NEOMEDIA TECHNOLOGIES INC
Form 10-Q/A
September 22, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

(1st Amendment)

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

For the quarterly period ended March 31, 2014

Or

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

For the transition period from __________ to ____________

Commission File Number 000-21743

NeoMedia Technologies, Inc.

(Exact Name of Issuer as Specified In Its Charter)

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

1515 Walnut Street, Suite 100, Boulder, Colorado 80302

(Address, including zip code, of principal executive offices)

303-546-7946

(Registrants' telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller Reporting Company x

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

Shares outstanding of the Registrant's common stock on April 25, 2014 was 4,984,827,279.

EXPLANATORY NOTE

We are filing this amendment to amend our quarterly report on Form 10-Q for the quarterly period ended March 31, 2014 which was originally filed with the Securities and Exchange Commission on April 30, 2014.

During the three month period ended March 31, 2014, for fair value accounting of the derivative financial instruments and debentures payable, we reassessed the valuation techniques used to estimate the liability fair values. Based on the assessment, we determined that the valuation technique should be modified to consider the potentially dilutive impact on the stock price resulting from the issuance of additional shares of common stock upon the conversion of the instruments as well as the resulting value in comparison to our market capitalization.

On July 16, 2014, after a series of comment letters beginning November 22, 2013, we received correspondence from the Securities and Exchange Commission (“SEC”), requesting that (i) we restate certain of our financial statements by filing amendments to the reports containing such financials, and (ii) we file an 8-K to report non- reliance on such financials. In its correspondence, the SEC asserted that certain modifications in our valuation methodology, deemed as accounting estimates, contained errors with respect to the valuation of convertible debentures issued by us, in that such methodology did not capture the debentures’ potentially dilutive effect upon their conversion into common stock.

We agreed with the SEC’s assertion that certain modifications in our valuation methodology contained errors with respect to the valuation of convertible debentures issued by us. Thus, we are restating our financial statements for the fiscal year ended December 31, 2013 and sections related therewith to reflect the change in valuation technique and correction of the fair value accounting of the derivative financial instruments and debentures payable.

Our operational performance remains unchanged. All other information included in our quarterly report on Form 10-Q for the quarterly period ended March 31, 2014 has not been amended. Except for the matter described above, this amendment does not modify or update disclosures in the originally filed quarterly report on Form 10-Q, or reflect events occurring after April 30, 2014, which is the date of the filing of the originally filed quarterly report on Form 10-Q.

NeoMedia Technologies, Inc.

Form 10-Q/A

(1ST Amendment)

For the Quarterly Period Ended March 31, 2014

Index

PART I — FINANCIAL INFORMATION

ITEM 1. Financial Statements

Restatement of 2014 and 2013 Financial Statements - During the three month period ended March 31, 2014, for fair value accounting of the derivative financial instruments and debentures payable, we reassessed the valuation techniques used to estimate the liability fair values. Based on the assessment, we determined that the valuation technique should be modified to consider the potentially dilutive impact on the stock price resulting from the issuance of additional shares of common stock upon the conversion of the instruments as well as the resulting value in comparison to our market capitalization.

On July 16, 2014, after a series of comment letters beginning November 22, 2013, we received correspondence from the Securities and Exchange Commission, requesting that (i) we restate certain of our financial statements by filing amendments to the reports containing such financials, and (ii) we file an 8-K to report non-reliance on such financials. In its correspondence, the SEC asserted that certain modifications in our valuation methodology, deemed as accounting estimates, contained errors with respect to the valuation of convertible debentures issued by us, in that such methodology did not capture the debentures' potentially dilutive effect upon their conversion into common stock.

We agreed with the SEC's assertion that certain modifications in our valuation methodology contained errors with respect to the valuation of convertible debentures issued by us. Thus, we restated our financial statements as of and for the year ended December 31, 2013 and to reflect the change in valuation technique and correction of the fair value accounting of the derivative financial instruments and debentures payable. As discussed in Note 1 and Note 2 to the Condensed Consolidated Financial Statements we also restated our results of operations for the three months ended March 31, 2014 and 2013.

