NEOMEDIA TECHNOLOGIES INC
Form 10-K/A
February 06, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

AMENDMENT NO. 2
TO
FORM 10-K

|X| ANNUAL REPORT UNDER SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2001

OR

|_| TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

FOR THE TRANSITION PERIOD ____________ TO__________

COMMISSION FILE NUMBER 0-21743

NEOMEDIA TECHNOLOGIES, INC.
(EXACT NAME OF ISSUER IN ITS CHARTER)

DELAWARE	36-3680347
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)
2201 SECOND STREET, SUITE 600 FORT MYERS, FLORIDA	33901
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	(ZIP CODE)

ISSUER'S TELEPHONE NUMBER (INCLUDING AREA CODE) 941-337-3434

SECURITIES REGISTERED UNDER SECTION 12(b) OF THE EXCHANGE ACT:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
COMMON STOCK, PAR VALUE $.01	NASDAQ SMALL CAP MARKET

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

Check if disclosure of delinquent filers in response to Item 405 of Regulation S-X is not contained in this form, and no disclosure will be contained, to the best of 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 |X|

Issuer's consolidated revenue for its most recent fiscal year was $8,142,000.

The aggregate market value of the voting stock held by non-affiliates of the issuer based on the price at which shares of common stock closed on the Nasdaq SmallCap Stock Market on March 13, 2002 ($0.29) was $9,694,000. Determination of stock ownership by non-affiliates is made solely for purposes of responding to the requirements of the form and the registrant is not bound by this determination for any other purpose.

As of March 13, 2002, there were outstanding 36,927,392_shares of the issuer's Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant's definitive Proxy Statement pursuant to Regulation 14A of the Securities Exchange Act of 1934, as amended, are incorporated by reference into Part III of the Form 10-K.

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PART I

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Form 10-K contains forward-looking statements and information relating to NeoMedia. NeoMedia intends to identify forward-looking statements in this prospectus by using words such as "believes," "intends," "expects," "may," "will," "should," "plan," "projected," "contemplates," "anticipates," "estimates," "predicts," "potential," "continue," or similar terminology. These statements are based on the Company's beliefs as well as assumptions the Company made using information currently available to us. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. Because these statements reflect the Company's current views concerning future events, these statements involve risks, uncertainties, and assumptions. Actual future results may differ significantly from the results discussed in the forward-looking statements.

ITEM 1. BUSINESS

GENERAL

NeoMedia Technologies, Inc. ("NeoMedia" or "the Company") develops proprietary technologies that link physical information and objects to the Internet marketed under the "PaperClickTM" brand name. The primary focus of the Company is to develop and commercialize such technologies. The Company has also developed an extensive patent portfolio covering convergence of the physical world and the Internet.

COMPANY STRUCTURE

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

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

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

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

NCIS (systems integration service offerings) is the original business line upon which the Company was organized. This unit resells client-server equipment and related software, and general and specialized consulting services targeted at software driven print applications, especially at process automation of production print facilities through its integrated document factory solution. Systems integration services also identifies prospects for custom applications based on our products and services. This unit recently moved its business offerings to a much higher Value-Add called Storage Area Networks (SAN). The operations are based in Lisle, Illinois.

COMPANY HISTORY

NeoMedia Technologies, Inc. ("NeoMedia"), was incorporated under the laws of the State of Delaware on July 29, 1996, to acquire by tax-free merger Dev-Tech Associates, Inc. ("Dev-Tech"), NeoMedia's predecessor, which was organized in Illinois in December 1989. In March 1996, Dev-Tech's common stock was split, with an aggregate of 2,551,120 shares of common stock being issued in exchange for the 164 then issued and outstanding shares of common stock. On August 5, 1996, NeoMedia acquired all of the shares of Dev-Tech in exchange for the issuance of shares of NeoMedia's common stock to Dev-Tech's stockholders ("Dev-Tech Merger").

NeoMedia also has the following wholly-owned subsidiaries: NeoMedia Migration, Inc., incorporated in Delaware; Distribuidora Vallarta, S.A., incorporated in Guatemala; NeoMedia Technologies of Canada, Inc., incorporated in Canada; NeoMedia Tech, Inc., incorporated in Delaware; NeoMedia EDV GMBH, incorporated in Austria; NeoMedia Technologies Holding Company B.V., incorporated in the Netherlands; NeoMedia Technologies de Mexico S.A. de C.V., incorporated in Mexico; NeoMedia Migration de Mexico S.A. de C.V., incorporated in Mexico; NeoMedia Technologies do Brazil Ltd., incorporated in Brazil, and NeoMedia Technologies UK Limited, incorporated in the United Kingdom.

RECENT DEVELOPMENTS

In January 2001 the Company entered into an agreement with A.T. Cross Company, a major international manufacturer of fine writing instruments and pen computing products, granting a worldwide, non-exclusive license of the Company's patents surrounding the manufacture, use, and sale of devices used in print-to-internet technologies.

In February 2001 the Company won Best of Show at the Internet World Wireless 2001 in the "Commerce" category. According to the IWW announcement, this award exemplifies the Company's outstanding achievements as a business leader in the internet marketplace, and represents broad industry recognition and appreciation of the Company's achievements.

In March 2001, the Company was granted its fourth patent in nineteen months by the United States Patent and Trademark Office. The new patent extends the Company's IP Portfolio with voice link to the web.

In March 2001, the Company purchased all of the net assets of Qode.com, Inc. (Qode), except for cash. In consideration for these assets, NeoMedia issued 274,699 shares of common stock, valued at $1,359,760. On August 31, 2001, the

Company signed a non-binding letter of intent to sell the assets and liabilities of the Qode business unit to The Finx Group, Inc., a holding company based in Elmsford, NY. The final contract is contingent upon the completion of due diligence and definitive terms and conditions stated in the letter of intent. The Company intends to sell the assets and liabilities of Qode, which consist of all inventory, equipment and the ownership and operation of the comprehensive universal internet database along with the corresponding patents. The Finx Group will assume $620,000 in Qode payables and $800,000 in long-term leases in exchange for 500,000 shares of the Finx Group, right to use and sell Qode services, and up to $5 million in affiliate revenues over the next five years. (see Footnote 2 of the accompanying financial statements for further detail)

In January 2002, the Company entered into an agreement with the law firm of Baniak Pine and Gannon, under which the firm will seek potential licensees of the Company's patent portfolio.

INDUSTRY OVERVIEW

NEOMEDIA INTERNET SWITCHING SERVICES

The goal of our Internet Switching Services business segment is to promote mass adoption of our switch and background computer process to link physical world objects to the Internet. Our switching platform is a state-of-the-art open and extensible cross-media publishing tool serving customers in a variety of industrial, commercial, and educational applications. This business segment is also responsible for licensing our intellectual property to others as a means of promoting this new market as well as providing a revenue and cash resource. We have been developing our physical world-to-Internet technology and offerings since 1996 and consider ourselves an innovator and pioneer in this industry. In the past year, we have seen similar technologies and concepts emerge in the marketplace, and see these events as a positive validation of the physical world-to-internet concept.

Press from competitors such as AirClic, Inc. and Digimarc, Inc. is expected to continue to raise consumer awareness of physical-to-Web convergence. We believe the key to the adoption of physical world-to-Internet technologies in the marketplace will be in the development of real world applications that provide the end user a valuable experience. Our service offering, however, differs from those of AirClic and other competitors in that, unlike their products and services, our products do not require the use of a proprietary or specified device, and we offer our service on a private label basis. We are

positioned to provide solutions that preserve the customer's brand and also provide tailored solutions to fit the customer needs.

NEOMEDIA CONSULTING AND INTEGRATION SERVICES

The technology and equipment resale business is becoming a commodity industry for products undifferentiated by value added proprietary elements and services. Resale operations are also being compressed as equipment manufacturers consolidate their distribution channels.

Proprietary products, such as NeoMedia encoders, systems integration services and Integrated Document Factory solutions offer a competitive value-add to our NCIS business. We have unique offerings, which, to the extent that they meet market needs, offer the potential for growth in this industry. In addition, our recent high-end storage Area Network Solution allows us to participate in the higher-margin area of the open systems marketplace.

The NCIS division also sells migration products (tools designed to "migrate" software code from one platform to another platform) primarily to mid-sized to large corporations and government agencies. The products include proprietary products and software tools to migrate Wang, HP3000, Data General, DEC and IBM DOS/VSE platforms (legacy systems) to a Unix or NT open system platform.

STRATEGY

NeoMedia has spent the past five years inventing and patenting the now confirmed "space" of linking the physical and Internet environments and developing and implementing five generations of continuously refined switch technology that seamlessly bridges these environments.

The Company is now entering a new phase of operations. This market has been validated with the emergence of other competitors, and the Company is turning its attention to the next stage of market development in this space; the implementation of service applications providing complete product solutions to traditional businesses with offerings related to commerce, publishing, extended media publishing, e-learning and others.

While pursing these goals NeoMedia must remain aware of strategic issues, opportunities and constraints that will govern the interplay of competition and alliances in this rapidly emerging market.

PRODUCTS/SERVICES

NEOMEDIA INTERNET SWITCHING SERVICES

PAPERCLICKTM SWITCHING SERVICE. PaperClickTM is a state-of-the-art application-switching platform that links physical objects to digital media through the use of scanned UPC, EAN, or custom PaperClickTM codes. This dynamic open solution serves a wide variety of customers in industrial, commercial, and educational applications.

INTELLECTUAL PROPERTY LICENSING. The Company currently holds four U.S. patents relating to the physical world-to-Internet marketplace. NeoMedia intends to license this intellectual property portfolio to companies endeavoring to tap the potential of this emerging market. To date, the Company has entered into such agreements with Digital:Convergence, A.T. Cross Company, and Symbol Technologies. During January 2002, NeoMedia announced that it had entered into an agreement with Baniak Pine and Gannon, a law firm specializing in patent licensing and litigation, under which the firm will represent NeoMedia in seeking out potential licensees of the Company's patent portfolio.

NEOMEDIA CONSULTING AND INTEGRATION SERVICES

NCIS is a group of highly skilled application developers thoroughly familiar with MSS and other associated NeoMedia technologies who contract to develop custom applications for clients.

PRODUCT SALES AND EQUIPMENT RE-SALES. NCIS markets and sells proprietary software products, including high-density symbology encoders (e.g. PDF417 and UPS Maxicode) and resells client-server hardware and related systems such as Sun Microsystems, IBM and others , as well as related applications software and services.

INTEGRATED DOCUMENT FACTORY (IDF). The IDF solution provides design and implementation of a collection of tested hardware and software solutions utilizing Xerox's printers and Sun servers to turn document creation, production, and printing into an assembly line manufacturing process. The system particularly assists financial service concerns such as banks, insurance companies, and brokerage firms as well as helps to manage high-volume printing of statements on a frequent basis.

STORAGE AREA NETWORKS (SAN). SAN is a Storage Management solutions and consultancy offering consisting of tools and services that insure data integrity, efficiency and accessibility, achieved through moving data backup, access and archival functions off of traditional LANs/WANs that are added on to a highly reliable independent managed network.

SYSTEM INTEGRATION SERVICES SYSTEMS. Integration Services is responsible for customer identification, pre and post sales relationship support, proposals, and account management surrounding custom application development for solutions involving the metered switch services (MSS). These customized solutions are built and integrated via the NAS business unit of the Company.

STRATEGIC RELATIONSHIPS

NEOMEDIA INTERNET SWITCHING SERVICES

In January 2001, the Company entered into patent license with A.T. Cross Company, a major international manufacturer of fine writing instruments and pen computing products. Cross obtained the rights under the Company's print-to Internet patents for personal portable scanning devices used to link bar codes on documents and other physical consumer goods to corresponding Internet content. Cross will pay a royalty per device to the Company for license rights granted under this agreement.

