NEW JERSEY RESOURCES CORP
Form 4
September 02, 2016

FORM 4

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

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

OMB APPROVAL
OMB Number: 3235-0287
Expires: January 31, 2005
Estimated average burden hours per response... 0.5

(Print or Type Responses)

1. Name and Address of Reporting Person *
LOCKWOOD GLENN C

(Last) (First) (Middle)

C/O NEW JERSEY RESOURCES CORPORATION, 1415 WYCKOFF ROAD

(Street)

WALL, NJ 07719

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
NEW JERSEY RESOURCES CORP [NJR]

3. Date of Earliest Transaction (Month/Day/Year)
08/31/2016

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

_____ Director _____ 10% Owner
__X__ Officer (give title below) _____ Other (specify below)
Executive V.P.

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Common Stock	08/31/2016		F		89 (1)	D	$ 33.64	170,625.045 (2)	D	
Common Stock	08/31/2016		F		104 (1)	D	$ 33.64	170,521.045 (2)	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
LOCKWOOD GLENN C C/O NEW JERSEY RESOURCES CORPORATION 1415 WYCKOFF ROAD WALL, NJ 07719			Executive V.P.	

Signatures

/s/ Richard Reich, as attorney-in-fact for Glenn C. Lockwood	09/02/2016
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Represents shares withheld to pay taxes related to monthly vesting of restricted stock due to executive's eligibility for retirement.

(2) Total includes accrual of 431.983 shares held in a deferred compensation account, which amount fluctuates based upon the market price of NJR common stock.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB number. has six patents for its physical world-to-Internet technology, and an additional six patents acquired with the purchase of Secure Source Technologies related to document security. The Company also has several trademarks relating to its proprietary software products. 10 Competition NeoMedia Internet Switching Software Although, the Company has been developing its physical world-to-Internet technology and offerings since 1996, the physical world-to-Internet market in which the Company competes is relatively new. In the past year, new technologies and concepts have emerged in the physical world-to-Internet space. The Company views the increased development of other products in this space as a validation of the physical world-to-Internet concept and believes that the increased promotion of these products and services by the Company and other companies in this space, including AirClic, Inc., will raise consumer awareness of this technology, resulting in a larger market. The Company believes

