of the debenture to determine the average ratio for the term of the note. Each quarter, the ratio in effect on the date of the valuation is compared with the average ratio over the term of the debenture to determine if the calculated conversion price is representative of past trends or if it is considered unrepresentative due to a large fluctuation in the stock price over a short period of time. If the calculated conversion price results in a ratio that deviates significantly from the average ratio over the term of the agreement, the average ratio of the conversion price to the trading market price is then multiplied by the current trading market price to determine the variable portion of the conversion price for use in the fair value calculations. This variable conversion price is then compared with the fixed conversion price and, as required by the terms of the debentures, the lower of the two amounts is used as the conversion price in the Monte Carlo Simulation model used for valuation purposes. On June 30, 2011, the fixed conversion price for each of the debentures was equal to or higher than the calculated variable conversion price. Accordingly, the variable conversion price was used in the Monte Carlo Simulation model. This analysis is performed each quarter to determine if the calculated conversion price is reasonable for purposes of determining the fair value of the embedded conversion features (for instruments recorded under FASB ASC 815-15-25-1) or the fair value of the hybrid instrument (for instruments recorded under FASB ASC 815-15-25-4).

Hybrid Financial Instruments Carried at Fair Value – 2007 and 2008 Convertible Debentures - The March 2007, August 2007, April 2008 and May 2008 convertible debentures are recorded in accordance with FASB ASC 815-15-25-4 and the entire hybrid instrument was initially recorded at fair value, with subsequent changes in fair value charged or credited to income each period. These financial instruments are valued using the common stock equivalent approach. The common stock equivalent is calculated using the shares indexed to the debentures valued at the market price of our stock and the present value of the coupon.

Subsequent to a January 5, 2010 amendment, the shares indexed to the debentures were calculated using the variable conversion price based on the 125 day look-back period and the present value of the coupon from inception of the debentures to the revised maturity date of July 29, 2012.

Current Period Valuations - For the Series C and D preferred stock and the August 2006, December 2006, July 2008, October 2008, May 2009, June 2009, July 2009, August 2009, May 2010, August 2010, September 2010, October 2010, December 2010, January 2011, February 2011, March 2011, April 2011, May 2011 and June 2011 debentures, the embedded derivative instrument, primarily the conversion feature, has been separated and accounted for as a derivative instrument liability, as discussed above. This derivative instrument liability is marked-to-market each reporting period.

The March 2007, August 2007, April 2008 and May 2008 debentures were each initially recorded at their full fair value pursuant to FASB ASC 815-15-25-4. That fair value is marked-to-market each reporting period, with any changes in the fair value charged or credited to income.

On January 5, 2010, the terms of all of the debentures issued prior to that date were modified to increase the look-back period used to calculate the variable conversion price per share for all debentures to a period of 125 days and to extend the stated maturity date to July 29, 2012, which increased our future anticipated cash flows related to those instruments. Because that increase exceeded the threshold prescribed by FASB ASC 470-50, Debt Modifications and Extinguishments, the modification of the amounts due under these instruments was accounted for as an extinguishment. Accordingly, the original convertible debentures were considered extinguished and the revised convertible debentures were recorded at their fair value, resulting in an extinguishment loss of approximately $5.6 million.

For instruments which were recorded under FASB ASC 815-15-25-4, the instruments were first adjusted to fair value as of January 5, 2010 using the conversion rate and maturity date prior to the amendment. The fair value of the instrument was then calculated using the modified conversion rate and maturity date to determine the fair value of the instrument subsequent to the amendment. The difference in the fair value before and after the amendment was recorded as an extinguishment loss.

For instruments recorded under FASB ASC 815-15-25-1, the embedded conversion feature was first adjusted to fair value as of the date of the amendment using the conversion rate and maturity date prior to the amendment. The carrying value of the host instrument and the embedded conversion feature, less any deferred financing costs, was then compared with the fair value of the hybrid instrument subsequent to the amendment and the difference was recorded as an extinguishment loss.

For our Series C and Series D preferred stock and our convertible debentures, the following table reflects the face value of the instruments and, as appropriate, either their amortized cost carrying value and the fair value of the separately-recognized compound embedded derivative or, for those debentures recorded in their entirety at fair value, their fair value, as well as for each of the instruments the number of common shares (in thousands) into which the instruments are convertible as of June 30, 2011 and December 31, 2010.