In May 2001, the Company entered into an agreement with Symbol Technologies, Inc., granting Symbol a worldwide, non-exclusive license of the Company's patents surrounding the sale and use of scanning devices used in physical world-to-Internet technologies.

NEOMEDIA CONSULTING AND INTEGRATION SERVICES

Although the NCIS business of segment the Company provides services and products to a spectrum of customers, ranging from closely held companies to Fortune 500 companies, for the years ended December 31, 2001 and 2000, one customer, Ameritech Services, Inc. ("Ameritech"), accounted for 36.6% and 29.9%, respectively, of NeoMedia NCIS revenue. The Company expects sales to Ameritech as a percentage of total sales to decline in the future. Furthermore, the Company does not have a written agreement with Ameritech and, therefore, there are no contractual provisions to prevent Ameritech from terminating its relationship with the Company at any time. Accordingly, the loss of this customer, or a significant reduction by it in buying the products and services offered by NeoMedia, absent diversification, would materially and adversely affect of NeoMedia NCIS's revenues and results of operations. In addition, a single supplier provides the equipment and software, which is re-marketed to this customer. Accordingly, the loss of this supplier would materially adversely affect NeoMedia NCIS. For these reasons, the Company is seeking, and continues to seek, to diversify its sources of revenue and vendors from whom it purchases.

SALES AND MARKETING

NEOMEDIA INTERNET SWITCHING SERVICES

PAPERCLICKTM. While the Company eliminated the majority of its sales and marketing staff during the third quarter of 2001, the Company continues to promote its PaperClickTM line of products to potential customers in a wide array of industries. Upon receipt of sufficient financing, the Company plans to re-focus its efforts on the sale of PaperClickTM licenses through the hiring of additional sales and marketing staff. NeoMedia has refocused its sales efforts by focusing on signing up channel partners who have industry market presence. NeoMedia is currently negotiating with a number of industry-focused companies who will be our "go-to-market" partners.

INTELLECTUAL PROPERTY LICENSING. During January 2002, the Company engaged Baniak Pine and Gannon, a law firm specializing in intellectual property licensing and litigation. The firm will assist NeoMedia in seeking out potential licensees of the Company's intellectual property portfolio, including any resulting litigation.

NEOMEDIA CONSULTING AND INTEGRATION SERVICES

NCIS markets its products and services, as well as those for which it acts as a remarketer, primarily through its direct sales force, which was composed of 8 personnel as of December 31, 2001. In addition, the business unit also relies upon its strategic alliances with industry leaders to help market its products and services, provide lead referrals and establish informal co-marketing arrangements. Representatives of the Company attend seminars and trade shows, both as speakers and participants, to help market its products and services.

RESEARCH AND DEVELOPMENT

NEOMEDIA INTERNET SWITCHING SERVICES

NeoMedia believes that its success in the Internet environment depends upon its ability to quickly develop new products and services, as well as make enhancements to its existing products. NISS employed 3, 24 and 19 persons in the area of product development as of December 31, 2001, 2000, and 1999, respectively. During the years ended December 31, 2001, 2000 and 1999, NeoMedia NAS incurred total software development costs of $2,064,000, $2,888,000 and $1,722,000, respectively, of which $1,515,000, $1,787,639 and $807,000, respectively, were capitalized as software development costs and $549,000, $1,101,000 and $915,000, respectively, were expensed as research and development costs.

NEOMEDIA CONSULTING AND INTEGRATION SERVICES

All significant research and development relating to NeoMedia NCIS products was discontinued at the end of 1999 when the Company discontinued its Y2K business. All employees that were in this area were reassigned or released during the fourth quarter of 1999.

INTELLECTUAL PROPERTY RIGHTS

The Company received its first patent from the U.S. Patent and Trademark Office in August 1999. The patent, number 5,933,829, was allowed for the process invented by the Company for "automatic access of electronic information through secure machine-readable codes on printed documents." The Company received its second patent, number 5,978,773, in November 1999. The patent was allowed for the broad and innovative process that allows familiar print media such as magazines, catalogs, advertisements, even product labels themselves, to become the user interface to the Web. The Company's third U.S. patent, 6,108,656, which issued in August 2000, is a continuation of 5,933,829 and contains additional claims that broaden scope and coverage. The Company's fourth patent, 6,199,048, issued on March 6, 2001 and is a continuation of 5,978,773. The 6,199,048 patent substantially extends the Company's patent coverage to address voice portals, multi-media and web portal applications.

In addition to these issued patents, the Company continues to develop, acquire and prosecute a substantial portfolio of domestic and international patent applications that include broad claims that apply to its core business and markets.

The Company's proprietary technology based on these patents enables everyone, regardless of training or experience, to easily access the World Wide Web on the Internet. These patents and their related proprietary technologies, along with other pending applications, enhance the use of the Internet for E-commerce by making it much more user friendly as well as secure. The Company also has numerous other domestic and international patents and continuations pending in these and other related areas.

The Company relies upon its patents, copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions, all of which afford only limited protection, to protect its proprietary technology and products. Although the Company takes steps to protect its trade secrets, such as requiring employees with access to the Company's proprietary information to execute confidentiality and non-disclosure agreements, it may be possible for unauthorized parties to copy or reverse engineer all or part of any one of the Company's proprietary technology and products. Furthermore, just as there can be no assurance that a misappropriation of the Company's proprietary technology and products will not occur, there can be no assurance that copyright, trademark and trade secret laws will be available in all circumstances to protect the Company's rights. In addition, although the laws of the United States may protect the Company's proprietary rights in its technology and products, the laws of foreign countries where the Company's products may be used may not protect its proprietary rights at all or to the same extent as the laws of the United States.

The Company does not believe that its proprietary technology and products infringe upon the rights of any third parties; however, there can be no assurance that a third party will not in the future claim infringement by the Company. Similarly, infringement claims could be asserted against products and technologies which the Company licenses from third parties.

The Company may provide some of its products to end users using non-exclusive, non-transferable licenses which provide that the licensee may use the software solely for internal operations on designated computers at specific sites or by a specified number of users. The Company generally does not make source codes available for its products.

Due to the difficulty of doing so, the Company has never policed, nor has it ever attempted to police, the unauthorized use of its products. Even though piracy of the Company's proprietary rights could materially adversely affect it, the Company believes that the threat of piracy, or the unavailability of protection under applicable laws, is less significant to its competitive and financial well being than its ability to respond to the rapid change in technology which characterizes the computer industry.

During January 2002, the Company engaged Baniak Pine and Gannon, a law firm specializing in intellectual property licensing and litigation. The firm will assist NeoMedia in seeking out potential licensees of the Company's intellectual property portfolio, including any resulting litigation.

COMPETITION

NEOMEDIA INTERNET SWITCHING SERVICES

The markets in which the Company competes are relatively new. Recent competitors in the print-to-web market include Digital:Convergence, Digimarc, and AirClic. The Company has a significant portfolio of both invented and acquired patents to support its proprietary technologies and provide a barrier to entry for potential competitors.

NEOMEDIA CONSULTING AND INTEGRATION SERVICES.

The largest competition, in terms of number of competitors, is for customers desiring systems integration, including the re-marketing of another party's products, and document solutions. These competitors range from local, small privately held companies to large national and international organizations, including large consulting firms. A large number of companies act as re-marketers of another party's products, and therefore, the competition in

this area is intense. In some instances, the Company, in acting as a re-marketer, may compete with the original manufacturer.

PRODUCT LIABILITY INSURANCE

The Company has never had any product liability claim asserted against it. However, the Company could be subject to product liability claims in connection with the use of the products and services that it sells. There can be no assurance that the Company would have sufficient resources to satisfy any liability resulting from these claims or would be able to have its customers indemnify or insure the Company against such claims. Although the Company maintains insurance against such claims, there can be no assurance that such coverage will be adequate in terms and scope to protect the Company against material adverse effects in the event of a successful claim.

GOVERNMENT REGULATION

Existing or future legislation could limit the growth of use of the Internet, which would curtail the Company's revenue growth. Statutes and regulations directly applicable to Internet communications, commerce and advertising are becoming more prevalent. Congress recently passed laws regarding children's online privacy, copyrights and taxation. The law remains largely unsettled, even in areas where there has been legislative action. It may take years to determine whether and how existing laws governing intellectual property, privacy, libel and taxation apply to the Internet, e-commerce and online advertising. In addition, the growth and development of e-commerce may prompt calls for more stringent consumer protection laws, both in the United States and abroad.

The Company's website allows for the storage of demographic data from our users. The European Union recently adopted a directive addressing data privacy that may limit the collection and use of certain information regarding Internet users. This directive may limit our ability to collect and use information in certain European countries. In addition, the Federal Trade Commission and several state governments have investigated the use by certain Internet companies of personal information. The Company could incur significant additional expenses if new regulations regarding the use of personal information are introduced or if our privacy practices are investigated.

ENVIRONMENTAL PROTECTION COMPLIANCE

The Company has no knowledge of any federal, state or local environmental compliance regulations which affect its business activities. The Company has not expended any capital to comply with any environmental protection statutes and does not anticipate that such expenditures will be necessary in the future.

EMPLOYEES

As of December 31, 2001, the Company employed 21 persons. Of the 21 employees, 9 were located at the Company's headquarters in Fort Myers, FL, and 12 at other domestic locations. Of the 21 employees, 3 are dedicated to the NISS business unit, 12 are dedicated to the NCIS business unit, and 6 provide shared services used by both business units. None of the Company's employees are represented by a labor union or bound by a collective bargaining agreement. The Company believes that its employee relations are good.

The Company's success depends to a significant extent on the performance of its senior management and certain key employees. Competition for highly skilled employees, including sales, technical and management personnel, is intense in the computer industry. The Company's failure to attract additional qualified employees or to retain the services of key personnel could materially adversely affect the Company's business.

SAFE HARBOR PROVISION OF THE PRIVATE SECURITIES LITIGATION ACT OF 1995

The Company operates in a dynamic and rapidly changing environment that involves numerous risks and uncertainties. The market for software products is

generally characterized by rapidly changing technology, frequent new product introductions and changes in customer requirements which can render existing products obsolete or unmarketable. The statements contained in this document that are not historical facts may be forward-looking statements (as such term is defined in the rules promulgated pursuant to the Securities Exchange Act of 1934) that are subject to a variety of risks and uncertainties more fully described in the Company's filings with the Securities and Exchange Commission. The forward-looking statements are based on the beliefs of the management of the Company, as well as assumptions made by, and information currently available to, the Company's management. Accordingly, these statements are subject to significant risks, uncertainties and contingencies which could cause the Company's actual growth, results, performance and business prospects and opportunities in 2001 and beyond to differ materially from those expressed in, or implied by, any such forward-looking statements. Wherever possible, words such as "anticipate," "plan," "expect," "believe," "estimate," and similar expressions have been used to identify these forward-looking statements, but are not the exclusive means of identifying such statements. These risks, uncertainties and contingencies include, but are not limited to, the Company's limited operating history on which expectations regarding its future performance can be based, competition from, among others, high technology companies that have greater financial, technical and marketing resources and distribution capabilities than the Company, the availability of sufficient capital, the effectiveness of the Company's efforts to control operating expenses and general economic and business conditions affecting the Company and its customers in the United States and other countries in which the Company sells and anticipates to sell its products and services. The Company is not obligated to update or revise these forward-looking statements to reflect new events or circumstances.