that the significant portfolio of physical world-to-Internet technologies that it has developed over the last five years will provide a barrier to entry for most 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 The Company has never had any product liability claim asserted against it. Currently the Company does not maintain insurance against such claims, which could result in 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. 11 Certain of the Company's proprietary technology allows for the storage of demographic data from NeoMedia's 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. 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, 2003, the Company employed 14 persons. Of the 14 employees, 7 are located at the Company's headquarters in Fort Myers, Florida, and 7 at other domestic locations. Of the 14 employees, 3 are dedicated to the Application Services business unit, 7 are dedicated to the Systems Integration Services business unit, and 4 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 2004 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. 12 RISK FACTORS Risks Specific To NeoMedia The Company Has Historically Lost Money and Losses May Continue The Company has incurred substantial losses since its inception, and anticipates continuing to incur substantial losses for the foreseeable future. The Company incurred a loss of $5,382,000 in the year ended December 31, 2003 and $7,421,000 in the year ended December 31, 2002. The Company's accumulated losses were approximately $76,147,000 as of December 31, 2003. As of December 31, 2003 and 2002, the Company had a working capital (deficit) of approximately $(6,526,000) and $(8,985,000), respectively. The Company had stockholders' deficit of $(3,203,000) and $(6,026,000) at December 31, 2003 and 2002, respectively. The Company generated revenues of $2,400,000 and $9,399,000 for the years ended December 31, 2003 and 2002, respectively. In addition, during the years ended December 31, 2003 and 2002, the Company recorded negative cash flows from operations of $3,191,000 and $535,000, 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 to the extent it has available financing, the Company intends to 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 Independent Accountants Have Added Going Concern Language To Their Report On The Company's Financial Statements, Which Means That The Company May Not Be Able To Continue Operations The report of Stonefield Josephson, Inc., the Company's independent auditors, with respect to the Company's financial statements and the related notes for the years ended December 31, 2003 and 2002, indicates that, at the date of their report, the Company had suffered recurring losses from operations and that the Company's current cash position raises substantial doubt about its ability to continue as a going concern. The Company's financial statements do not include any adjustments that might result from this uncertainty. There is Limited Information Upon Which Investors Can Evaluate The Company's Business Because The Physical World - to - Internet Market Has Existed For A Short Period Of Time 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 has a relatively limited operating history upon which an investor may base an evaluation of the Company's primary business and determine the Company's prospects for achieving its intended business objectives. To date, the Company has sold its physical world-to-Internet products to only 12 companies. Further, Digital:Convergence, the Company's primary customer for its physical world-to-Internet products in 2000, has filed Chapter 7 of the United States Bankruptcy Code 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. An investor 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: 13 o maintain and increase its client base; o implement and successfully execute its business and marketing strategy; o continue to develop and upgrade its products; o continually update and improve its service offerings and features; o respond to industry and competitive developments; and o attract, retain, and motivate qualified personnel. The Company may not be successful in addressing these risks. If the Company is unable to do so, its business, prospects, financial condition, and results of operations would be materially and adversely affected. The Company's Common Stock Is Subject to Price Volatility 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 that its operating results may fluctuate materially, as a result of which quarter-to-quarter comparisons of its results of operations may not be meaningful. If in some future quarter, whether as a result of such a fluctuation or otherwise, the Company's 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. An investor should not rely on the Company's results of any interim period as an indication of its 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: o the Company's ability to retain existing clients and customers; o the Company's ability to attract new clients and customers at a steady rate; o the Company's ability to maintain client satisfaction; o the Company's ability to motivate potential clients and customers to acquire and implement new technologies; o the extent to which the Company's products gain market acceptance; o the timing and size of client and customer purchases; o introductions of products and services by competitors; o price competition in the markets in which the Company competes; o the pricing of hardware and software that the Company resells or integrates into its products; o the level of use of the Internet and online services, as well as the rate of market acceptance of physical world-to-Internet marketing; o the Company's ability to upgrade and develop its systems and infrastructure in a timely and effective manner; 14 o the Company's ability to attract, train, and retain skilled management, strategic, technical, and creative professionals; o the amount and timing of operating costs and capital expenditures relating to the expansion of the Company's business, operations, and infrastructure; o unanticipated technical, legal, and regulatory difficulties with respect to use of the Internet; and o general economic conditions and economic conditions specific to Internet technology usage and electronic commerce. The Company's Common Stock Is Deemed To Be "Penny Stock," Which May Make It More Difficult For Investors To Sell Their Shares Due To Suitability Requirements The Company's common stock is deemed to be "penny stock" as that term is defined in Rule 3a51-1 promulgated under the Securities Exchange Act of 1934. These requirements may reduce the potential market for the Company's common stock by reducing the number of potential investors. This may make it more difficult for investors in the Company's common stock to sell shares to third parties or to otherwise dispose of them. This could cause the Company's stock price to decline. Penny stocks are stock: o with a price of less than $5.00 per share; o that are not traded on a "recognized" national exchange; o whose prices are not quoted on the NASDAQ automated quotation system (NASDAQ listed stock must still have a price of not less than $5.00 per share); or o in issuers with net tangible assets less than $2.0 million (if the issuer has been in continuous operation for at least three years) or $10.0 million (if in continuous operation for less than three years), or with average revenues of less than $6.0 million for the last three years. Broker/dealers dealing in penny stocks are required to provide potential investors with a document disclosing the risks of penny stocks. Moreover, broker/dealers are required to determine whether an investment in a penny stock is a suitable investment for a prospective investor. The Company Is Uncertain Of The Success Of Its Internet Switching Software 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 link from physical objects, including printed material, to the Internet. The Company can provide no assurance that: o this Internet Switching Software business unit will ever achieve profitability; o the Company's current product offerings will not be adversely affected by the focusing of its resources on the physical world-to-Internet space; or o the products the Company develops will obtain market acceptance. In the event that the Internet Switching Software business unit should never achieve profitability, that the Company's current product offerings should 15 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's Success is Dependent Upon The Resale Of Software And Equipment For Revenue; A Reduction In These Sales Would Materially Adversely Affect The Company's Operations And The Price Of Its Stock During the years ended December 31, 2003 and 2002, the Company derived 83% and 95%, respectively, of its 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 its stock price. The Company can provide no assurance that: o the market for its products and services will continue; o 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 it resells; or o the Company's relationship with companies whose products and services the Company sells will continue, including its relationship with Sun Microsystems Computer Company. Further, the Company believes that 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 Its Operations Are Unsuccessful At December 31, 2003, approximately 65% of the Company's total assets were intangible assets, consisting primarily of rights related to its patents and other intellectual property. If the Company's 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 its stockholders to recoup their investments in the Company's capital stock. The Company's ISS Business Unit Marketing Strategy Has Not Been Tested And May Not Result In Success To date, the Company has conducted limited marketing efforts directly relating to its ISS business unit. All of the Company's marketing efforts have been largely untested in the marketplace, and may not result in sales of its 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, its products and services. With respect to the Company's marketing efforts conducted directly, the Company intends to expand its sales staff upon the receipt of sufficient operating capital. The Company's failure to further develop its marketing capabilities and successfully market its products and services would have a material adverse effect on its business, prospects, financial condition, and results of operations. The Company's Internally Developed Systems Are Inefficient And May Put The Company At A Competitive Disadvantage The Company uses internally developed technologies for a portion of its systems integration services, as well as the technologies required to interconnect its clients' and customers' physical world-to-Internet systems and hardware with its own. As the Company 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. 