NeoMedia Technologies, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except share and per share data)

	March 31, 2014 (UNAUDITED)	December 31, 2013 (RESTATED)
ASSETS		
Current assets:		

Cash and cash equivalents	$ 266	$ 267
Accounts receivable	386	295
Prepaid expenses and other current assets	88	107
Total current assets	740	669
Property and equipment, net	4	5
Goodwill	3,418	3,418
Patents and other intangible assets, net	1,144	1,213
Other long-term assets	20	-
Total assets	$ 5,326	$ 5,305
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	$ 334	$ 236
Accrued expenses	473	291
Deferred revenues and customer prepayments	1,971	2,252
Notes payable	28	56
Derivative financial instruments – warrants	247	620
Derivative financial instruments - Series C and D Convertible Preferred Stock and debentures payable	159	296
Debentures payable - carried at fair value	38,795	38,250
Total current liabilities	42,007	42,001
Commitments and contingencies	-	-
Series C convertible preferred stock, $0.01 par value, 27,000 shares authorized, 4,816 shares issued and outstanding and a liquidation value of $4,816 at March 31, 2014 and December 31, 2013	4,816	4,816
Series D convertible preferred stock, $0.01 par value, 25,000 shares authorized, 3,481 shares issued and outstanding with a liquidation value of $348 at March 31, 2014 and December 31, 2013	348	348
Shareholders' deficit:		
Common stock, $0.001 par value, 5,000,000,000 shares authorized, 4,984,827,279 and 332,321,819 shares issued and outstanding as of March 31, 2014 and December 31, 2013	4,985	4,985
Additional paid-in capital	190,946	190,946
Accumulated deficit	(236,895)	(236,910)
Accumulated other comprehensive loss	(102)	(102)
Treasury stock, at cost, 2,012 shares of common stock	(779)	(779)
Total shareholders' deficit	(41,845)	(41,860)
Total liabilities and shareholders' deficit	$ 5,326	$ 5,305

See accompanying notes.

NeoMedia Technologies, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations and Comprehensive Income (Unaudited)

(in thousands, except share and per share data)

	Three Months Ended March 31, 2014 (RESTATED)	2013 (RESTATED)
Revenues	$1,003	$602
Cost of revenues	158	31
Gross profit	845	571
Sales and marketing expenses	15	61
General and administrative expenses	603	857
Research and development costs	177	212
Operating income (loss)	50	(559)
Gain (loss) from change in fair value of hybrid financial instruments	(545)	24,487
Gain from change in fair value of derivative liability – warrants	373	3,166
Gain from change in fair value of derivative liability - Series C and D Convertible Preferred Stock and debentures	137	1,943
Net income	$15	$29,037
Comprehensive income:		
Net income	$15	$29,037
Foreign currency translation adjustment	-	111
Comprehensive income	$15	$29,148
Net income per common share, basic and diluted:		
Basic	$0.000	$0.010
Fully diluted	$0.000	$0.001
Weighted average number of common shares:		
Basic	4,984,827,279	2,789,315,439
Fully diluted	266,001,250,808	27,931,664,140

See accompanying notes.

NeoMedia Technologies, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Unaudited)

(in thousands)

	Three Months Ended March 31,	
	2014 (RESTATED)	2013 (RESTATED)
Cash Flows from Operating Activities:		
Net income	$ 15	$ 29,037
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	70	179
(Gain) loss from change in fair value of hybrid financial instruments	545	(24,487)
Gain from change in fair value of derivative liability – warrants	(373)	(3,166)
Gain from change in fair value of derivative liability - Series C and D Convertible Preferred Stock and debentures	(137)	(1,943)
Changes in operating assets and liabilities		
Accounts receivable	(91)	(59)
Prepaid expenses and other assets	(1)	175
Accounts payable and accrued expenses	280	105
Deferred revenues and customer prepayments	(281)	(388)
Net cash provided by (used in) operating activities	27	(547)
Cash Flows from Investing Activities:		
Net cash from investing activities	-	-
Cash Flows from Financing Activities:		
Payments on short-term notes payable	(28)	-
Net cash used in financing activities	(28)	-
Effect of exchange rate changes on cash	-	(2)
Net change in cash and cash equivalents	(1)	(549)
Cash and cash equivalents, beginning of period	267	611
Cash and cash equivalents, end of period	$ 266	$ 62
Supplemental cash flow information:		
Convertible debentures converted to common stock	$ -	$ 320

See accompanying notes.

NeoMedia Technologies, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

March 31, 2014

(Unaudited)

Note 1 – General

NeoMedia Technologies, Inc. (the "Company," "NeoMedia," "we," "us," "our," and similar terms), a Delaware corporation, was founded in 1989 and is headquartered in Boulder, Colorado. We have positioned ourselves to lead the development of 2D mobile barcode technology and infrastructure solutions that enable the mobile barcode ecosystem world-wide. NeoMedia harnesses the power of the mobile phone in innovative ways with state-of-the-art mobile barcode technology solutions. With this technology, mobile devices with cameras become barcode scanners, enabling a range of practical applications including mobile marketing and mobile commerce. In addition, we offer licensing of our extensive intellectual property portfolio.