RISK FACTORS

RISKS SPECIFIC TO NEOMEDIA

THE COMPANY HAD A RETAINED DEFICIT; THE COMPANY ANTICIPATES FUTURE LOSSES.

The Company has incurred substantial losses since our inception, and anticipates continuing to incur substantial losses for the foreseeable future. The Company incurred a loss of $25,469,000 in the year ended December 31, 2001, $5,409,000 in the year ended December 31, 2000, $10,472,000 in the year ended December 31, 1999, $11,495,000 in the year ended December 31, 1998, and $5,973,000 in the year ended December 31, 1997. The Company's accumulated losses were approximately $63,344,000 as of December 31, 2001. As of December 31, 2001 and 2000, we had a working capital (deficit) of approximately $(5,163,000) and $8,426,000, respectively. The Company had stockholders' equity of $(263,000) and $19,110,000 at December 31, 2001 and 2000, respectively. The Company generated revenues of $8,142,000 and $27,565,000 for the years ended December 31, 2001 and 2000. In addition, during years ended December 31, 2001 and 2000, the Company recorded negative cash flows from operations of $5,202,000 and $6,775,000, respectively. To succeed, the Company must develop new client and customer relationships and substantially increase its revenue derived from improved products and additional value-added services. The Company has expended and will continue to expend substantial resources to develop and improve its products, increase its value-added services and to market its products and services. These development and marketing expenses must be incurred well in advance of the recognition of revenue. As a result, the Company may not be able to achieve or sustain profitability.

THE COMPANY'S AUDITORS HAVE QUALIFIED THEIR REPORT ON THE COMPANY FINANCIAL STATEMENTS WITH RESPECT TO THE COMPANY'S ABILITY TO CONTINUE AS A GOING CONCERN.

The report of Stonefield Josephson, Inc., the Company's current independent auditors, with respect to the Company's financial statements and the related notes for the year ended December 31, 2001, indicate that, at the date of their report, the Company had suffered recurring losses from operations and the Company's current cash position raised substantial doubt about the Company's ability to continue as a going concern. The Company's financial statements do not include any adjustments that might result from this uncertainty. The report of Arthur Andersen LLP, the Company's former independent auditors, with respect to the Company's financial statements and the related notes for the years ended December 31, 2000 and 1999, indicate that, at the date of their report, the Company had suffered recurring losses from operations and the Company's current cash position raised substantial doubt about the Company's ability to continue as a going concern. The Company's financial statements do not include any adjustments that might result from this uncertainty.

BECAUSE THE PHYSICAL WORLD - TO - INTERNET MARKET IN WHICH THE COMPANY OPERATES HAS EXISTED FOR A SHORT PERIOD OF TIME, THERE IS LIMITED INFORMATION UPON WHICH INVESTORS CAN EVALUATE THE BUSINESS.

The physical world-to-Internet market in which the Company operates is a recently developed market. Further, the Company has conducted operations in this market only since March 1996. Consequently, the Company may be deemed to have a relatively limited operating history upon which investors may base an evaluation of the Company's primary business and determine its prospects for achieving intended business objectives. To date, the Company has sold our physical world-to-Internet products to only 12 companies. Further, Digital:Convergence Corporation, the Company's primary customer for the Company's physical world-to-Internet products, is facing pressing financial difficulties and is presently being sued by the Company for default on a promissory note issued to the Company in lieu of payment. The Company is prone to all of the risks inherent to the establishment of any new business venture, including unforeseen changes in its business plan. Investors should consider the likelihood of the company's future success to be highly speculative in light of the Company's limited operating history in its primary market, as well as the limited resources, problems, expenses, risks, and complications frequently encountered by similarly situated companies in the early stages of development, particularly companies in new and rapidly evolving markets, such as the physical world-to-Internet space. To address these risks, the Company must, among other things,

- Maintain and increase the Company's client base;
- Implement and successfully execute the Company's business and marketing strategy;
- Continue to develop and upgrade the Company's products;
- Continually update and improve the Company's service offerings and features;
- Respond to industry and competitive developments; and
- Attract, retain, and motivate qualified personnel.

The Company may not be successful in addressing these risks. If the Company were unable to do so, the Company's business, prospects, financial condition, and results of operations would be materially and adversely affected.

FLUCTUATIONS IN THE COMPANY'S OPERATING RESULTS MAY AFFECT THE COMPANY'S STOCK PRICE.

As a result of the emerging and evolving nature of the markets in which the Company competes, as well as the current nature of the public markets and the Company's current financial condition, the Company believes its operating results may fluctuate materially, as a result of which quarter-to-quarter comparisons of the Company's results of operations may not be meaningful. If in some future quarter, whether as a result of such a fluctuation or otherwise, the Company results of operations fall below the expectations of securities analysts and investors, the trading price of the Company's common stock would likely be materially and adversely affected. Investors should not rely on the Company's results of any interim period as an indication of the Company's future performance. Additionally, the Company's quarterly results of operations may fluctuate significantly in the future as a result of a variety of factors, many of which are outside the Company's control. Factors that may cause the Company's quarterly results to fluctuate include, among others:

- The Company's ability to retain existing clients and customers;
- The Company's ability to attract new clients and customers at a steady rate;
- The Company's ability to maintain client satisfaction;
- The Company's ability to motivate potential clients and customers to acquire and implement new technologies;

- The extent to which the Company's products gain market acceptance;
- The timing and size of client and customer purchases;
- Introductions of products and services by competitors;
- Price competition in the markets in which the Company competes;
- The pricing of hardware and software which the Company resells or integrates into it's products;
- The level of use of the Internet and online services and the rate of market acceptance of physical world-to-Internet marketing;
- The Company's ability to upgrade and develop it's systems and infrastructure in a timely and effective manner;

- The Company's ability to attract, train, and retain skilled management, strategic, technical, and creative professionals;
- The amount and timing of operating costs and capital expenditures relating to the expansion of the Company's business, operations, and infrastructure;
- Unanticipated technical, legal, and regulatory difficulties with respect to use of the Internet; and
- General economic conditions and economic conditions specific to Internet technology usage and electronic commerce.

THE COMPANY IS UNCERTAIN OF THE SUCCESS OF THE COMPANY'S INTERNET SWITCHING SERVICES BUSINESS UNIT AND THE FAILURE OF THIS UNIT WOULD NEGATIVELY AFFECT THE PRICE OF THE COMPANY'S STOCK.

The Company provides products and services that provide a seamless link from physical objects, including printed material, to the Internet. The Company can provide no assurance that:

- This application services business unit will ever achieve profitability;
- The Company's current product offerings will not be adversely affected by the focusing of the Company resources on the physical world-to-Internet space; or
- The products the Company develops will obtain market acceptance.

In the event that the application Services business unit should never achieve profitability, that the Company's current product offerings should so suffer, or that the Company's products fail to obtain market acceptance, the Company's business, prospects, financial condition, and results of operations would be materially adversely affected.

THE COMPANY DEPENDS ON THE RESALE OF SOFTWARE AND EQUIPMENT FOR REVENUE AND A REDUCTION IN THESE SALES WOULD MATERIALLY ADVERSELY AFFECT THE COMPANY'S OPERATIONS AND THE VALUE OF THE COMPANY'S STOCK.

During the years ended December 31, 2001, 2000, 1999, 1998, and 1997, we derived 73%, 66%, 78%, 72%, and 78%, respectively, of the Company's revenues from the resale of computer software and technology equipment. A loss or a reduction of this revenue would have a material adverse effect on the Company's business, prospects, financial condition, and results of operations, as well as the Company's stock price. The Company can provide no assurance that:

- The market for the Company's products and services will continue;
- The Company will be successful in marketing these products due to competition and other factors; o The Company will continue to be able to obtain short-term financing for the purchase of the products that the Company resells; or
- The Company's relationship with companies whose products and services it sells will continue, the Company's relationship with Sun Microsystems Computer Company.

Further, the technology and equipment resale business is becoming a commodity industry for products undifferentiated by value-added proprietary elements and services. A large number of companies act as re-marketers of another party's products, and therefore, the competition in this area is intense. Resale operations are also being compressed as equipment manufacturers consolidate their distribution channels. In some instances, the Company, in acting as a re-marketer, may compete with the original manufacturer. An inability to effectively compete and generate revenues in this industry would have a material adverse effect on the Company's business, prospects, financial condition, and results of operations.

A LARGE PERCENTAGE OF THE COMPANY'S ASSETS ARE INTANGIBLE ASSETS, WHICH WILL HAVE LITTLE OR NO VALUE IF THE COMPANY'S OPERATIONS ARE UNSUCCESSFUL.

At December 31, 2001, approximately 56% of the Company's total assets were intangible assets, consisting primarily of rights related to the Company's patents and other intellectual property. If the Company operations are unsuccessful, these assets will have little or no value, which will materially adversely affect the value of the Company's stock and the ability of the Company's stockholders to recoup their investments in the Company's capital stock.

THE COMPANY'S MARKETING STRATEGY HAS NOT BEEN TESTED AND MAY NOT RESULT IN SUCCESS.

To date, the Company has conducted limited-marketing efforts directly. All of the Company's marketing efforts have been largely untested in the marketplace, and may not result in sales of the Company's products and services. To penetrate the markets in which the Company competes, the Company will have to exert significant efforts to create awareness of, and demand for, the Company's products and services. With respect to the Company's marketing efforts conducted directly, the Company intends to expand the Company's sales staff upon receipt of adequate financing. The Company's failure to further develop it's marketing capabilities and successfully market it's products and services would have a material adverse effect on the Company's business, prospects, financial condition, and results of operations.

THE COMPANY RELIES ON INTERNALLY DEVELOPED SYSTEMS, WHICH ARE INEFFICIENT, WHICH MAY PUT THE COMPANY AT A COMPETITIVE DISADVANTAGE.

The Company uses internally developed technologies for a portion of it's systems integration services, as well as the technologies required to interconnect it's clients' and customers' physical world-to-Internet systems and hardware with the Company's own. As the Company has developed these systems in order to integrate disparate systems and hardware on a case-by-case basis, these systems are inefficient and require a significant amount of customization. Such client and customer specific customization is time-consuming and costly and may place the Company at a competitive disadvantage when compared to competitors with more efficient systems. The Company intends to upgrade and expand it's systems and technologies and to integrate newly-developed and purchased technologies with it's own in order to improve the efficiency of the company's systems and technologies, although the Company is unable to predict whether these upgrades will improve the Company's competitive position when compared to it's competitors.

THE COMPANY HAS LIMITED HUMAN RESOURCES; THE COMPANY NEEDS TO ATTRACT AND RETAIN HIGHLY SKILLED PERSONNEL; AND THE COMPANY MAY BE UNABLE TO EFFECTIVELY MANAGE COMPANY GROWTH WITH THE COMPANY'S LIMITED RESOURCES.

The Company's future success will depend in large part on the Company's ability to attract, train, and retain additional highly skilled executive level management, creative, technical, and sales personnel. Competition is intense for these types of personnel from other technology companies and more established organizations, many of which have significantly larger operations and greater financial, marketing, human, and other resources than the Company has currently. The Company may not be successful in attracting and retaining qualified personnel on a timely basis, on competitive terms, or at all. Due to the Company's current working capital deficiency, the Company is currently unable to afford a directors' and officers' liability insurance policy with a term of greater than six months. The Company's existing policy expires on July 25, 2002. To the extent that sufficient resources are available, the Company intends to maintain a directors' and officers' liability insurance policy at all times. However, any inability to maintain such liability insurance in the future would materially adversely affect the Company's ability to attract and retain qualified director and officer candidates. If the Company is not successful in attracting and retaining qualified personnel, it's business, prospects, financial condition, and results of operations would be materially adversely affected.