16 The Company Could Fail to Attract Or Retain Key Personnel The Company's future success will depend in large part on its 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. The Company may not be successful in attracting and retaining qualified personnel on a timely basis, on competitive terms, or at all. The Company's failure to attract and retain qualified personnel would have a material adverse effect on its business, prospects, financial condition, and results of operations will be materially adversely affected. The Company Depends Upon Its 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, including Charles T. Jensen, its President, Chief Executive Officer and Chief Operating Officer, and Charles W. Fritz, the Company's founder and Chairman of the Board of Directors. The loss of the services of Mr. Jensen or Mr. Fritz could materially harm the Company's business because of the cost and time necessary to replace and train a replacement. Such a loss would also divert management attention away from operational issues. The Company does not presently maintain a key-man life insurance policy on Mr. Jensen or Mr. Fritz. The Company May Be Unable To Protect Its Intellectual Property Rights And 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 its proprietary technology, including its patents and other intellectual property, and on the Company's ability to protect its proprietary technology and other intellectual property rights. In addition, the Company must conduct its 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 its employees, as well as its patents. To protect its 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 six patents for its physical world-to-Internet technology, and an additional six patents acquired with the purchase of Secure Source Technologies related to document security. The Company also has several trademarks relating to its proprietary products. Although the Company believes that it has taken appropriate steps to protect its unpatented proprietary rights, including requiring that its employees and third parties who are granted 17 access to its proprietary technology enter into confidentiality agreements with the Company, the Company can provide no assurance that these measures will be sufficient to protect its rights against third parties. Others may independently develop or otherwise acquire patented or unpatented technologies or products similar or superior to those of the Company. The Company licenses from third parties certain software tools that it includes in its 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 its 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. The Company Is Exposed To Product Liability Claims 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 Its Stock Many of the Company's projects are critical to the operations of its 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 the Company sells. The Company does not currently maintain product liability insurance. There can be no assurance that: o the Company has contractually limited its liability for such claims adequately or at all; o the Company would have sufficient resources to satisfy any liability resulting from any such claim; The successful assertion of one or more large claims against the Company could have a material adverse effect on the Company's business, prospects, financial condition, and results of operations. The Company Will Not Pay Cash Dividends and Investors May Have To Sell Their Shares In Order To Realize Their Investment The Company has not paid any cash dividends on its common stock and does 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. As a result, investors may have to sell their shares of common stock to realize their investment. 18 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 the Company, 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 NeoMedia, 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 NeoMedia 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 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 the Company's directors, officers and principal stockholders, Charles W. Fritz, William E. Fritz and The Fritz Family Limited Partnership and their holdings were exempted from the triggering provisions of the Company's "poison pill" plan, as a result of the fact that, as of the plan's adoption, their holdings might have otherwise 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 25,000,000 shares of Preferred Stock, par value $0.01 per share. The Company has no present plans for the issuance of any preferred stock. However, the issuance of any preferred stock could have a material adverse effect on the rights of holders of the Company's common stock, and, therefore, could reduce the value of shares of the Company's common stock. In addition, specific rights granted to future holders of preferred stock could be used to restrict NeoMedia's ability to merge with, or sell its assets to, a third party. The ability of the Board of Directors to issue preferred stock could have the effect of rendering more difficult, delaying, discouraging, preventing, or rendering more costly an acquisition of the Company or a change in the Company's control thereby preserving NeoMedia's control by the current stockholders. 19 Risks Relating To The Company's Industry The Security of the Internet Poses Risks To The Success Of 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 its 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. 20 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 its business, prospects, financial condition, and results of operations. The Internet, physical world-to-Internet, equipment resales, and systems integration markets are characterized by: o rapid technological change; o changes in user and customer requirements and preferences; o frequent new product and service introductions embodying new technologies; and o 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: o enhance and improve the responsiveness and functionality of the Company's products and services; o license or develop technologies useful in the Company's business on a timely basis; o enhance the Company's existing services, and develop new services and technologies that address the increasingly sophisticated and varied needs of its prospective or current customers; and o 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 Markets Where Its Competitors Have More Resources 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. The Company 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 the Company. 21 Many of the Company's competitors have longer operating histories, larger customer bases, longer relationships with clients, and significantly greater financial, technical, marketing, and public relations resources than NeoMedia. 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 its business. Similarly, the Company competes against significantly larger and better-financed companies in its systems integration and resales businesses, including the manufacturers of the equipment and technologies that the Company integrates and resells. If the Company 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 the Company 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 no longer 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. In The Future There Could Be Government Regulations And Legal Uncertainties Which 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 its cost of doing business, or otherwise have a material adverse effect on the Company's 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 allows for the storage of demographic data from the Company's 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 its 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. 22 ITEM 2. Description of Properties The Company's principal executive, development and administrative office is located at 2201 Second Street, Suite 402, Fort Myers, Florida 33901. The Company occupies approximately 5,000 square feet under terms of a written lease from an unaffiliated party which expires on July 31, 2005, with monthly rent totaling approximately