The accompanying unaudited condensed consolidated financial statements have been prepared without audit pursuant to the rules and regulations of the United States Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with US GAAP have been condensed or omitted pursuant to such rules and regulations, although we believe that the disclosures made are adequate to make the information not misleading. We believe these statements include all adjustments, which are of a normal and recurring nature, considered necessary for a fair presentation of the financial statements. The unaudited condensed consolidated financial statements included herein should be read in conjunction with the financial statements and notes thereto included in our annual report on Form 10-K filed with the SEC on March 17, 2014 and its subsequent amendment. The results of operations for the three months ended March 31, 2014 are not necessarily indicative of the results to be expected for the full year. In addition, as we communicated in a Periodic Report on Form 8-K on July 29, 2014, we are restating certain of our financial statements by filing amendments to our previously filed Form 10-K for December 31, 2013 (and interim periodic reports on Form 10-Q).   We and the SEC have concluded that certain modifications in the Company's valuation methodology, deemed as accounting estimates by the Company, contained errors with respect to the valuation of convertible debentures issued by the Company, in that such methodology did not capture the debentures' potentially dilutive effect upon their conversion into common stock. Please see the disclosure immediately below entitled "Restatement to 2014 and 2013 Interim Reporting and of the December 31, 2013 Balance Sheet" for further information as these changes in valuation methodology has affected our previously filed interim report on Form 10-Q for March 31, 2014.

Note 2 – Summary of Significant Accounting Policies

Basis of Presentation – The condensed consolidated financial statements include the accounts of NeoMedia and its wholly-owned subsidiaries. We operate as one reportable segment. All intercompany accounts, transactions and profits have been eliminated in consolidation. Certain prior period amounts in the condensed consolidated financial statements and notes thereto have been reclassified to conform to the current year's presentation.

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

Change in Estimates – For the three month period ended March 31, 2013 fair value accounting of the derivative financial instruments and debentures payable, we reassessed the valuation techniques used to estimate the liability fair values. Based on the assessment, including discussions with the third-party valuation firm assisting us with the calculation, we determined that the valuation technique should be modified to consider the potentially dilutive impact on the stock price resulting from the issuance of additional shares of common stock upon the conversion of the instruments as well as the resulting value in comparison to our market capitalization.

The modification of the valuation technique represents a change in accounting estimate as discussed in Accounting Standards Codification ("ASC") Topic 250-10-45-17, *Accounting Changes and Error Corrections*. The impact from the modification in valuation technique has therefore been reflected in the period of change and will be reflected in future periods. See Note 3 – Financing for additional discussion.

Going Concern – We have historically incurred operating losses, and we may continue to generate negative cash flows as we implement our business plan. There can be no assurance that our continuing efforts to execute our business plan will be successful and that we will be able to continue as a going concern. The accompanying condensed consolidated financial statements have been prepared in conformity with US GAAP, which contemplates our continuation as a going concern given fair value accounting related to our debentures. Our net income for the three months ended March 31, 2014 and 2013 was $15,000 as compared to $29.0 million, respectively, including $35,000 and $29.6 million, respectively, of net gains related to our financing instruments.

Net cash provided by operations during the three months ended March 31, 2014 was $27,000 as compared to net cash used in operations of $0.5 million during the three months ended March 31, 2013. As of March 31, 2014, we have an accumulated deficit of $236.9 million. We also have a working capital deficit of $41.3 million, including $39.2 million in current liabilities for our derivative and debenture financing instruments.

We currently do not have sufficient cash or commitments for financing to sustain our operations for the next twelve months if we are unable to generate sufficient cash flows from operations. Our plan is to develop new client and customer relationships and substantially increase our revenue derived from our products/services and IP licensing. If our revenues do not reach the level anticipated in our plan, we may require additional financing in order to execute our operating plan. If additional financing is required, we cannot predict whether this additional financing will be in the form of equity, debt, or another form, and we may not be able to obtain the necessary additional capital on a timely basis, on acceptable terms, or at all. In the event that financing sources are not available, or that we are unsuccessful in increasing our revenues and profits, we may be unable to implement our current plans for expansion, repay our debt obligations or respond to competitive pressures, any of which would have a material adverse effect on our business, prospects, financial condition and results of operations.

The convertible debentures and preferred stock used to finance the Company, which may be converted into common stock at the sole option of the holders, have a highly dilutive impact when they are converted, greatly increasing the number of shares of common stock outstanding. During 2013, there were 2,879 million shares of common stock issued for these conversions. We cannot predict if or when each holder may or may not elect to convert into shares of common stock.