THE COMPANY DEPENDS UPON THE COMPANY'S SENIOR MANAGEMENT AND THEIR LOSS OR UNAVAILABILITY COULD PUT THE COMPANY AT A COMPETITIVE DISADVANTAGE.

The Company's success depends largely on the skills of certain key management and technical personnel. The loss or unavailability of any of these individuals for any significant period of time could have a material adverse effect on the Company's business, prospects, financial condition, and results of operations. None of the Company's key management or technical personnel is presently subject to employment agreements. The Company has recently awarded stock options to key members of management. All key management personnel are required to sign non-solicitation and confidentiality agreements. However, there is no guarantee that these option incentives or contractual restrictions will discourage the Company's key management and technical personnel from leaving. If the Company were not successful in retaining it's key personnel, the Company's business, prospects, financial condition, and results of operations would be materially adversely affected.

THE COMPANY MAY BE UNABLE TO PROTECT THE COMPANY'S INTELLECTUAL PROPERTY RIGHTS AND THE COMPANY MAY BE LIABLE FOR INFRINGING THE INTELLECTUAL PROPERTY RIGHTS OF OTHERS.

The Company's success in the physical world-to-Internet and the value-added systems integration markets is dependent upon the Company's proprietary technology, including the Company's patents and other intellectual property, and on the Company's ability to protect the Company's proprietary technology and other intellectual property rights. In addition, the Company must conduct the Company's operations without infringing on the proprietary rights of third parties. The Company also intends to rely upon unpatented trade secrets and the know-how and expertise of the Company's employees, as well as the Company's patents. To protect the Company's proprietary technology and other intellectual property, the Company relies primarily on a combination of the protections provided by applicable patent, copyright, trademark, and trade secret laws as well as on confidentiality procedures and licensing arrangements. The Company has four patents for it's physical world-to-Internet technology. The Company also has several trademarks relating to the Company's proprietary products. Although the Company believes that the Company has taken appropriate steps to protect the Company's unpatented proprietary rights, including requiring that the Company's employees and third parties who are granted access to the Company's proprietary technology enter into confidentiality agreements with the Company, the Company can provide no assurance that these measures will be sufficient to protect the Company's rights against third parties. Others may independently develop or otherwise acquire patented or unpatented technologies or products similar or superior to the Company.

The Company licenses from third parties certain software tools that it includes in the Company's services and products. If any of these licenses were terminated, the Company could be required to seek licenses for similar software from other third parties or develop these tools internally. The Company may not be able to obtain such licenses or develop such tools in a timely fashion, on acceptable terms, or at all. Companies participating in the software and Internet technology industries are frequently involved in disputes relating to intellectual property. The Company may in the future be required to defend the Company's intellectual property rights against infringement, duplication, discovery, and misappropriation by third parties or to defend against third-party claims of infringement. Likewise, disputes may arise in the future with respect to ownership of technology developed by employees who were previously employed by other companies. Any such litigation or disputes could result in substantial costs to, and a diversion of effort by, the Company. An adverse determination could subject the Company to significant liabilities to third parties, require the Company to seek licenses from, or pay royalties to, third parties, or require the Company to develop appropriate alternative technology. Some or all of these licenses may not be available to the Company on acceptable terms or at all, and the Company may be unable to develop alternate technology at an acceptable price or at all. Any of these events could have a material adverse effect on the Company's business, prospects, financial condition, and results of operations. See "Risks Specific To NeoMedia - Currently Pending Legal Actions Threaten To Divest The Company Of Critical Intellectual Property."

CURRENTLY PENDING LEGAL ACTIONS THREATEN TO DIVEST THE COMPANY OF CRITICAL INTELLECTUAL PROPERTY.

On September 6, 2001, AirClic, Inc. ("AirClic") filed suit against the Company in the Court of Common Pleas, Montgomery County, Pennsylvania, seeking, among other things, the accelerated repayment of a $500,000 loan it advanced to the Company under the terms of a letter of intent entered into between AirClic and the Company. The letter of intent was subsequently abandoned on the basis of the Company's alleged breach of certain representations made by the Company in the promissory note issued by the Company to AirClic in respect of such advance. The note issued by the Company in respect of AirClic's $500,000 advance is secured by substantially all of the Company's intellectual property, including its core physical world-to-Internet technologies. If the Company is deemed to have defaulted under the note, and does not pay the judgment, AirClic, which is one of NeoMedia's key competitors, could acquire the Company's core intellectual property, which would have a material adverse effect on the Company's business, prospects, financial condition, and results of operations. The Company is vigorously defending this lawsuit and has interposed counterclaims against AirClic. The lawsuit is in its preliminary stages and, as such, at this time it is difficult to assess the outcome. Whether or not AirClic is successful in asserting its claims that the Company breached certain representations made by the Company in the note, the note became due and payable in accordance with its terms on January 11, 2002. Based on the cash currently available to the Company, payment of the note and related interest would have a material adverse effect on the Company's financial condition. If the Company fails to pay such note, AirClic could proceed against the Company's intellectual property securing the note, which would have a material adverse effect on the Company's business, prospects, financial condition, and results of operations. The Company is aggressively seeking bridge financing to enable it to pay the principal and interest remaining under the note following the resolution of the counterclaims

against AirClic. The Company has not accrued any additional liability over and above the note payable and related accrued interest.

AirClic has also filed suit against the Company in the United States District Court for the Eastern District of Pennsylvania. In this second action, AirClic seeks a declaration that certain core intellectual property securing the note issued by the Company to AirClic, some of which is patented and others for which a patent application is pending is invalid and unenforceable. Any declaration that the Company's core patented or patentable technology is invalid and unenforceable would have a material adverse effect on the Company's business, prospects, financial condition, and results of operations. The Company is vigorously defending against this lawsuit as well. The Company has not accrued any liability in connection with this matter. See "Risks Specific to NeoMedia - The Company May Be Unable To Protect It's Intellectual Property Rights And The Company May Be Liable For Infringing The Intellectual Property Rights Of Others".

THE COMPANY IS EXPOSED TO PRODUCT LIABILITY CLAIMS FOR WHICH INSURANCE COVERAGE IS LIMITED, POTENTIALLY INADEQUATE AND IN SOME CASES UNAVAILABLE, AND AN UNINSURED CLAIM COULD HAVE A MATERIAL ADVERSE EFFECT ON THE COMPANY'S BUSINESS, PROSPECTS, FINANCIAL CONDITION, AND RESULTS OF OPERATIONS, AS WELL AS THE VALUE OF THE COMPANY STOCK.

Many of the Company's projects are critical to the operations of the Company's clients' businesses. Any failure in a client's information system could result in a claim for substantial damages against the Company, regardless of the Company's responsibility for such failure. The Company could, therefore, be subject to claims in connection with the products and services that it sells. The Company currently maintains product liability and errors and omissions insurance. There can be no assurance that:

- The Company has contractually limited our liability for such claims adequately or at all;
- The Company would have sufficient resources to satisfy any liability resulting from any such claim;
- The Company coverage, if available, will be adequate in term and scope to protect it against material adverse effects in the event of a successful claim; or
- The Company insurer will not disclaim coverage as to any future claim.

The successful assertion of one or more large claims against the Company that exceed available insurance coverage could materially adversely affect the Company's business, prospects, financial condition, and results of operations.

THE COMPANY CANNOT PREDICT ITS FUTURE CAPITAL NEEDS AND THE COMPANY MAY NOT BE ABLE TO SECURE ADDITIONAL FINANCING.

The Company expects to receive up to $500,000 attributable to the payment of the exercise prices of options for shares of common stock that the Company is in the process of registering for public resale. The Company also expects to receive up to $3,230,000, plus interest at a rate of 6% per annum, upon repayment of promissory notes issued to the Company, in each case as consideration for 19,000,000 shares of Company common stock, sold at $0.17 per share. Despite the anticipated infusion of such capital, and because the Company cannot reliably predict when or if such warrant exercises, cash payments and note repayments will occur, if at all, the Company is unable to determine whether and for how long the Company will be able to meet its capital requirements. The Company anticipates offerings up to 10,000,000 additional shares of common stock within six months of the date of this filing and offering of convertible debt and preferred stock securities in order to obtain short-term financing. As is typical with short-term, bridge financing, this capital may be obtained upon terms highly unfavorable to the Company. Further, the Company cannot be certain that anticipated revenues from operations would be sufficient to satisfy its capital requirements. The Company believes that it will have sufficient capital to sustain operations through December 31,2002. The Company's belief is based on its operating plan, which in turn is based on assumptions that may prove to be incorrect. If capital raised from financing efforts and the Company's financial resources are insufficient it may require additional financing in order to execute on the Company operating plan and continue as a going concern. The Company cannot predict whether this additional financing will be in the form of equity or debt, or be in another form. The Company may not be able to obtain the necessary additional capital on a timely basis, on acceptable terms, or at all. In any of these events, the Company may be unable to implement its current plans for expansion, repay its debt obligations as they become due or respond to competitive pressures, any of which circumstances would have a material adverse effect on its business, prospects, financial condition and results of operations. In the event that any future financing should take the

form of a sale of equity securities, the holders of the common stock may experience additional dilution.

BECAUSE THE COMPANY WILL NOT PAY CASH DIVIDENDS, INVESTORS MAY HAVE TO SELL THEIR SHARES IN ORDER TO REALIZE THEIR INVESTMENT.

The Company has not paid any cash dividends on our common stock and do not intend to pay cash dividends in the foreseeable future. The Company intends to retain future earnings, if any, for reinvestment in the development and marketing of its products and services. Any credit agreements into which the Company may enter with institutional lenders may restrict the Company's ability to pay dividends. Whether the Company pays cash dividends in the future will be at the discretion of the Company's Board of Directors and will be dependent upon the Company's financial condition, results of operations, capital requirements, and any other factors that the Board of Directors decides is relevant. As a result, investors may have to sell their shares of common stock to realize their investment.

SOME PROVISIONS OF THE COMPANY'S CERTIFICATE OF INCORPORATION AND BY-LAWS MAY DETER TAKEOVER ATTEMPTS, WHICH MAY LIMIT THE OPPORTUNITY OF THE COMPANY'S STOCKHOLDERS TO SELL THEIR SHARES AT A PREMIUM TO THE THEN MARKET PRICE.

Some of the provisions of the Company's certificate of incorporation and by-laws could make it more difficult for a third party to acquire us, even if doing so might be beneficial to the Company's stockholders by providing them with the opportunity to sell their shares at a premium to the then market price. On December 10, 1999, the Company's Board of Directors adopted a stockholders rights plan and declared a non-taxable dividend of one right to acquire Series A

Preferred Stock of the Company, par value $0.01 per share, on each outstanding share of the Company's common stock to stockholders of record on December 10, 1999 and each share of common stock issued thereafter until a pre-defined hostile takeover date. The stockholder rights plan was adopted as an anti-takeover measure commonly referred to as a "poison pill." The stockholder rights plan was designed to enable all stockholders not engaged in a hostile takeover attempt to receive fair and equal treatment in any proposed takeover of the corporation and to guard against partial or two-tiered tender offers, open market accumulations and other hostile tactics to gain control of NeoMedia. The stockholders rights plan, which is similar to plans adopted by many leading public companies, was not adopted in response to any effort to acquire control of NeoMedia at the time of adoption. This stockholders rights plan may have the effect of rendering more difficult, delaying, discouraging, preventing, or rendering more costly an acquisition of NeoMedia or a change in control of NeoMedia. Certain of our directors, officers and principal stockholders, Charles W. Fritz, William E. Fritz and The Fritz Family Limited Partnership were exempted from triggering the "poison pill" as a result of their significant holdings at the time of the plan's adoption, which otherwise might have triggered the "poison pill."