$7,000. The Company maintains a sales facility at 2150 Western Court, Suite 230, Lisle, Illinois 60532, occupying approximately 6,000 square feet under the terms of a written lease from an unaffiliated party expiring on October 31, 2004, with monthly rent totaling approximately $3,000. The Company also prepaid approximately $63,000 of rent under the current lease through the issuance of common stock during 2003. The Company recognizes approximately $5,000 per month in additional rent expense relating to the stock issuance. The Company believes that existing office space is adequate to meet 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. Virgin Entertainment Group On January 2, 2004, NeoMedia filed a patent infringement lawsuit against Virgin(R) Entertainment Group, Inc., Virgin Megastore Online and Virgin Megastore ("Virgin"). The Complaint for Patent Infringement and Damages was filed in the United States District Court for the Northern District of Illinois, Eastern Division, by Baniak Pine & Gannon, the Company's intellectual property law firm. The Complaint claims that Virgin has infringed four of NeoMedia's patents - U.S. Patents Nos. 5,933,829, 5,978,773, 6,108,656, and 6,199,048. The Complaint alleges that the Virgin Megaplay Stations located in Virgin's Megastores infringe NeoMedia's patents by using Virgin's Megascan technology to allow customers to scan UPC codes from in-store CDs and DVDs to access Internet-based product information, such as music and movie previews, and album and video art. The Complaint also alleges that Virgin had notice of NeoMedia's patents since the latter part of 2002 or before, yet it continued with its infringing activities. NeoMedia's Complaint seeks compensatory damages for Virgin's infringement, with those damages to be trebled due to the willful and wanton nature of the infringement. NeoMedia also seeks to preliminarily and permanently enjoin Virgin from its infringing activities. AirClic, Inc. Litigation On September 6, 2001, AirClic, Inc. 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 pursuant to the terms of a Secured Promissory Note made on July 11, 2003 and a non-binding Letter of Intent dated July 3, 2001 between AirClic and the Company. The note was secured by substantially all of the Company's intellectual property, including the core physical world-to-Internet technologies. In the suit, the Company acknowledged its obligations under the note but filed a counterclaim against AirClic seeking damages for fraud, negligent misrepresentation and promissory estoppel. On October 3, 2003, the Company paid AirClic the principal plus interest in the approximate amount of $610,000. On December 5, 2003, the Company paid an additional $115,000 in legal fees and entered into a settlement agreement with AirClic under which the suit was dismissed. The Company has no further obligation relating to this matter. 23 On January 23, 2004, NeoMedia filed a patent infringement lawsuit against AirClic, Scanbuy, Inc., and LScan Technologies, Inc. The suit claims that each of the parties has manufactured, or has manufactured for it, and has used, or actively induced others to use, technology which allows customers to use a built-in UPC bar code scanner to scan individual items and access information. The Complaint states that AirClic, Scanbuy and LScan have had actual and constructive notice of the existence of the patents-in-suite, and, despite such notice, failed to cease and desist their acts of infringement, and continue to engage in acts of infringement of the patents in suit. NeoMedia's Complaint seeks compensatory damages for infringement by AirClic, Scanbuy and LScan, with those damages to be trebled due to the willful and wanton nature of the infringement. NeoMedia also seeks to preliminarily and permanently enjoin AirClic, Scanbuy and LScan from their infringing activities. Other Litigation 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. On September 6, 2002, the Company settled this suit for $133,000 of NeoMedia common stock, to be valued at the time of registration of the shares. The Company's stock was trading at approximately $0.05 at that time. The Company included for registration 2.7 million shares in the name of Ripfire in its Form S-1 that was declared effective by the SEC on February 14, 2003. The Company's stock was trading at approximately $0.02 on February 14, 2003. The actual number of shares to be issued to Ripfire per the pricing outlined in the agreement was approximately 9.8 million. On March 31, 2003, the Company issued the 2.7 million shares of common stock that had been registered in the S-1 to Ripfire. The Company is attempting to negotiate settlement of the remaining balance. The Company had a remaining accrued liability of $106,000 relating to this matter as of December 31, 2003. 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. In October 2003, the Company settled this matter for $10,000 cash payments over time, plus 3,000,000 shares of common stock. The Company had accrued a liability of $7,000 as of