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

Restatement to 2014 and 2013 Interim Reporting – As noted above and disclosed initially in our Periodic Report on Form 8-K on July 29, 2014, during the three month period ended March 31, 2014, for fair value accounting of the derivative financial instruments and debentures payable, we reassessed the valuation techniques used to estimate the liability fair values. Based on the assessment, including discussions with the third-party valuation firm assisting us with the calculation, we determined that the valuation technique should be modified to consider the potentially dilutive impact on the stock price resulting from the issuance of additional shares of common stock upon the conversion of the instruments as well as the resulting value in comparison to our market capitalization.

We agree with the SEC's assertion that certain modifications in our valuation methodology contained errors with respect to the valuation of convertible debentures issued by us. We are restating the March 31, 2014 and 2013 three month periods to reflect the change in valuation technique and correction of the fair value accounting of the derivative financial instruments and debentures payable. In addition, we are also restating our December 31, 2013 Balance Sheet as it pertains to the Fair Value of our Warrants, Preferred Series C & D and Convertible Debentures to amounts as stated below from how they were reported as of December 31, 2013 in our 10-K:

	December 31, 2013 (as previously reported)	Adjustments	December 31, 2013 (Restated)
Derivative Financial Instruments – warrants	$ 684	$ (64)	$ 620
Derivative Financial Instruments – Series C and D PS and DP	$ 23,606	$ (23,310)	$ 296
Debentures payable – carried at fair value	$ 257,451	$ (219,201)	$ 38,250
Total Liabilities	$ 284,576	$ (242,575)	$ 42,001
Accumulated deficit	$ (479,485)	$ 242,575	$ (236,910)
Total shareholders' deficit	$ (284,435)	$ 242,575	$ (41,860)

The table below reflects the changes in restating the derivative liabilities for the three months ended March 31, 2014 (in thousands):

Derivative Liability Restatement for the 3 months ended March 31, 2014:

	3 Months. March 31, 2014 (as previously reported)	Adjustments	3 Months. March 31, 2014 (Restated)
Gain (loss) from change in fair value of hybrid financial instruments	$ 218,656	$ (219,201)	$ (545)
Gain (loss) from change in fair value of derivative liability – warrants	$ 437	$ (64)	$ 373
Gain (loss) from change in fair value of derivative liability – Series C & D	$ 23,447	$ (23,310)	$ 137
Net income	$ 242,590	$ (242,575)	$ 15
Net income available to common shareholders	$ 242,590	$ (242,575)	$ 15
Comprehensive income	$ 242,590	$ (242,575)	$ 15

Page 8

Statement of Cash Flow:

	3 Months. March 31, 2014 (as previously reported)	Adjustments	3 Months. March 31, 2014 (Restated)
Net income	$ 242,590	$ (242,575)	$ 15
Gain (loss) from change in fair value of hybrid financial instruments	$ (218,656)	$ 219,201	$ 545
Gain (loss) from change in fair value of derivative liability – warrants	$ (437)	$ 64	$ (373)
Gain (loss) from change in fair value of derivative liability – Series C & D	$ (23,447)	$ 23,310	$ (137)
Net cash used in operating activities	$ 27	$ -	$ 27

The table below reflects the changes in restating the derivative liabilities for the three months ended March 31, 2013 (in thousands):

Derivative Liability Restatement for the 3 months ended March 31, 2013:

	3 Months. March 31, 2013 (as previously reported)	Adjustments	3 Months. March 31, 2013 (Restated)
Gain (loss) from change in fair value of hybrid financial instruments	$ 6,774	$ 17,713	$ 24,487
Gain (loss) from change in fair value of derivative liability – warrants	$ 3,122	$ 44	$ 3,166

Gain (loss) from change in fair value of derivative liability – Series C & D	$	(299	)	$	2,242	$	1,943
Net income	$	9,038		$	19,999	$	29,037
Net income available to common shareholders	$	9,038		$	19,999	$	29,037
Comprehensive income	$	9,149		$	19,999	$	29,148

Page 9

Statement of Cash Flow:

	3 Months. March 31, 2013 (as previously reported)	Adjustments	3 Months. March 31, 2013 (Restated)
Net income	$ 9,038	$ 19,999	$ 29,037
Gain (loss) from change in fair value of hybrid financial instruments	$ (6,774)	$ (17,713)	$ (24,487)
Gain (loss) from change in fair value of derivative liability – warrants	$ (3,122)	$ (44)	$ (3,166)
Gain (loss) from change in fair value of derivative liability – Series C & D	$ 299	$ (2,242)	$ (1,943)
Net cash used in operating activities	$ (547)	$ -	$ (547)

In addition to the material misstatement related to our change in valuation methodologies described above, and of the December 31, 2013 Balance Sheet, in connection with the completion of our third quarter 2013 and first quarter 2013 reporting, we identified certain errors associated with our first quarter 2013 interim reporting. We assessed the impact of these errors and concluded that the errors did not result in a material misstatement. To correct the errors, we have restated the three months ended March 31, 2013 reporting as discussed below. Our assessment considered the guidance provided by ASC Topic 250, *Accounting Changes and Error Corrections* and ASC Topic 250-10-S99-1, *Assessing Materiality*. Based on our conclusion that the errors were not material individually or in aggregate to any of the prior reporting periods, we determined amendments to previously filed financial statement reports were not required in accordance with the applicable ASC guidance. We also concluded that the revisions applicable to prior periods should be reflected herein and will be reflected in future filings containing such information.