In addition, the Company's certificate of incorporation authorizes the Board of Directors to designate and issue preferred stock, in one or more series, the terms of which may be determined at the time of issuance by the Board of Directors, without further action by stockholders, and may include voting rights, including the right to vote as a series on particular matters, preferences as to dividends and liquidation, conversion, and redemption rights, and sinking fund provisions.

The Company is authorized to issue a total of 10,000,000 shares of Preferred Stock, par value $0.01 per share. The Company's designated Preferred Stock is comprised of 200,000 shares of Series A Preferred Stock, par value $0.01 per share, which shares are issuable in connection with the Company's stockholders rights plan, and 500,000 shares of Series B Convertible Preferred Stock, par value $0.01 per share, of which 452,289 shares were issued as of December 31, 2001. The 452,489 Series B shares outstanding as of December 31, 2001 automatically converted into the same number of common shares on January 2, 2002.

THE COMPANY'S COMMON STOCK TRADES SPORADICALLY, THE OFFERING PRICE OF THE COMMON STOCK IS ARBITRARY, THE MARKET PRICE OF THE SECURITIES MAY BE VOLATILE, AND THE COMPANY MUST SATISFY THE APPLICABLE REQUIREMENTS FOR THE COMMON STOCK TO TRADE ON THE NASDAQ SMALL CAP MARKET.

The Company's common stock currently trades sporadically on the Nasdaq Small Cap Market. The market for the Company's common stock may continue to be

an inactive market. Accordingly, unless and until an active public market develops, investors may have difficulty selling their shares of common stock into which the preferred stock offered is automatically convertible at a price that is attractive to the investor.

The Company's common stock has traded as low as $0.11 and as high as $6.75 between June 30, 2000 and March 5, 2002. From time to time after this filing, the market price of the common stock may experience significant volatility. The Company's quarterly results, failure to meet analysts expectations, announcements by the Company or the Company's competitors regarding acquisitions or dispositions, loss of existing clients, new procedures or technology, changes in general conditions in the economy, and general market conditions could cause the market price of the common stock to fluctuate substantially. In addition, the stock market has experienced significant price and volume fluctuations that have particularly affected the trading prices of equity securities of many technology companies. These price and volume fluctuations often have been unrelated to the operating performance of the affected companies. In the past, following periods of volatility in the market price of a company's securities, securities class action litigation has often been instituted against such a company. This type of litigation, regardless of the outcome, could result in substantial costs and a diversion of management's attention and resources, which could materially adversely affect the Company's business, prospects, financial condition, and results of operations. The Nasdaq Stock Market has net capital surplus and stock price maintenance criterion for trading on the Nasdaq Small Cap Market. The Company is currently below the minimum requirements for Net Tangible Assets and Stockholder equity. The Company's ability to continue to be listed on the Nasdaq Stock Market will depend on whether the Company is able to maintain net tangible assets of at least $2,000,000 and maintain a minimum stock price of $1.00.

If the Company cannot maintain the standards for continued listing, the Company's common stock could be subject to delisting from the Nasdaq Small Cap Market. Trading, if any, in the common stock would then be conducted in the over-the-counter market on the OTC Bulletin Board established for securities that do not meet the Nasdaq Small Cap Market listing requirements, or in what are commonly referred to as the "pink sheets." As a result, an investor may find it more difficult to dispose of, or to obtain accurate quotations as to the price of, the Company's shares.

INVESTORS MAY SUFFER SIGNIFICANT ADDITIONAL DILUTION IF OUTSTANDING OPTIONS AND WARRANTS ARE EXERCISED.

The Company also has outstanding stock options to purchase approximately 5.0 million shares of common stock and warrants to purchase approximately 3.2 million shares of common stock, some of which may in the future, but do not currently, have exercise prices at or significantly below the price at which the preferred stock converts into common stock or the price of the Company's common shares on the public market. To the extent such options or warrants are exercised, there will be further dilution. In addition, in the event that any future financing should be in the form of, be convertible into, or exchangeable for, equity securities, and upon the exercise of options and warrants, investors may experience additional dilution.

FUTURE SALES OF COMMON STOCK BY THE COMPANY'S EXISTING STOCKHOLDERS COULD ADVERSELY AFFECT THE COMPANY'S STOCK PRICE.

The market price of the Company's common stock could decline as a result of sales of a large number of shares of the Company's common stock in the market as a result of offerings of common stock or securities convertible, exercisable or exchangeable for common stock, or the perception that these sales could occur. These sales also might make it more difficult for the Company to sell equity securities in the future at a time and at a price that the Company deems appropriate. The Company's officers and directors are not currently subject to lock-up agreements preventing them from selling their shares. Two of the Company's officers and directors, Charles W. Fritz and William E. Fritz intend to sell an aggregate of 3,945,551 shares of common stock in connection with a registration that we are currently in the process of making effective. Additionally, shares issued upon the exercise of stock options granted under the Company's stock option plans will be eligible for resale in the public market from time to time subject to vesting.

In addition, the Company may offer for sale up to 10,000,000 additional shares of common stock within six months from the date of this filing, as necessary to raise capital to sustain Company operations. While applicable law provides that unregistered securities may not generally be resold within one year of their purchase, market conditions may require the Company to register such shares for public sale earlier than such shares would otherwise become freely tradable, thereby creating the possibility of further dilution to purchasers of the Company shares.

RISKS RELATING TO THE COMPANY'S INDUSTRY

INTERNET SECURITY POSES RISKS TO THE COMPANY'S ENTIRE BUSINESS.

Concerns over the security of the Internet and other electronic transactions and the privacy of consumers and merchants may inhibit the growth of the Internet and other online services generally, especially as a means of conducting commercial transactions, which may have a material adverse effect on the Company's physical world-to-Internet business.

THE COMPANY WILL ONLY BE ABLE TO EXECUTE ITS PHYSICAL WORLD-TO-INTERNET BUSINESS PLAN IF INTERNET USAGE AND ELECTRONIC COMMERCE CONTINUE TO GROW.

The Company's future revenues and any future profits are substantially dependent upon the widespread acceptance and use of the Internet and other online services as an effective medium of information and commerce. If use of the Internet and other online services does not continue to grow or grows more slowly than the Company expects, if the infrastructure for the Internet and other online services does not effectively support the growth that may occur, or if the Internet and other online services do not become a viable commercial marketplace, the Company's physical world-to-Internet business, and therefore the Company's business, prospects, financial condition, and results of operations, could be materially adversely affected. Rapid growth in the use of, and interest in, the Internet, the Web, and online services is a recent phenomenon, and may not continue on a lasting basis. In addition, customers may not adopt, and continue to use, the Internet and other online services as a medium of information retrieval or commerce. Demand and market acceptance for recently introduced services and products over the Internet are subject to a high level of uncertainty, and few services and products have generated profits. For the Company to be successful, consumers and businesses must be willing to accept and use novel and cost efficient ways of conducting business and exchanging information.

In addition, the public in general may not accept the Internet and other online services as a viable commercial or information marketplace for a number of reasons, including potentially inadequate development of the necessary network infrastructure or delayed development of enabling technologies and performance improvements. To the extent that the Internet and other online networks continue to experience significant growth in the number of users, their frequency of use, or in their bandwidth requirements, the infrastructure for the Internet and online networks may be unable to support the demands placed upon them. In addition, the Internet or other online networks could lose their viability due to delays in the development or adoption of new standards and protocols required to handle increased levels of Internet activity, or due to increased governmental regulation. Significant issues concerning the commercial and informational use of the Internet and online networks technologies, including security, reliability, cost, ease of use, and quality of service, remain unresolved and may inhibit the growth of Internet business solutions that utilize these technologies. Changes in, or insufficient availability of, telecommunications services to support the Internet or other online services also could result in slower response times and adversely affect usage of the Internet and other online networks generally and the Company's physical world-to-Internet product and networks in particular.

THE COMPANY MAY NOT BE ABLE TO ADAPT AS THE INTERNET, PHYSICAL WORLD-TO-INTERNET, EQUIPMENT RESALES, AND SYSTEMS INTEGRATIONS MARKETS, AND CUSTOMER DEMANDS, CONTINUE TO EVOLVE.

The Company may not be able to adapt as the Internet, physical world-to-Internet, equipment resales and systems integration markets, and consumer demands, continue to evolve. The Company's failure to respond in a timely manner to changing market conditions or client requirements would have a material adverse effect on the Company's business, prospects, financial condition, and results of operations. The Internet, physical world-to-Internet, equipment resales, and systems integration markets are characterized by:

- Rapid technological change;
- Changes in user and customer requirements and preferences;
- Frequent new product and service introductions embodying new technologies; and
- The emergence of new industry standards and practices that could render proprietary technology and hardware and software infrastructure obsolete.

The Company's success will depend, in part, on its ability to:

- Enhance and improve the responsiveness and functionality of the Company's products and services;
- License or develop technologies useful in the Company's business on a timely basis;
- Enhance the Company's existing services, and develop new services and technologies that address the increasingly sophisticated and varied needs of the Company's prospective or current customers; and
- Respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis.

THE COMPANY MAY NOT BE ABLE TO COMPETE EFFECTIVELY IN THE MARKETS IN WHICH IT COMPETES.

While the market for physical world-to-Internet technology is relatively new, it is already highly competitive and characterized by an increasing number of entrants that have introduced or developed products and services similar to those offered by the Company. NeoMedia believes that competition will intensify and increase in the future. The Company's target market is rapidly evolving and is subject to continuous technological change. As a result, the Company's competitors may be better positioned to address these developments or may react more favorably to these changes, which could have a material adverse effect on the Company's business, prospects, financial condition, and results of operations.

In addition, the equipment resales and systems integration markets are increasingly competitive. The Company competes in these industries on the basis of a number of factors, including the attractiveness of the services offered, the breadth and quality of these services, creative design and systems engineering expertise, pricing, technological innovation, and understanding clients' needs. A number of these factors are beyond the Company's control. Existing or future competitors may develop or offer products or services that provide significant technological, creative, performance, price, or other advantages over the products and services offered by NeoMedia.

Many of the Company's competitors have longer operating histories, larger customer bases, and longer relationships with clients, and significantly greater financial, technical, marketing, and public relations resources than the Company does. Based on total assets and annual revenues, the Company is significantly smaller than its two largest competitors in the physical world-to-Internet industry, the primary focus of the Company's business. Similarly, the Company competes against significantly larger and better-financed companies in the Company's systems integration and resales businesses, including the manufacturers of the equipment and technologies that the Company integrates and resells. If NeoMedia competes with its primary competitors for the same geographical or institutional markets, their financial strength could prevent the Company from capturing those markets. The Company may not successfully compete in any market in which it conducts or may conduct operations. In addition, based on the increasing consolidation, price competition, and participation of equipment manufacturers in the systems integration and equipment resales markets, the Company believes that it will not be able to compete effectively in these markets in the future. It is for this reason, that the Company has increasingly focused its business plan on competing in the emerging market for physical world-to-Internet products.

REGULATORY AND LEGAL UNCERTAINTIES COULD HARM THE COMPANY'S BUSINESS.