December 31, 2003. On July 27, 2002, the Company's former General Counsel filed suit in U.S. District Court, Ft. Myers division, seeking payment of the 2000 executive incentive, severance and unpaid vacation days in the amount of approximately $154,000. In June 2001, the Company's compensation committee approved an adjustment to the 2000 executive incentive plan that reduced the executive incentive payout as a result of the write-off of the Digital:Convergence intellectual property license contract in the second quarter of 2001. As a result, the Company reduced the accrual for such payout by an aggregate of approximately $1.1 million in the second quarter of 2002. The plaintiff was seeking payment of the entire original incentive payout. On November 12, 2002, NeoMedia settled the lawsuit. The settlement calls for cash payments totaling approximately $90,000 over a period of ten months, plus 250,000 vested options to purchase shares of NeoMedia common stock at an exercise price of $0.01 with a term of five years. The Company had a liability of approximately $3,000 relating to this matter as of December 31, 2003. On September 12, 2002, R. R. Donnelley & Sons Company filed a summons in the Circuit Court of The Twentieth Judicial Circuit in and for Lee County, Florida, seeking payment of approximately $92,000 in past due professional services bills, plus interest and attorney fees. During July 2003, the Company settled the suit for cash payments over a period of approximately one year. The Company had an accrued liability of approximately $82,000 relating to this matter as of December 31, 2003. On October 28, 2002, Merrick & Klimek, P.C., filed a complaint against the Company seeking payment of approximately $170,000 in past due legal services. The amount in question is subject to an unsecured promissory note that matured 24 unpaid on February 28, 2002. On May 1, 2003, the Company settled the suit for cash payments totaling approximately $196,000, to be paid at a rate of $30,000 per quarter until the balance is satisfied. If the balance is paid within one year of the settlement, the Company will not pay interest charges. The Company had a remaining liability of approximately $116,000 relating to this matter as of December 31, 2003, which was included in notes payable. On November 11, 2002, Avnet/Hallmark Computer Marketing Group filed a complaint against the Company seeking payment of approximately $66,000 in past due amounts relating to hardware and software re-sold by the Company. During December 2002, the Company made payment of approximately $30,000 to Avnet/Hallmark, reducing the balance owed to approximately $37,000. On April 1, 2003, the plaintiff received a judgment from the circuit court for the remaining balance. The Company has agreed to a payment plan for the balance over a period of approximately nine months. The Company had a liability of approximately $17,000 relating to this matter as of December 31, 2003. On February 6, 2003, Allen Norton & Blue, P.A., filed a complaint against the Company seeking payment of approximately $25,000 in past due legal services. The Company has agreed to a payment plan relating to this matter under which the balance will be paid over approximately 12 months. The Company had a liability of approximately $13,000 relating to this matter as of December 31, 2003. On April 18, 2003, a former participant in the Company's 2001 self-insured health plan sued the Company to recover approximately $46,000 in unpaid health claims from 2001. On December 1, 2003, the Company settled this suit for cash payments over a period of approximately one year. The Company had accrued approximately $36,000 as of December 31, 2003. On January 26, 2004, Day West & Associates, Inc., filed a complaint against the Company seeking payment of approximately $6,000 in past due legal services. The Company is attempting to negotiate settlement of the suit. The Company had not accrued any liability relating to his matter as of December 31, 2003. ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS None. 25 PART II ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS (a) Market Information. The Company's shares trade on the OTC Bulletin Board under the symbol "NEOM." As of December 31, 2003, the Company had 243,991,257 common shares outstanding. The following table summarizes the high and low closing sales prices per share of the common stock for the periods indicated as reported on The OTC Bulletin Board and Nasdaq SmallCap Market, as applicable: (U.S. $) ---------------------------------- --- 2001 HIGH LOW ---------------------------------- ----------------------------- -------------------------- First Quarter $6.00 $2.50 Second Quarter 4.50 1.76 Third Quarter 1.85 0.16 Fourth Quarter 0.24 0.11 ---------------------------------- ----------------------------- -------------------------- 2002 HIGH LOW ---------------------------------- ----------------------------- -------------------------- First Quarter $0.41 $0.14 Second Quarter 0.17 0.05 Third Quarter 0.10 0.02 Fourth Quarter 0.05 0.01 ---------------------------------- ----------------------------- -------------------------- 2003 HIGH LOW ---------------------------------- ----------------------------- -------------------------- First Quarter $0.06 $0.01 Second Quarter 0.04 0.01 Third Quarter 0.29 0.01 Fourth Quarter 0.23 0.10 (b) Holders. As of December12, 2003, NeoMedia had approximately 3,500 recordholders of common stock. (c) Dividends. The Company has not declared or paid any dividends on its common stock during the years ended December 31, 2003 or 2002. The