The condensed consolidated statements of operations for the three months ended March 31, 2013 included a clerical error resulting in the foreign currency translation adjustment within comprehensive income (loss) reflecting a $111,000 loss but should have reflected a $111,000 gain. The reporting has been revised herein to reflect the proper amounts.

The condensed consolidated statements of cash flows for the three months ended March 31, 2013 overstated net cash used in operating activities and the effect of exchange rate changes on cash by approximately $113,000. The revised net cash used in operating activities was approximately $547,000 and the effect of exchange rate changes on cash was negative $2,000. The amounts have been restated herein to reflect the proper amounts.

As discussed in Note 4 – Financing, we are limited to issuing shares of common stock in connection with preferred stock and debenture conversions at no less than par value. The methodology used to determine the number of common stock shares issued for debentures and preferred stock is based upon the market value received for the shares issued, and any short-fall between the par value of the shares issued and the market value of the shares is recorded as a deemed dividend. During the three months ended March 31, 2013, the conversion of debentures and Series C Preferred Stock resulted in deemed dividends of $681,000 and $16,000, respectively, and the deemed dividend amounts were not reflected in the net loss available to common shareholders. The reporting herein has been revised to reflect the proper amounts.

Basic and Diluted Net Income Per Common Share – The components of basic and diluted income per share attributable to the Company's common stock shareholders were as follows (in thousands, except share and per share data):

	Three Months Ended March 31, 2014 (RESTATED)		2013 (RESTATED)	
Numerator:				
Net income available to common shareholders	$15		$29,037	
Effect of dilutive securities:				
Hybrid financial instruments	(545	)	(24,487	)
Derivative liability – warrants	373	)	3,166	
Derivative liability - Series C and D Convertible Preferred Stock and debentures	137	)	1,943	
Numerator for diluted income per common share	$(20	)	$9,659	
Denominator:				
Weighted average shares used to compute basic income per common share	4,984,827,279		2,789,315,439	
Effect of dilutive securities:				
Hybrid financial instruments	233,957,214,103		32,949,714	
Derivative liability - warrants	440,652,725		2,083,292	
Derivative liability - Series C and D preferred stock and debentures	26,618,556,701		3,398,694	
Denominator for diluted income per common share	266,001,250,808		27,931,664,140	
Basic income per common share	$0.000		$0.010	
Diluted income per common share	$0.000		$0.001	

We excluded approximately 1,173,000 and 1,883,833,000 dilutive securities from the calculation of diluted income per common share for the three months ended March 31, 2014 and 2013, respectively, because inclusion of these securities would be antidilutive.

Recent Accounting Pronouncements – From time to time, new accounting pronouncements are issued that we adopt as of the specified effective date. We believe that the impact of recently issued standards that are not yet effective will not have a material impact on our results of operations and financial position.

Note 3 – Financing

At March 31, 2014, financial instruments arising from our financing transactions with YA Global Investments, L.P. ("YA Global"), an accredited investor, included shares of our Series C Convertible Preferred Stock issued in February 2006, Series D Convertible Preferred Stock issued in January 2010, a series of six consolidated secured convertible debentures (the "Consolidated Debentures") issued July 1, 2013 and various warrants to purchase shares of our common stock. All of our assets are pledged to secure our obligations under the debt securities. At various times, YA Global has assigned or distributed portions of its holdings of these securities to other holders, including persons who are officers of YA Global and its related entities, as well as to other holders who are investors in YA Global's funds.

Secured Debentures – We had originally entered into financing transactions with YA Global, which included a series of twenty-seven secured convertible debentures issued between August 2006 and July 2012. Effective July 1, 2013, the terms of the debentures held by YA Global were modified to consolidate the principal and interest amounts outstanding under all of the outstanding secured convertible debentures previously issued by us to YA Global, such that, upon the issuance of the Consolidated Debentures and cancellation of the prior debentures, the amount of outstanding debentures issued to YA Global decreased from twenty-seven to six debentures. The maturity dates of these secured convertible debentures were also extended from August 1, 2014 to August 1, 2015.