The Company is not currently subject to direct regulation by any government agency other than laws or regulations applicable generally to electronic commerce. Any new legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to the Company's business, or the application of existing laws and regulations to the Internet and other online services, could have a material adverse effect on the Company's business, prospects, financial condition, and results of operations. Due to the increasing popularity and use of the Internet and other online services, federal, state, and local governments may adopt laws and regulations, or amend existing laws and regulations, with respect to the Internet or other online services covering issues such as taxation, user privacy, pricing, content, copyrights, distribution, and characteristics and quality of products and services. The growth and development of the market for electronic commerce may prompt calls for more stringent consumer protection laws to impose additional burdens on companies conducting business online. The adoption of any additional laws or regulations may decrease the growth of the Internet or other online services, which could, in turn, decrease the demand for the Company's services and increase the Company's cost of doing business, or otherwise have a material adverse effect on its business, prospects, financial condition, and results of operations. Moreover, the relevant governmental authorities have not

resolved the applicability to the Internet and other online services of existing laws in various jurisdictions governing issues such as property ownership and personal privacy and it may take time to resolve these issues definitively.

Certain of the Company's proprietary technology allow for the storage of demographic data from its users. In 2000, the European Union adopted a directive addressing data privacy that may limit the collection and use of certain information regarding Internet users. This directive may limit the Company's ability to collect and use information collected by the Company's technology in certain European countries. In addition, the Federal Trade Commission and several state governments have investigated the use by certain Internet companies of personal information. The Company could incur significant additional expenses if new regulations regarding the use of personal information are introduced or if the Company's privacy practices are investigated.

ITEM 2. DESCRIPTION OF PROPERTIES

The Company's principal executive, development and administrative office is located at 2201 Second Street, Suite 600, Fort Myers, Florida 33901. The Company occupies approximately 15,000 square feet under terms of a written lease from an unaffiliated party which expired on January 31, 2001. The Company signed a renewal for three years at this facility during the first quarter of 2001. The Company has a sales facility at 2150 Western Court, Suite 230, Lisle, Illinois 60532, where the Company occupies approximately 6,000 square feet under the terms of a written lease from an unaffiliated party expiring on October 31, 2003. In March 2001, with the acquisition of the assets of Qode.com, Inc., the Company added an additional 8,388 square feet office lease at 4850 N. State Road 7, Suite 104, Ft. Lauderdale, Florida, with monthly rent totaling approximately $9,200. The lease expires March, 2005. This lease is being terminated subject to a settlement agreement between the Company and Headway associates, the landlord (see "Legal Proceedings").

During 2001, we closed our office in Monterrey, Mexico, which was primarily used for sales and consulting efforts.

The Company believes that its existing office space is adequate to meet its current and short-term requirements.

ITEM 3. LEGAL PROCEEDINGS

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

On September 6, 2001, AirClic, Inc. ("AirClic") filed suit against the Company in the Court of Common Pleas, Montgomery County, Pennsylvania, seeking, among other things, the accelerated repayment of a $500,000 loan it advanced to the Company under the terms of a letter of intent entered into between AirClic and the Company. The letter of intent was subsequently abandoned on the basis of the Company's alleged breach of certain representations made by the Company in the promissory note issued by the Company to AirClic in respect of such advance. The note issued by the Company in respect of AirClic's $500,000 advance is secured by substantially all of the Company's intellectual property, including its core physical world-to-Internet technologies. If the Company is deemed to have defaulted under the note, and does not pay the judgment, AirClic, which is one of the NeoMedia's key competitors, could acquire the Company's core intellectual property, which would have a material adverse effect on the Company's business, prospects, financial condition, and results of operations. The Company is vigorously defending this lawsuit and has interposed counterclaims against AirClic. The lawsuit is in its preliminary stages and, as such, at this time it is difficult to assess the outcome. Whether or not AirClic is successful in asserting its claims that the Company breached certain representations made by the Company in the note, the note became due and payable in accordance with its terms on January 11, 2002. Based on the cash currently available to the Company, payment of the note and related interest would have a material adverse effect on the Company's financial condition. If the Company faisl to pay such note, AirClic could proceed against the Company's intellectual property securing the note, which would have a material adverse effect on the Company's business, prospects, financial condition, and results of operations. The Company is aggressively seeking bridge financing to enable it to pay the principal and interest remaining under the note following the resolution of the

counterclaims against AirClic. The Company has not accrued any additional liability over and above the note payable and related accrued interest.

AirClic has also filed suit against the Company in the United States

District Court for the Eastern District of Pennsylvania. In this second action, AirClic seeks a declaration that certain core intellectual property securing the note issued by the Company to AirClic, some of which is patented and others for which a patent application is pending is invalid and unenforceable. Any declaration that the Company's core patented or patentable technology is invalid and unenforceable would have a material adverse effect on the Company's business, prospects, financial condition, and results of operations. The Company is vigorously defending against this lawsuit as well. The Company has not accrued any liability in connection with this matter.

On June 26, 2001, the Company filed a $3 million lawsuit in the U.S. District Court, Northern District of Texas, Dallas Division, against Digital:Convergence Corporation for breach of contract regarding a $3 million promissory note due on June 24, 2001 that was not paid. The Company is seeking payment of the $3 million note plus interest and attorneys fees. The Company has not accrued any gain contingency related to this matter.

In April 2001, the former President and director of NeoMedia filed a lawsuit against the Company and several of its directors. The suit was filed in the Circuit Court of the Twentieth Judicial Circuit for Sarasota, Florida. The claim alleges the individual was fraudulently induced into accepting employment and that the Company breached the employment agreement. The individual's employment with the Company ended in January 2001. The Company believes the claim is without merit and is vigorously defending itself. Final outcome of this matter is uncertain and a range of loss cannot reasonably be estimated. The Company has accrued approximately $347,000 in severance and incentive payments relating to this matter.

On August 20, 2001, Ripfire, Inc. filed suit against the Company in the San Francisco County Superior Court seeking payment of $138,000 under a software license agreement entered into between the Company and Ripfire in May 2001 relating to implementation of the Qode Universal Commerce Solution. The Company has entered into a letter of intent with the Finx Group, Inc. to sell certain assets and liabilities relating to Qode. As part of the letter of intent, the Finx Group will assume all liabilities up to $138,000 relating to the Ripfire contract. Accordingly, the Company has not accrued a liability in the accompanying financial statements. The Company, along with the Finx Group, is currently negotiating settlement of this matter.

On October 3, 2001, Headway Associates, Ltd. filed a complaint for damages in the Circuit Court of the Seventeenth Judicial Circuit for Broward County, Florida. Headway Associates, Ltd. is seeking payment of all amounts due under the terms the lease agreement of the Ft. Lauderdale office of NeoMedia's Qode business unit. The lease commenced on March 3, 2000 and terminates on March 31, 2005. On February 25, 2002, Headway agreed to accept $100,000 cash payment over a two-month period for settlement of all past-due and future amounts owed under the lease. This amount is accrued in the accompanying financial statements.

On November 30, 2001, Orsus Solutions USA, Inc., filed a summons seeking payment in full of approximately $525,000 relating to a software and services contract associated with implementation of the Qode Universal Commerce Solution. The Company has entered into a letter of intent with the Finx Group, Inc. to sell certain assets and liabilities relating to Qode. As part of the letter of intent, the Finx Group will assume all liabilities up to $530,000 relating to the Orsus contract. Accordingly, the Company has not accrued a liability in the accompanying financial statements. The Company, along with the Finx Group, is currently negotiating settlement of this matter.

On March 20, 2002, IOS Capital, Inc. filed a summons seeking full payment of approximately $38,700 relating to past due and future payments under an office equipment lease. The Company has returned the equipment and intends to settle the past due amounts. As of December 31, 2001, the Company had recorded a liability of approximately $10,000 relating to this matter.

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

On October 24, 2001, the Company filed a proxy statement with the SEC to request a shareholder vote that would increase the number of the Company's authorized shares of common stock from 50,000,000 shares to 100,000,000 and

increase the number of the Company's authorized shares of preferred stock from 10,000,000 shares to 25,000,000. The proxy also requested approval to sell 19,000,000 shares of common stock to accredited investors in exchange for limited recourse promissory notes. On December 11, 2001, the Company's shareholders approved the sale of 19,000,000 shares at $0.08 per share in exchange for limited recourse promissory notes. The price has since been increased to $0.17 per share. The proposition to increase the number of authorized common and preferred shares did not pass as a result of the failure to secure favorable votes from holders of a majority of the outstanding shares.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

(a) MARKET INFORMATION. NeoMedia's common stock began trading on The Nasdaq Small Cap Stock Market under the symbol "NEOM" on November 25, 1996, the date of its initial public offering. Prior to such time there was no established public trading market for NeoMedia's common stock.

Set forth below is the range of high and low sales prices for the common stock and warrants for the three-month periods indicated as reported by NASDAQ. The quotations do not include retail markups, markdowns or commissions and may not represent actual transactions.

TYPE OF SECURITY	PERIOD ENDED	HIGH	LOW
	Common Stock March 31, 2000	$ 14.50	$5.69
	June 30, 2000	$ 11.13	$5.00
	September 30, 2000	$ 6.75	$4.13
	December 31, 2000	$ 6.50	$1.94
	March 31, 2001	$ 6.00	$2.50
	June 30, 2001	$ 4.50	$1.76
	September 30, 2001	$ 1.85	$0.16
	December 31, 2001	$ 0.24	$0.11

NeoMedia's stock price has been and will continue to be subject to significant volatility. Past financial performance should not be considered a reliable indicator of future performance, and investors should not use historical trends to anticipate results or trends in future periods. If revenues or earnings in any quarter fail to meet expectations of the investment community, there could be an immediate and significant impact on NeoMedia's stock price. In addition, NeoMedia's stock price may be affected by broader market trends that may be unrelated to NeoMedia's performance.

(b) HOLDERS. As of March 13, 2002, there were 158 registered shareholders and approximately 3,000 beneficial shareholders of record of NeoMedia's common stock. NeoMedia believes that it has a greater number of shareholders because a substantial number of NeoMedia's common stock is held of record in street name by broker-dealers for their customers.

(c) DIVIDENDS. As of March 15, 2002, NeoMedia has not paid any dividends on its common stock and does not expect to pay a cash dividend in the foreseeable future, but intends to devote all funds to the operation of its businesses. As of March 15, 2002, NeoMedia has a letter of credit with Bank One, Chicago, Illinois, the terms of which require Bank One's written permission prior to the declaration of cash dividends.

(d) RECENT ISSUANCES OF UNREGISTERED SECURITIES.

In November 1998, NeoMedia borrowed $500,000, in two separate notes from unrelated third parties. These notes were due in November, 1999 with an interest rate of 20%. One $250,000 note was extended until January 6, 2000, and the other was extended until February 25, 2000. These notes were secured by 375,000 shares of NeoMedia's common stock by placing them in an escrow account. These shares were considered issued but not outstanding for 1999. As part of obtaining the financing, 37,500 stock warrants, exercisable at $2.00 per share, were issued to the lender. These warrants were exercised in February 2000. During 2000, both notes were repaid and the 375,000 shares securing the notes have been released from escrow and retired by the Company.

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In January 1999, NeoMedia issued 82,372 shares of NeoMedia's common stock to an individual related party at a price of $3.04 per share. In connection with the sale, NeoMedia also issued 8,237 warrants with an exercise price of $3.04. The gross proceeds of such transaction were approximately $250,000.

In January 1999, NeoMedia issued warrants to purchase 230,000 shares of common stock at a price of $2.13 per share to an outside consultant for services performed.