Company will base any issuance of dividends upon its earnings, financial condition, capital requirements and other factors considered important by its board of directors. Delaware law and the Company's certificate of incorporation do not require the board of directors to declare dividends on the Company's common stock. The Company expects to retain all earnings, if any, generated by its operations for the development and growth of its business and does not anticipate paying any dividends to its stockholders for the foreseeable future. (d) Recent Issuances of Unregistered Securities. On February 6, 2004, the Company issued 7,000,000 shares of common stock to CSI International, Inc. shareholders in connection with NeoMedia's purchase of CSI. The closing market price on the date of issuance was $0.10. On October 31, 2003, the Company entered into an agreement to issue 8,000,000 shares of stock to International Digital Scientific, Inc., as payment of all past and future amounts owed under a note payable from 1994. The shares were valued at $0.113. The market price at the time of the agreement was $0.113. 26 On October 23, 2003, the Company entered into an agreement to issue 3,000,000 shares of stock to Orsus Solutions, USA, Inc., an unrelated vendor, as payment of past due liabilities of $331,000. The shares were valued at $0.107. The market price at the time of the agreement was $0.107. On October 28, 2003, the Company issued 95,238 shares of stock to Newbridge Securities Corporation, an unrelated advisor, for services relating to the Standby Equity Distribution Agreement. The shares were valued at $0.105, the market price on the date of issuance. On October 27, 2003, the Company issued 7,279 shares of stock to one unrelated vendor as payment of past due liabilities of $1,000. The shares were valued at $0.105, the market price on the date of issuance. On October 27, 2003, the Company issued to Cornell Capital Partners, LP, 10,000,000 warrants to purchase shares of its common stock at an exercise price of $0.05 per share. The warrants were issued as a one-time commitment fee relating to the Standby Equity Distribution Agreement between Cornell and NeoMedia. On October 3, 2003, the Company finalized its purchase of Secure Source Technologies, Inc. for 3,500,000 shares of stock. The shares were valued at $0.14, the market price on the date of closing. On October 20, 2003, the Company issued 66,841 shares of stock to one unrelated vendor as payment of past due liabilities of $10,000. The shares were valued at $0.10. The market price on the date of the agreement was $0.10. On October 7, 2003, the Company issued 103,907 shares of stock to one unrelated vendor as payment of past due liabilities of $16,000. The shares were valued at $0.13. The market price on the date of the agreement was $0.13. On October 6, 2003, the Company issued 37,743 shares of stock to one unrelated vendor as payment of past due liabilities of $5,000. The shares were valued at $0.14. The market price on the date of issuance was $0.16. On September 25, 2003, the Company issued 875,855 shares of stock to an unrelated vendor as payment of past due liabilities totaling $34,000. The shares were valued at $0.23 based on the market price on the grant date. The market price on the date of issuance was $0.20. On August 26, 2003, the Company issued 1,600,000 shares of stock to a former employee as payment of past due incentive compensation in the amount of $29,000. The shares were valued at $0.02. The market price on the date of issuance was $0.02. On August 26, 2003, the Company entered into an agreement to issue 450,000 shares of stock an unrelated vendor as payment of past due liabilities totaling $9,000. The shares were valued at $0.02. The market price on the date of the agreement was $0.02. On July 9, 2003, the Company borrowed $25,000 from William E. Fritz, one of its outside directors. This amount was added to the principal of a $10,000 note payable to Mr. Fritz that matures in April 2004, with all other terms of the note remaining the same. As consideration for the loan, the Company granted Mr. Fritz 2,500,000 warrants to purchase shares of the Company's common stock at an exercise price of $0.01 per share. On April 21, 2003, the Company sold 25,000,000 shares of its common stock, par value $0.01, in a private placement at a price of $0.01 per share. In connection with the sale, the Company also granted the purchaser 25,000,000 27 warrants to purchase shares of its common stock at an exercise price of $0.01 per share. The warrants had a fair value of $298,000 and have been recorded as a cost of issuance. The purchaser was William E. Fritz, a member of the Company's Board of Directors. Proceeds to us from sale of the shares were $250,000. The Company recognized a discount expense in general and administrative expenses of approximately $50,000 relating to this transaction with Mr. Fritz. On August 6, 2003, Mr. Fritz exercised his warrants and purchased 25,000,000 additional shares of common stock at a price of $0.01 per share. On April 17, 2003, the Company's Board of Directors approved the payment in full of approximately $154,000 of liabilities owed by us to Charles W. Fritz, its Founder and Chairman of the Board of Directors, through the issuance of 15,445,967 shares of common stock. The shares were valued at $0.01. The market price on the date of issuance was $0.011. The Company recognized an expense in general and administrative expenses of approximately $15,000 relating to this transaction with Mr. Fritz. During November 2002, the Company issued Convertible Secured Promissory Notes with an aggregate face value of $60,000 to 3 separate parties, including Charles W. Fritz, Chairman of the Board of Directors of NeoMedia; William E. Fritz, an outside director; and James J. Keil, an outside director. In connection with the notes, the Company granted to the holders an additional 1,355,670 shares of its common stock and 60,000 warrants to purchase shares of its common stock at $0.03 per share, with a term of three years. The warrants and shares were issued in January 2003. In August 2002, the Company issued 900,000 shares of common stock to 2150 Western Court L.L.C, the landlord of its Lisle, Illinois sales office, as settlement of a lawsuit relating to past-due and future building rents. The shares were valued at $0.03 per share, the market price at the date of issuance. In June 2002, the Company issued 10,000 shares of common stock to an unrelated vendor as an interest payment on past-due accounts payable. The shares were valued at $0.09. The market price on the date of issuance was $0.09. In February 2002, the Company issued 19,000,000 shares of its 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 $3,040,000 upon maturity of the notes, as a purchase price of $0.01 per share, or $190,000 in aggregate, was paid in cash. During August 2002, the notes matured without payment, and the Company subsequently cancelled the 19 million shares issued in connection with such notes. The Company accrued a liability in the third quarter of 2001 of $190,000 relating to the par value paid in connection with the issuance of the shares, and such amount remained unpaid as of December 31, 2003. In February 2002, the Company issued 500,000 warrants to a provider of commercial financing services, in exchange for interest due to the provider on past due amounts under a credit agreement. 