The underlying agreements for each of the Consolidated Debentures are very similar in form. The Consolidated Debentures are convertible into our common stock, at the option of the holder, at the lower of a fixed conversion price per share or a percentage of the lowest volume-weighted average price ("VWAP") for a specified number of days prior to the conversion (the "look-back period"). The conversion is limited such that the holder cannot exceed 9.99% ownership of the outstanding common stock, unless the holder waives their right to such limitation. All of the debentures are secured according to the terms of a Security Pledge Agreement dated August 23, 2006, which was entered into in connection with the first convertible debenture issued to YA Global and which provides YA Global with a security interest in substantially all of our assets. The debentures are also secured by a Patent Security Agreement dated July 29, 2008. On August 13, 2010, our wholly owned subsidiary, NeoMedia Europe GmbH, became a guarantor of all outstanding financing transactions between us and YA Global, through pledges of their intellectual property and other movable assets. As security for our obligations to YA Global, all of our Pledged Property, Patent Collateral and other collateral is affirmed through the several successive Ratification Agreements executed in connection with each of the 2010, 2011 and 2012 financings. The 2013 modification and consolidation of the outstanding secured convertible debentures as well as the execution of an Amended and Restated Patent Security Agreement in 2013 reaffirmed the Pledged Property, Patent Collateral and other collateral pledged as security for our obligations to YA Global.

We evaluated the financing transactions in accordance with ASC 815, *Derivatives and Hedging*, and determined that the conversion features of the Series C and Series D Convertible Preferred Stock and the Consolidated Debentures were not afforded the exemption for conventional convertible instruments due to their variable conversion rates. The contracts have no explicit limit on the number of shares issuable, so they did not meet the conditions set forth in current accounting standards for equity classification. Accordingly, either the embedded derivative instruments, including the conversion option, must be bifurcated and accounted for as derivative instrument liabilities or, as permitted by ASC 815-15-25-4, *Recognition of Embedded Derivatives*, the instruments may be carried in their entirety at fair value.

At inception, we elected to bifurcate the embedded derivatives related to the Series C and Series D Convertible Preferred Stock, while electing the fair value option for the Consolidated Debentures. ASC 825, Fi*nancial Instruments*, allows us to elect the fair value option for recording financial instruments when they are initially recognized or if there is an event that requires re-measurement of the instruments at fair value, such as a significant modification of the debt.

On February 4, 2013, we entered into a Debenture Extension Agreement with YA Global to extend the maturity dates of the secured convertible debentures to August 1, 2014. Because the effect of the extension did not exceed a significance threshold relative to cash flows prescribed by ASC 470-50, *Debt Modifications and Extinguishments*, extinguishment accounting was not applicable. On July 1, 2013, in addition to consolidating the secured debentures into six Consolidated Debentures, the maturity date was extended to August 1, 2015. Four of the Consolidated Debentures are non-interest bearing while the remaining two Consolidated Debentures accrue interest at 9.5% as outlined in further detail below. Debentures assigned to other investors by YA Global were also modified effective July 1, 2013 to extend the maturity date to August 1, 2015. We evaluated the impact of the modification on the accounting for the Consolidated Debentures in accordance with ASC 470-50-40-6 through 12 to determine whether extinguishment accounting was appropriate. Because the effect of the extension did not exceed a significance threshold relative to cash flows prescribed by ASC 470-50, *Debt Modifications and Extinguishments*, extinguishment accounting was not applicable.

The following table summarizes the significant terms of each of the debentures for which the entire hybrid instrument is recorded at fair value as of March 31, 2014:

				Conversion Price – Lower of Fixed Price or Percentage of VWAP for Look-back period		
Debenture Issuance Year	Face Amount (in thousands)	Interest Rate	Fixed Price	Anti-Dilution Adjusted Price	%	Look-back Period
2006	$ 1,962	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2007	567	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2007	272	-	$2.00	$ 0.00019	95 %	125 Days
2008	1,217	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2008	830	-	$2.00	$ 0.00019	95 %	125 Days
2009	134	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2011	852	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2012	762	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2012	210	-	$2.00	$ 0.00019	95 %	125 Days
2013	22,084	9.5 %	$2.00	$ 0.00018	90 %	125 Days
2013	12,127	-	$2.00	$ 0.00019	95 %	125 Days
Total	$ 41,017					

We bifurcate the compound embedded derivatives related to the Series C and Series D Convertible Preferred Stock and carry these financial instruments as liabilities in the accompanying balance sheet. Election to carry the instruments at fair value in their entirety is not available since their terms have not been modified. Significant components of the compound embedded derivative include (i) the embedded conversion feature, (ii) down-round anti-dilution protection features and (iii) default, non-delivery and buy-in puts, all of which were combined into one compound instrument that is carried at fair value as a derivative liability. Changes in the fair value of the compound derivative liability are recorded within income each period.