In January and February 1999, NeoMedia issued an aggregate of 145,000 shares of NeoMedia's common stock at a price of $3.50 per share to five individual and one institutional unrelated parties. In connection with the sale, NeoMedia also issued an aggregate of 3,000 warrants with an exercise price of $3.50. The gross proceeds of such transaction were approximately $507,500. In connection with the sale, NeoMedia also issued as a commission 280,000 warrants to purchase shares of NeoMedia common stock at an exercise price of $2.13 per share

In January 1999, NeoMedia issued 42,857 shares of NeoMedia's common stock at a price of $3.50 per share to an individual related party. In connection with the sale, NeoMedia also issued 4,286 warrants with an exercise price of $3.50. The gross proceeds of such transaction were approximately $150,000.

In February 1999, NeoMedia issued 250,000 shares of NeoMedia's common stock at a price of $4.00 per share to AT Cross Company, an unrelated party. In connection with the sale, NeoMedia also issued 100,000 warrants with an exercise price of $5.00. The gross proceeds of such transaction were $1,000,000.

In April 1999, NeoMedia issued an aggregate of 1,000,000 shares of NeoMedia's common stock at a price of $3.45 per share to two individual and three institutional unrelated parties. The gross proceeds of such transaction were approximately $3,450,000. In connection with the sale, NeoMedia issued as a commission 175,000 warrants to purchase shares of NeoMedia common stock at an exercise price of $3.45 per share.

In April 1999, NeoMedia issued warrants to purchase 50,000 shares of common stock at a price of $0.01 per share to an outside institution for services performed.

In May 1999, NeoMedia issued an aggregate of 65,000 shares of NeoMedia's common stock at a price of $4.75 per share to two individual unrelated parties. In connection with the sale, NeoMedia also issued an aggregate of 6,500 warrants with an exercise price of $5.00. The gross proceeds of such transaction were approximately $309,000. In connection with the sale, NeoMedia paid commissions of $3,375 cash plus 3,250 warrants to purchase shares of NeoMedia common stock at an exercise price of $5.00 per share.

In June 1999, NeoMedia issued 250,000 shares of NeoMedia's common stock at a price of $4.00 per share to AT Cross Company, an unrelated party. In connection with the sale, NeoMedia also issued 100,000 warrants with an exercise price of $7.00. The gross proceeds of such transaction were approximately $1,000,000.

In September 1999, NeoMedia issued an aggregate of 210,000 shares of NeoMedia's common stock at a price of $7.00 per share to one individual and two institutional unrelated parties. The gross proceeds of such transaction were approximately $1,470,000. In connection with the sale, NeoMedia issued as a commission 105,000 warrants to purchase shares of NeoMedia common stock at an exercise price of $6.00 per share.

In September 1999, NeoMedia issued an aggregate of 275,231 shares of NeoMedia's common stock at a price of $5.75 per share to two individual and three institutional unrelated parties. In connection with the sale, NeoMedia also issued an aggregate of 27,523 warrants with an exercise price of $6.75. The gross proceeds of such transaction were approximately $1,583,000. In connection with the sale, NeoMedia paid commissions of $30,000 cash, and also issued 11,172 shares of its common stock valued at $6.19 per share and 10,000 warrants to purchase shares of NeoMedia common stock at an exercise price of $6.19 per share.

In October 1999, NeoMedia issued 15,000 shares of NeoMedia's common stock at a price of $4.38 per share to an individual unrelated party. In connection with the sale, NeoMedia also issued 1,500 warrants with an exercise price of $4.38. The gross proceeds of such transaction were approximately $66,000.

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In November 1999, NeoMedia issued an aggregate of 143,334 shares of NeoMedia's common stock at a price of $3.75 per share to two individual and two institutional unrelated parties. In connection with the sale, NeoMedia also issued an aggregate of 5,067 warrants with an exercise price of $5.50, 1,267 warrants with an exercise price of $4.75, 5,333 warrants with an exercise price of $4.67, and 2,667 warrants with an exercise price of $5.84. The gross proceeds of such transaction were approximately $538,000. In connection with the sale, NeoMedia paid commissions of approximately $35,000.

In January 2000, NeoMedia issued an aggregate of 301,368 shares of NeoMedia's common stock at a price of $3.75 per share to ten individual and four institutional unrelated parties. In connection with the sale, NeoMedia also issued an aggregate of 12,570 warrants with an exercise price of $7.19, 5,400 warrants with an exercise price of $6.44, and 12,167 warrants with an exercise price of $7.37. The gross proceeds of such transaction were approximately $1,130,000. In connection with the sale, NeoMedia issued as commissions 9,502 shares of its common stock valued at $7.09 per share.

In February 2000, NeoMedia issued 39,535 shares of NeoMedia's common stock at a price of $6.88 per share to one individual and one institutional unrelated party. In connection with the sale, NeoMedia also issued 2,500 warrants with an exercise price of $12.74 and 1,454 warrants with an exercise price of $9.56. The gross proceeds of such transaction were approximately $272,000.

In February 2000, NeoMedia issued 50,000 shares of NeoMedia's common stock at a price of $6.00 per share to an institutional unrelated party. In connection with the sale, NeoMedia also issued 2,982 warrants with an exercise price of $10.06. The gross proceeds of such transaction were approximately $300,000.

In February 2000, NeoMedia issued 37,500 shares of NeoMedia common stock upon the exercise of outstanding warrants at a price of $2.00 per share. The gross proceeds of such transaction were approximately $75,000.

In March 2000, NeoMedia issued an aggregate of 1,000,000 shares of NeoMedia's common stock at a price of $7.50 per share to 20 individual and one institutional unrelated party. The gross proceeds of such transaction were approximately $7,500,000. In connection with the sale, NeoMedia issued as a commission 125,000 warrants to purchase shares of NeoMedia common stock at an exercise price of $7.50 per share, 125,000 warrants to purchase shares of NeoMedia common stock at an exercise price of $15.00 per share, and 100,000 warrants to purchase shares of NeoMedia common stock at an exercise price of $7.20 per share.

In May 2000, NeoMedia issued 187,500 shares of NeoMedia common stock upon the exercise of outstanding warrants at a price of $7.38 per share. The gross proceeds of such transaction were approximately $1,383,000.

In October 2000, NeoMedia issued warrants to purchase 1,400,000 shares of common stock at a price of $6.00 per share to Digital:Convergence Corporation as consideration for a 10-year intellectual property license agreement.

In March and April 2001, NeoMedia issued 316,500 shares of NeoMedia's common stock at a price of $3.40 per share to four unrelated institutional parties. The gross proceeds of such transaction were approximately $1,076,000. In connection with the sale, NeoMedia issued as a commission 50,000 warrants to purchase shares of NeoMedia common stock at an exercise price of $3.56 per share.

In March 2001, NeoMedia issued 18,000 shares of NeoMedia's common stock at a price of $3.41 per share to an institutional unrelated party. The gross proceeds of such transaction were $61,000.

In March 2001, NeoMedia issued 156,250 shares of NeoMedia's common stock at a price of $3.20 per share to an institutional unrelated party. The gross proceeds of such transaction were $500,000.

In March 2001, NeoMedia issued an aggregate of 170,000 shares of NeoMedia common stock upon the exercise of outstanding warrants at a price of $2.13 per share. The gross proceeds of such transaction were approximately $362,000.

In March 2001, NeoMedia placed 1,676,500 shares of NeoMedia common stock in escrow in exchange for certain assets and liabilities of Qode.com, Inc.. The

shares are subject to earn-out under a sale and purchase agreement with

Qode.com, Inc. In connection with the sale and purchase agreement, the Company also issued 274,699 shares of NeoMedia common stock to certain of Qode.com, Inc.'s debtholders.

In April 2001, NeoMedia issued warrants to purchase 50,000 shares of common stock at a price of $0.01 per share to an outside institution for services performed

In May 2001, NeoMedia issued an aggregate of 320,050 shares of NeoMedia common stock upon the exercise of outstanding warrants at a price of $2.00 per share. The gross proceeds of such transaction were $641,000.

In June 2001, NeoMedia issued an aggregate of 4,100 shares of NeoMedia common stock upon the exercise of outstanding warrants at a price of $2.00 per share. The gross proceeds of such transaction were $8,000.

In July 2001, NeoMedia issued an aggregate of 11,300 shares of NeoMedia common stock upon the exercise of outstanding warrants at a price of $2.00 per share. The gross proceeds of such transaction were $23,000.

In September 2001, the Company released from escrow 35,074 shares of its common stock under the terms of the Company's sale and purchase agreement with Qode.com, Inc. The shares were payment for first and second contract quarter performance under the earn-out plan included in the sale and purchase agreement.

In November 2001, NeoMedia issued an aggregate of 3,000,000 shares of our common stock to two unrelated parties at a price of $0.08 per share. These shares were subsequently cancelled and re-issued as part of a 19 million share offering during the first quarter of 2002.

In January 2002, the Company issued 452,489 shares of common stock to About.com, Inc. The shares were issued upon conversion of 452,489 shares of Series B Preferred Stock issued to About.com, Inc. as payment for advertising expense incurred during 2001.

In January 2002, NeoMedia issued 1,646,987 shares of common stock to two unrelated vendors as settlement of past-due accounts payable and future payments under equipment lease agreements. There were no cash proceeds to NeoMedia in these transactions.

In February 2002, NeoMedia issued 19,000,000 shares of NeoMedia's common stock at a price of $0.17 per share to five individuals and two institutional unrelated parties. The shares were issued in exchange for limited recourse promissory notes maturing at the earlier of i.) 90 days from the date of issuance, or ii.) 30 days from the date of registration of the shares. The gross proceeds of such transaction will be approximately $3,230,000 upon maturity of the notes.

The above issuances of securities were made by the Company in reliance on exemptions from registration contained in Section 4(2) of the Securities Act of 1933, as amended, and the rules and regulations thereunder, as offerings not involving a public offering.

ITEM 6. SELECTED FINANCIAL DATA

The following data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and the related notes appearing in Item 8.

SELECTED FINANCIAL DATA

	RESULTS FOR THE YEAR ENDED DECEMBER 31,			
	1996 (ACTUAL)	1997 (ACTUAL)	1998 (ACTUAL)	1999 (ACTUAL)
			(in thousands, except share	
CONSOLIDATED STATEMENT OF OPERATIONS DATA:				
Revenues	$17,518	$24,434	$23,478	$25,256
Cost of sales	14,948	20,070	19,149	22,470
Gross margin	2,570	4,364	4,329	2,786
Operating expenses	4,949	10,268	15,945	13,032
Digital Convergence write-off	--	--	--	--
Loss on impairment of assets	--	--	--	--
Loss from operations	(2,379)	(5,904)	(11,616)	(10,246)
Interest expense/(income)	540	147	(121)	226
Income tax provision/(benefit)	156	(78)	--	--
Loss from continuing operations	(3,075)	(5,973)	(11,495)	(10,472)
Loss from operations and disposal of discontinued business unit	--	--	--	--
Net loss	($3,075)	($5,973)	($11,495(	$10,472)
LOSS PER SHARE DATA:				
Loss per share from continuing operations	($0.72)	($0.90)	($1.34)	($1.01)
Net loss per share	($0.72)	($0.90)	($1.34)	($1.01)
Weighted average common shares outstanding (basic and diluted)	4,266,753	6,615,107	8,560,841	0,377,4713
CONSOLIDATED BALANCE SHEET DATA:				
Total assets	$11,266	$19,799	$12,630	$13,657
Long-term debt	1,589	915	801	676

(a) - Includes $22,518,000 of assets related to Digital Convergence license contract that were written off during 2001

(b) - Includes $13,503,000 of long-term deferred revenue related to Digital Convergence license contract that was written off during 2001

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

OVERVIEW

During 2001, the company's continued focus was aimed toward its Internet Switching Systems (NISS, formerly NAS) business. NISS consists of the patented PaperClickTM technology that enables users to link directly from the physical to the digital world. NeoMedia's mission is to invent, develop, and commercialize technologies and products that effectively leverage the integration of the physical and electronic to provide clear functional value for the Company's end-users, competitive advantage for their business partners and return-on-investment for their investors. Additionally, the Company has retained the services of the intellectual property law firm of Baniak Pine & Gannon to pursue license agreements surrounding NeoMedia's valuable patent portfolio.