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 A Convertible Preferred Stock issued to About.com, Inc. as payment for advertising expenses incurred during 2001. The market price on the date of issuance was $0.15. This issuance was made pursuant to Section 3(a)(9) of the Act. In January 2002, the Company issued 55,000 shares of common stock at a price of $0.13 per share to an individual unrelated party. The market price on the date of issuance was $0.14. Cash proceeds to NeoMedia were $7,150. 28 In January 2002, the Company issued 1,614,501 shares of common stock to an unrelated vendor as settlement of past-due accounts payable and future payments under equipment lease agreements. The shares were valued at $0.17. The market price on the date of issuance was $0.17. In January 2002, the Company issued 32,486 shares of common stock to an unrelated vendor as settlement of past-due accounts payable in the amount of $5,000. The shares were valued at $0.15. The market price on the date of issuance was $0.17. The Company relied upon the exemption provided in Section 4(2) of the Securities Act and/or Rule 506, which cover "transactions by an issuer not involving any public offering," to issue securities discussed above without registration under the Securities Act of 1933. The certificates representing the securities issued displayed a restrictive legend to prevent transfer except in compliance with applicable laws, and the Company's transfer agent was instructed not to permit transfers unless directed to do so by us, after approval by the Company's legal counsel. The Company believes that the investors to whom securities were issued had such knowledge and experience in financial and business matters as to be capable of evaluating the merits and risks of the prospective investment. The Company also believes that the investors had access to the same type of information as would be contained in a registration statement. 29 ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS Overview Over the past several years, NeoMedia's focus has been aimed toward the intellectual property commercialization unit of 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, as well as the patents surrounding certain physical-world-to-web linking processes. 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 NeoMedia's end-users, competitive advantage for their business partners and return-on-investment for their investors. To this end, NeoMedia has signed four intellectual property licenses since its inception, and also recently acquired additional patents as part of NeoMedia's acquisition of Secure Source Technologies, Inc. On September 8, 2003, NeoMedia announced its PaperClick for Camera Cell PhonesTM product, which reads and decodes UPC/EAN or other bar codes to link users to the Internet, providing information and enabling e-commerce on a compatible camera cell phone, such as the Nokia 3650 model. On October 30, 2003, NeoMedia unveiled its go-to-market strategy for the product. During 2003, NeoMedia signed contracts with several key partners outlined in the strategy, including agents Big Gig Strategies and SRP Consulting, and European advertising agency 12Snap. The Company has also entered into letters of intent with global brand communication company Seven Worldwide, and markting organizations iCoupon and Digital Rum. Loch Energy, Inc. During the first quarter of 2003, NeoMedia announced that it had reached an agreement in principle to acquire and merge with Loch Energy, Inc., an oil and gas provider based in Humble, Texas. On October 1, 2003, NeoMedia discovered that the royalty interest from future sales of oil owned by Loch were oversold, which would likely result in materially lower projected available cashflow from Loch's operations. This projected available cashflow was the basis for the acquisition. On October 2, 2003, NeoMedia's Board of Directors voted to terminate the acquisition and merger proceedings. SEC Inquiry NeoMedia recently received requests from the SEC's Southeast Regional Office for certain documents including those concerning negotiations and arrangements with certain strategic partners and consultants, patents, recent issuances of securities, investor relations, and the stock ownership by NeoMedia's officers and directors. NeoMedia responded promptly and fully and will cooperate with any further requests. The SEC's letter states that the staff's inquiry is informal and should not be construed as an indication of any violation of law or as a reflection on any person, entity, or security. Acquisitions CSI International, Inc. On February 6, 2004, NeoMedia acquired CSI International, Inc., of Calgary, Alberta, Canada, a private technology products company in the micro paint repair industry. NeoMedia paid 7,000,000 shares of its common stock, plus $2.5 million cash in exchange for all outstanding shares of CSI. NeoMedia has centralized the administrative functions in its Ft. Myers, Florida headquarters, and maintains the sales and operations office in Calgary, Alberta, Canada. BSD Software, Inc. On December 9, 2003, NeoMedia signed a non-binding letter of intent to acquire Triton Global Business Services Inc. and its parent company, BSD Software Inc. (Pink Sheets: BSDS), both of Calgary, Alberta, Canada. The LOI outlined terms, including an exchange of one share of NeoMedia common stock for each share of BSD Software, not to exceed 40 million shares. The transaction is dependent on due diligence by both companies, approval by NeoMedia's Board of Directors, BSD Software's Board of Directors, shareholders, required regulatory approvals, and other conditions. Triton, formed in 1998 and acquired by BSD in 2002, is an Internet Protocol-enabled provider of live and automated operator calling services, e-business support, billing and clearinghouse functions and information management services to telecommunications, Internet and e-business service providers. 