June 30, 2011	Face Value (in thousands)	Carrying Value	Accrued Interest	Embedded Conversion Feature	Fair Value	Common Stock Shares
Series C preferred Stock	$6,104	$6,104	$-	$10,204	$-	465,929
Series D preferred Stock	$2,500	$2,500	$-	4,179	-	190,840
August 24, 2006	$5,000	$5,000	$2,125	9,682	-	583,985
December 29, 2006	2,500	2,500	1,064	4,840	-	292,092
March 27, 2007	7,312	n/a	n/a	n/a	23,778	611,365
August 24, 2007	1,775	n/a	n/a	n/a	6,890	164,352
April 11, 2008	390	n/a	n/a	n/a	1,883	36,111
May 16 ,2008	500	n/a	n/a	n/a	2,406	46,296
May 29, 2008	790	n/a	n/a	n/a	3,798	73,148
July 10, 2008	138	138	62	334	-	18,526
July 29, 2008	2,325	2,325	953	4,382	-	256,130
October 23, 2008	2,325	2,325	871	4,389	-	249,702
May 1, 2009	258	258	109	465	-	31,493
June 5, 2009	715	682	209	1,386	-	72,195
July 15, 2009	535	535	149	1,012	-	53,435
August 14, 2009	475	475	127	902	-	47,009
May 27, 2010	2,006	548	307	4,966	-	180,715
August 13, 2010	550	43	68	1,294	-	48,259
September 29, 2010	475	32	50	1,100	-	41,009
October 28, 2010	400	23	38	917	-	34,199
December 15, 2010	450	24	34	1,015	-	37,826
January 10, 2011	450	16	30	1,006	-	37,476
February 8, 2011	650	22	36	1,438	-	53,567
March 11, 2011	450	12	19	984	-	36,667
April 13, 2011	450	153	14	972	-	36,222
May 31, 2011	450	27	5	955	-	35,561
June 28, 2011	250	2	-	525	-	19,554
Total	$31,619	$15,140	$6,270	$56,947	$38,755	3,753,663

December 31, 2010	Face Value (in thousands)	Carrying Value	Accrued Interest	Embedded Conversion Feature	Fair Value	Common Stock Shares
Series C preferred Stock	$8,336	$8,336	$-	$6,706	$-	125,348
Series D preferred Stock	$2,500	$2,500	$-	1,918	-	36,819
August 24, 2006	$5,000	$5,000	$1,876	5,007	-	109,154
December 29, 2006	2,500	2,500	940	2,502	-	54,596
March 27, 2007	7,459	n/a	n/a	n/a	17,905	118,391
August 24, 2007	1,775	n/a	n/a	n/a	4,888	31,696
April 11, 2008	390	n/a	n/a	n/a	1,106	6,964
May 16 ,2008	500	n/a	n/a	n/a	1,392	8,929
May 29, 2008	790	n/a	n/a	n/a	2,193	14,107
July 10, 2008	138	138	51	180	-	3,387
July 29, 2008	2,325	2,325	792	2,381	-	46,873
October 23, 2008	2,325	2,325	709	2,279	-	46,873
May 1, 2009	258	258	92	237	-	5,249
June 5, 2009	715	668	158	771	-	13,139
July 15, 2009	535	535	111	404	-	9,719
August 14, 2009	475	475	93	482	-	8,546
May 27, 2010	2,006	302	168	2,785	-	32,690
August 13, 2010	550	13	29	732	-	8,715
September 29, 2010	475	9	17	620	-	7,398
October 28, 2010	400	6	10	517	-	6,163
December 15, 2010	450	6	3	571	-	6,811
Total	$29,066	$14,560	$5,049	$28,092	$27,484	701,567

The terms of the embedded conversion features in the convertible instruments presented above provide for variable conversion rates that are indexed to our common stock price. As a result, the number of indexed shares is subject to continuous fluctuation. For presentation purposes, the number of shares of common stock into which the embedded conversion feature of the Series C and Series D preferred stock was convertible as of June 30, 2011 was calculated as face value plus assumed dividends (if declared), divided by the lesser of the fixed rate or the calculated variable conversion price using the 125 day look-back period. The number of shares of common stock into which the embedded conversion feature in the convertible debentures was convertible as of June 30, 2011 was calculated as the face value of each instrument divided by the variable conversion price using the appropriate look-back period.

The March 2007, August 2007, April 2008 and May 2008 debentures are carried in their entirety at fair value in accordance with FASB ASC 815-15-25-4 and the value of the embedded conversion feature is effectively embodied in those fair values.

Changes in the fair value of convertible instruments that are carried in their entirety at fair value (the March 2007, August 2007, April 2008 and May 2008 debentures) are reported as "Gain (loss) from change in fair value of hybrid financial instruments" in the accompanying consolidated statements of operations. The changes in fair value of these hybrid financial instruments were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands)		(in thousands)	
March 27, 2007	$ (9,606)	$ 717	$(8,030)	$ 12,805
August 24, 2007	(2,446)	227	(2,002)	3,439
April 11, 2008	(893)	55	(777)	768
May 16, 2008	(1,145)	69	(1,014)	984
May 29, 2008	(1,809)	112	(1,605)	1,556
Gain (loss) from changes in fair value of		&#		