Conversions and Repayments – Our preferred stock and convertible debentures are convertible into shares of our common stock. Upon conversion of any of the convertible financial instruments in which the compound embedded derivative is bifurcated, the carrying amount of the instrument and the related derivative liability are credited to the capital accounts upon conversion to reflect the stock issued and no gain or loss is recognized. For instruments that are recorded in their entirety at the fair value of the hybrid instrument, the fair value of the hybrid instrument converted is credited to the capital accounts upon conversion to reflect the stock issued and no gain or loss is recognized. The trading market price of our common stock (and the conversion price) has been less than its par value from time to time. We are limited to issuing shares of common stock at no less than the par value, and all shares of our common stock issued in those conversions were issued at par value. However, the methodology used to estimate the number of shares of convertible debentures and preferred stock converted during this time are based upon the value received for the shares issued, with the difference between that value and the par value recorded as a deemed dividend.

The following table provides a summary of the preferred stock conversions that have occurred since inception and the number of common shares issued upon conversion.

	Preferred shares issued	Preferred shares converted	Preferred shares remaining	Common shares issued
	(in thousands)			
Series C Convertible Preferred Stock	22	17	5	314,619
Series D Convertible Preferred Stock	25	22	3	245,162

Page 13

The outstanding principal and accrued interest for the debentures as of March 31, 2014 is reflected in the following table in addition to the principal and interest converted since inception and the number of shares of common stock issued upon conversion.

	Outstanding principal and accrued interest at March 31, 2014	Principal and accrued interest converted since inception	Common Shares issued
	(in thousands)		
Debentures	$43,468	$ 11,747	4,403,415

Warrants – YA Global holds warrants to purchase shares of our common stock that were issued in connection with the convertible debentures and the Series C and Series D Convertible Preferred Stock. The warrants are exercisable at a fixed exercise price which, from time to time, has been reduced due to anti-dilution provisions when we have entered into subsequent financing arrangements with a lower price. The exercise prices may be reset again in the future if we subsequently issue stock or enter into a financing arrangement with a lower price. In addition, upon each adjustment in the exercise price, the number of warrant shares issuable is adjusted to the number of shares determined by multiplying the warrant exercise price in effect prior to the adjustment by the number of warrant shares issuable prior to the adjustment divided by the warrant exercise price resulting from the adjustment.

The warrants issued to YA Global do not meet all of the established criteria for equity classification in ASC 815-40, *Derivatives and Hedging – Contracts in Entity's Own Equity,* and accordingly, are recorded as derivative liabilities at fair value. Changes in the fair value of the warrants are charged or credited to income each period.

Effective February 1, 2013, 1.4 billion of the 1.9 billion warrants held by YA Global were cancelled and the remaining 500 million had their exercise price reduced to $0.0001 per share. These changes resulted in a decrease in fair value of the warrants of approximately $1.6 million during the first quarter of 2013 as reflected in the gain from change in fair value of derivative liabilities - warrants.

Fair value disclosures for Series C and D Bifurcated Embedded Derivative Instruments – For financings in which the embedded derivative instruments are bifurcated and recorded separately, the compound embedded derivative instruments are valued using a Monte Carlo Simulation methodology because that model embodies certain relevant assumptions (including, but not limited to, interest rate risk, credit risk, and conversion/redemption privileges) that are necessary to value these complex derivatives.

Assumptions used in calculating the preferred share values as of March 31, 2014 included remaining equivalent term of 1.34 years, annualized volatility of 187%, stated dividend of 8%, equivalent credit-risk adjusted rate of 13.0% and conversion price of $0.000194. Equivalent amounts reflect the net results of multiple modeling simulations that the Monte Carlo Simulation methodology applies to underlying assumptions. We modified the valuation technique to consider the potentially dilutive impact on the stock price resulting from the issuance of additional common shares upon the conversion of the preferred shares and convertible debentures. Approximately $23.3 million of the gain from change in fair value of derivative liability – Series C and D Convertible Preferred Stock and debentures was attributable to the change in valuation technique for the three months ended March 31, 2014. The Company determined inclusion of the impact from potentially dilutive shares in the valuation technique to be a change in accounting estimate as discussed in ASC Topic 250-10-45-17, *Accounting Changes and Error Corrections*, and is therefore reflected in the period of change and will be reflected in future periods.

The following table reflects the face value of the instruments and the fair value of the separately-recognized compound embedded derivative, as well the number of common shares into which the instruments are convertible as of March 31, 2014 and December 31, 2013.