In March 2001, the Company purchased substantially all the assets of Qode.com, Inc. In August 2001, the Company entered into a letter of intent with a third party to purchase the assets and assume certain of the liabilities related to the business unit. The discontinuation of the Qode business unit resulted in a loss from disposal of discontinued business unit of $3.1 million in 2001. Additionally, the loss from operations of the business unit during 2001was $3.6 million. (see also Footnote 2 in the accompanying financial statements)

RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2001 AS COMPARED TO THE YEAR ENDED DECEMBER 31, 2000

NET SALES. Total net sales for the year ended December 31, 2001 were $8.1 million, which represented a $19.5 million, or 70.1%, decrease from $27.6 million for the year ended December 31, 2000. This decrease primarily resulted from reduced resales of Sun Microsystems equipment due to increased competition and general economic conditions. Additionally, we recognized $7.8 million of revenue in 2000 related to the DC license contract. No revenue was recognized related to this contract in 2001. The Company expects net sales in 2002 will increase significantly from 2001, due to a resurgence in demand for software and technology equipment and services, combined with anticipated revenue streams from intellectual property licenses.

Total net sales during the fourth quarter of 2001 were $4.5 million, compared with $0.9 million in the third quarter of 2001, $1.2 million in the second quarter of 2001, and $1.5 million in the first quarter of 2001. The fourth-quarter increase is primarily due to a large Storage Area Network (SAN) sale of $1.1 million in that quarter. Additionally, sales from the Company's Consulting and Integration Services business unit have been historically higher in the fourth quarter of the calendar year.

LICENSE FEES. License fees were $0.6 million for the year ended December 31, 2001, compared with $8.4 million for the year ended December 31, 2000, a decrease of $7.8 million, or 92.9%. The decrease resulted primarily from the recognition of $7.8 million revenue during 2000 related to the Digital:Convergence license contract. No revenue was recognized related to this contract in 2001. The Company is anticipating license revenue growth in 2002 compared with 2001 as it aggressively pursues license contracts relating to its intellectual property.

RESALES OF SOFTWARE AND TECHNOLOGY EQUIPMENT AND SERVICE FEES. Resales of software and technology equipment and service fees decreased by $11.5 million, or 63.4%, to $7.6 million for the year ended December 31, 2001, as compared to $19.1 million for the year ended December 31, 2000. This decrease primarily resulted from fewer sales of Sun Microsystems hardware due to increased competition and general economic conditions. The Company believes that resurgent demand for such products, combined with the Company's movement into higher margin and Value-Add products and services such as Storage Area Networks, will result in increased revenue from resales of software and technology equipment and service fees during 2002.

COST OF SALES. Cost of resales as a percentage of related resales was 86.0% in 2001, compared to 90% in 2000. This decrease is substantially due to a sales mix of higher-margin products such as service fees and maintenance contracts.

SALES AND MARKETING. A portion of the compensation to the sales and marketing staff constitutes salary and is fixed in nature and the remainder of this compensation, which is paid as a commission, is directly related to sales volume. Sales and marketing expenses were $2.5 million for the year ended December 31, 2001, compared to $6.5 million for the year ended December 31, 2000, a decrease of $4.0 million or 61.5%. This decrease primarily resulted from fewer marketing personnel in 2001, coupled with a decrease in sales commissions from reduced sales. Sales and marketing expense will continue to decrease in 2002 as the Company moves away from its applications service provider model.

GENERAL AND ADMINISTRATIVE. General and administrative expenses decreased by $2.2 million, or 30.1%, to $4.8 million for the year ended December 31, 2001, compared to $7.2 million for the year ended December 31, 2000. The decrease is

primarily related to a reduction in personnel as a result of the Company's cost reduction initiative. General and administrative expenses will continue to decline in 2002 as the Company realizes the full-year benefit of cost-reduction measures begun in the fourth quarter of 2001.

RESEARCH AND DEVELOPMENT. During the year ended December 31, 2001, NeoMedia charged to expense $0.5 million of research and development costs, a decrease of $0.6 million or 54.5% compared to $1.1 million charged to expense for the year ended December 31, 2000. This decrease is predominately associated with decreased personnel devoted to NeoMedia's development during the second half of 2001, combined with increased capitalization of software development costs associated with NeoMedia's "switching" platform and the Qode Universal Commerce Solution during the first half of 2001. Research and development expense will continue to decrease in 2002 as the Company moves away from its applications service provider model

LOSS ON IMPAIRMENT OF ASSETS. During the third quarter of 2001, the Company wrote off all assets associated with its discontinued MLM/Affinity product line, resulting in an impairment charge of $2.9 million.

LOSS ON DIGITAL:CONVERGENCE. During the second quarter of 2001, the Company wrote off all assets and liabilities relating to its intellectual property license with Digital:Convergence, resulting in a net charge of $7.4 million.

INTEREST EXPENSE (INCOME), NET. Interest expense/(income) consists primarily of interest paid to creditors as part of financed purchases, notes payable and NeoMedia's asset-based collateralized line of credit net of interest earned on cash equivalent investments. Interest (income) decreased by $153,000, or 87.9%, to $(21,000) for the year ended December 31, 2001 from $(174,000) for the year ended December 31, 2000, due to reduced cash balances throughout 2001 as compared to 2000.

LOSS FROM CONTINUING OPERATIONS. During the year ended December 31, 2001, the Company's loss from continuing operations increased by $13.4 million or 248.1% from $5.4 million in 2000 to $18.8 million in 2001. This increase is primarily due to the loss on the Digital:Convergence license contract of $7.4 in the second quarter of 2001 and an impairment loss of $2.8 million in the third quarter of 2001 related to the discontinuation of the Company's MLM/Affinity product line.

LOSS FROM OPERATIONS AND DISPOSAL OF DISCONTINUED OPERATIONS. The Company discontinued operations of its Qode business unit in 2001, resulting in a loss from operations of discontinued business units of $3.6 million. There was no loss from this business unit during 2000. The business unit's assets were purchased in March 2001 and the implementation was cancelled during the second quarter of 2001.

LOSS ON DISPOSAL OF DISCONTINUED OPERATIONS. The Company sustained a loss of $3.1 million in 2001 from the disposal of the Qode business unit in 2001.

NET LOSS. The net loss for the year ended December 31, 2001 was $25.5 million, which represented a $20.1 million, or 372.2% increase from a $5.4 million loss for the year ended December 31, 2000. The increase in net loss is due primarily to the loss on the Digital:Convergence contract, an impairment loss of in the third quarter of 2001 related to the discontinuation of the Company's MLM/Affinity product line and the discontinuation of the Company's Qode business unit, and reduced resales of software and technology equipment and service fees resulting from increased competition and general economic conditions, offset by lower expenses as a result of the Company's cost reduction effort.

RESULTS OF OPERATIONS FOR THE YEAR ENDED DECEMBER 31, 2000 AS COMPARED TO THE YEAR ENDED DECEMBER 31, 1999

NET SALES. Total net sales for the year ended December 31, 2000 were $27.6 million, which represented a $2.3 million, or 9.1%, increase from $25.3 million for the year ended December 31, 1999. This increase primarily resulted from intellectual property (IP) license contract signed with Digital Convergence offset by decreased sales of Y2K licenses and services from $3.3 million in 1999 to $0.1 million in 2000.

LICENSE FEES. Total license fees increased from $2.4 million to $8.4 million, or 250.0%, for the years ended December 31, 1999 and December 31, 2000. The increase was due to a license agreement, entered into during the fourth of quarter of 2000, between NeoMedia and Digital Convergence Corporation ("DC"), granting DC a worldwide, non-exclusive license of the Company's patent portfolio for directly linking documents, objects, and transactions directly to the Internet. Revenue from this agreement totaled $7.8 million in 2000. This was offset by a decrease of $1.8 million due to the discontinuation of the Company's

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Y2K product line. Cost of sales as a percentage of related sales was 15.4% during 2000 compared to 73.7% during 1999. This decrease in the cost of sales as a percentage of related sales was primarily due to DC license sale in 2000 and the discontinuation of Y2K licenses on which the Company paid royalties.

RESALES OF SOFTWARE AND TECHNOLOGY EQUIPMENT AND SERVICE FEES. Resales of software and technology equipment and service fees decreased by $3.7 million, or 16.1%, to $19.1 million for the year ended December 31, 2000, as compared to $22.8 million for the year ended December 31, 1999. This decrease primarily resulted from decreased resales of IBM equipment due to discontinuation of sales in our Canadian market. Also contributing to the decrease was reduced service revenue from Y2K products of $1.6 million. Cost of sales as a percentage of related sales decreased to 90.0% during 2000 from 90.5% during 1999.

SALES AND MARKETING. A portion of the compensation to the sales and marketing staff constitutes salary and is fixed in nature and the remainder of this compensation, which is paid as a commission, is directly related to sales volume. Sales and marketing expenses decreased $0.3 million, or 4.4%, to $6.5 million for the year ended December 31, 2000 from $6.8 million for the year ended December 31, 1999, due to a decrease in NeoMedia's NAS direct sales force, offset by personnel additions in marketing.

GENERAL AND ADMINISTRATIVE. General and administrative expenses increased $1.7 million, or 32.1%, to $7.0 million for the year ended December 31, 2000, from $5.3 million for the year ended December 31, 1999. This increase was due to the accrual of executive performance incentive in 2000. No performance incentive expense was incurred in 1999. Also, increased legal costs of $0.5 million were expensed in 2000.

RESEARCH AND DEVELOPMENT. During the year ended December 31, 2000, NeoMedia charged to expense $1,101,000 of research and development expenses, an increase of $114,000 or 11.6% compared to $986,000 charged to expense for the year ended December 31, 1999. This increase was due to increased resources directed toward the development of the ASP business. To the extent the Company can obtain additional capital, it will continue to make significant investments in research and development.

INTEREST (INCOME) EXPENSE, NET. Interest expense consists primarily of interest paid to creditors as part of financed purchases, capitalized leases and NeoMedia's asset-based collateralized line of credit net of interest earned on cash equivalent investments. Interest expense decreased by $400,000, or 177%, to income of $(174,000) for the year ended December 31, 2000 from $226,000 of expense for the year ended December 31, 1999. This was due to reduced interest expense resulting from the repayment of notes in the first quarter of 2000, as well as interest income from higher cash balances during 2000.

NET LOSS. The net loss for the year ended December 31, 2000 was $5.4 million, which represented a $5.1 million, or 48.6% decrease from a $10.5 million loss for the year ended December 31, 1999. The decrease was primarily due to revenue from the licensing of NeoMedia's intellectual property in 2000. This was offset by a 97% decrease of Y2K revenue in 2000 along with increased general and administrative expenses.

LIQUIDITY AND CAPITAL RESOURCES

NeoMedia anticipates that its existing cash balances and funds available from borrowings under its existing financing agreement will have to be supplemented with additional funds, through loans and/or capital contributions, to finance NeoMedia's operations in 2002. During the first quarter of 2002, the Company has successfully sold 19 million shares of its common stock at a price of $0.17 per share in exchange for limited recourse promissory notes maturing no later than May 2002, resulting in proceeds of $3,230,000 to the Company. The Company expects to obtain an additional $1.0 million of debt and/or equity financing during the first quarter and second quarters of 2002. Management believes tha