March 31, 2014

	Face Value	Carrying Value	Embedded Conversion Feature	Common Stock Shares
	(in thousands)			
Series C Convertible Preferred Stock	$4,816	$ 4,816	$ 148	24,823,015
Series D Convertible Preferred Stock	348	348	11	1,794,330
Total	$5,164	$ 5,164	$ 159	26,617,345

December 31, 2013 (Restated)

	Face Value	Carrying Value	Embedded Conversion Feature	Common Stock Shares
	(in thousands)			
Series C Convertible Preferred Stock	$4,816	$ 4,816	$ 276	24,823,015
Series D Convertible Preferred Stock	348	348	20	1,794,330
Total	$5,164	$ 5,164	$ 296	26,617,345

The terms of the embedded conversion features in the convertible instruments presented above provide for variable conversion rates that are indexed to our quoted common stock price. As a result, the number of indexed shares is subject to continuous fluctuation. For presentation purposes, the number of shares of common stock into which the embedded conversion feature of the Series C and Series D Convertible Preferred Stock was convertible as of March 31, 2014 and 2013 was calculated as face value plus assumed dividends (if declared), divided by the lesser of the fixed rate or the calculated variable conversion price using the 125 day look-back period.

Changes in the fair value of derivative instrument liabilities related to the bifurcated embedded derivative features of the convertible instruments are reported as Gain (loss) from Change in Fair Value of Derivative Liability – Series C and Series D Convertible Preferred Stock and Debentures in the accompanying condensed consolidated statements of operations.

Restated gain from change in fair value of derivative liability – Series C and D Convertible Preferred Stock and debentures

	Three months ended March 31,	
	2014 (Restated)	2013 (Restated)
	(in thousands)	
Series C Convertible Preferred Stock	$ 128	$ 1,798
Series D Convertible Preferred Stock	9	129
Debentures:		
2006	-	16
Gain (loss) from change in fair value of derivative liability - Series C and D Convertible Preferred Stock and debentures	$ 137	$ 1,943

Page 15

Hybrid Financial Instruments Carried at Fair Value – At inception, the March 2007, August 2007, April 2008, May 2008 and April 2012 convertible debentures were recorded in their entirety at fair value as hybrid instruments in accordance with ASC 815-15-25-4 with subsequent changes in fair value charged or credited to income each period. As of May 25, 2012, we elected the fair value option for all other convertible debentures held by YA Global upon a re-measurement date that was triggered by significant modifications of the financial instruments. The convertible debentures continued to be recorded in their entirety at fair value upon their consolidation into six Consolidated Debentures effective July 1, 2013. The conversion price in each of the convertible debentures is subject to adjustment for down-round, anti-dilution protection. Accordingly, if we sell common stock or common share indexed financial instruments below the stated or variable conversion price of the debenture, the conversion price adjusts to that lower amount.

Because these debentures are carried in their entirety at fair value, the value of the embedded conversion feature is embodied in those fair values. We estimate the fair value of the hybrid instrument as the present value of the cash flows of the instrument, using a risk-adjusted interest rate, enhanced by the value of the conversion option, valued using a Monte Carlo model. This method was considered by our management to be the most appropriate method of encompassing the credit risk and exercise behavior that a market participant would consider when valuing the hybrid financial instrument. Inputs used to value the hybrid instruments as of March 31, 2014 included: (i) present value of future cash flows for the debentures using an effective market interest rate of 13.0%, (ii) remaining term of 1.34 years, (iii) annualized volatility of 187%, and (iv)anti-dilution adjusted conversion prices ranging from $0.00018 - $0.00019. We also modified the valuation technique to consider the potentially dilutive impact on the stock price from the issuance of common shares upon the conversion of the debentures. Approximately $217.4 million of the gain from change in fair value of hybrid financial instruments was attributable to the change in valuation technique for the three months ended March 31, 2014. The Company determined inclusion of the impact from potentially dilutive shares in the valuation technique to be a change in accounting estimate as discussed in ASC Topic 250-10-45-17, *Accounting Changes and Error Corrections*, and is therefore reflected in the period of change and will be reflected in future periods.

The following table reflects the face value of the financial instruments, the fair value of the hybrid financial instrument and the number of shares of common stock into which the instruments are convertible as of March 31, 2014 and December 31, 2013.

March 31, 2014	Face Value (in thousands)	Fair Value	Common Stock Shares
Debentures:			
2006	$1,962	$2,041	12,285,288
2007	839	950	3,244,058
2008	2,047	1,898	11,689,415
2009	134	155	923,440
2011	852	866	5,226,562
2012	972	1,013	8,524,582

2013	34,211	31,872	192,394,516
Total	$41,017	$38,795	234,287,861

Page 16

December 31, 2013 (Restated)	Face Value	Fair	Common Stock