30 NeoMedia's operating results have been subject to variation and will continue to be subject to variation, depending upon factors, such as the mix of business among services and products, the cost of material, labor and technology, particularly in connection with the delivery of business services, the costs associated with initiating new contracts, the economic condition of NeoMedia's target markets, and the cost of acquiring and integrating new businesses. Results of Operations for the Year Ended December 31, 2003 as Compared to the Year Ended December 31, 2002 Net sales. Total net sales for the year ended December 31, 2003 were $2,400,000, which represented a $6,999,000, or 74%, decrease from $9,399,000 for the year ended December 31, 2002. This decrease primarily resulted from reduced resales of Sun Microsystems equipment due to increased competition and general economic conditions. NeoMedia intends to continue to pursue additional resales of equipment, software and services. NeoMedia expects resales to more closely resemble the results for the year ended December 31, 2003, rather than the year ended December 31, 2002. With the acquisition of CSI, the Company expects sales in 2004 from this new segment of business to be substantially higher than in 2003. License fees. License fees were $414,000 for the year ended December 31, 2003, compared with $446,000 for the year ended December 31, 2002, a decrease of $32,000, or 7%. The decrease was due to slightly lower sales of internally developed software licenses in 2003. NeoMedia will continue to attempt to increase sales of these high-margin products, and expects license fees to remain materially constant over the next 12 months. Resales of software and technology equipment and service fees. Resales of software and technology equipment and service fees decreased by $6,967,000, or 78%, to $1,986,000 for the year ended December 31, 2003, as compared to $8,953,000 for the year ended December 31, 2002. This decrease primarily resulted from reduced resales of Sun Microsystems equipment due to increased competition and general economic conditions. NeoMedia intends to continue to pursue additional resales of equipment, software and services. NeoMedia expects resales to more closely resemble the results for the year ended December 31, 2003, rather than the year ended December 31, 2002. Cost of Sales. Cost of license fees was $300,000 for the year ended December 31, 2003, a decrease of $541,000, or 64%, compared with $841,000 for the year ended December 31, 2002. The decrease resulted from reduced amortization expense in 2003 of capitalized development costs relating to the PaperClick, MLM/Affinity, and Qode products that were written off during 2002. Cost of resales was $1,829,000 for the year ended December 31, 2003, a decrease of $5,594,000, or 75%, compared with $7,423,000 for the year ended December 31, 2002. The decrease resulted from decreased resales in 2003 compared with 2002. Cost of resales as a percentage of related resales was 92% in 2003, compared to 83% in 2002. This increase is due to an increased sales mix of lower-margin equipment products sold in 2003 compared to 2002, combined with the general erosion of margins in the resale sector. NeoMedia expects costs of resales to fluctuate with the sales of its equipment, software, and services over the next 12 months. With the acquisition of CSI, the Company expects cost of sales in 2004 from this new segment of business to be substantially higher than in 2003. 31 Gross Profit. Gross profit was $271,000 for the year ended December 31, 2003, a decrease of $864,000, or 76%, compared with gross profit of $1,135,000 for the year ended December 31, 2002. This decrease was primarily the result of lower resales of, and lower margin on, computer equipment, software, and services in 2003 relative to 2002. Sales and marketing. Sales and marketing expenses were $523,000 for the year ended December 31, 2003, compared to $1,009,000 for the year ended December 31, 2002, a decrease of $486,000 or 48%. This decrease resulted primarily from reduced sales commissions earned on lower sales in 2003 as compared with 2002, as well as a smaller sales force during 2003. NeoMedia expects sales and marketing expense to increase over the next 12 months with the acquisition of CSI International and the potential acquisition of BSD Software, as well as with the continued development and potential rollout of the Company's PaperClick product suite. General and administrative. General and administrative expenses increased by $202,000, or 5%, to $4,270,000 for the year ended December 31, 2003, compared to $4,068,000 for the year ended December 31, 2002. The increase resulted primarily from non-cash expenses relating to NeoMedia's option repricing program, expense for stock options issued with exercise prices below market price, and stock-based professional service expense. NeoMedia expects general and administrative expense to increase over the next 12 months with the acquisition of CSI International and the potential acquisition of BSD Software. Research and development. During the year ended December 31, 2003, NeoMedia charged to expense $332,000 of research and development costs, a decrease of $443,000 or 57% compared to $775,000 charged to expense for the year ended December 31, 2002. The decrease is primarily due to a continued reduction in research and development overhead since first quarter 2002. NeoMedia expects research and development costs to increase slightly over the next 12 months with the continued development and potential rollout of the Company's PaperClick product suite. Loss on Impairment of Assets. During the year ended December 31, 2002, NeoMedia recognized a loss on impairment of assets of $1,003,000 for the write-off capitalized development costs relating to its PaperClick physical-world-to-internet software. NeoMedia did not take an impairment charge during the year ended December 31, 2003. Loss on extinguishment of debt. During the year ended December 31, 2003, NeoMedia recognized a loss on extinguishment of debt of $152,000, resulting primarily from the payment of debt through the issuance of shares of common stock. Interest expense. Interest expense consists primarily of interest accrued for creditors as part of financed purchases, past due balances, notes payable and interest earned on cash equivalent investments. Interest expense increased by $198,000, or 111%, to $376,000 for the year ended December 31, 2003 from $178,000 for the year ended December 31, 2002, due to interest expense incurred during 2003 associated with notes payable, lawsuits, and past due trade accounts payable. Loss on disposal of discontinued operations. During the year ended December 31, 2002, NeoMedia recognized a loss on disposal of discontinued business unit of $1,523,000 to write off the remaining Qode-related assets. No disposal loss was recognized during the year ended December 31, 2003. Net Loss. The net loss for the year ended December 31, 2003 was $5,382,000, which represented a $2,039,000, or 27% decrease from a $7,421,000 loss for the year ended December 31, 2002. The decrease resulted primarily from an impairment charge of $1,003,000 relating to NeoMedia's PaperClick assets and a loss on disposal of NeoMedia's Qode business unit of $1,523,000 in 2002. The decrease was offset by higher non-cash expenses in 2003 relating to NeoMedia's option repricing program, expense for stock options issued with exercise prices below market price, and stock-based professional service expense, as well as lower sales and gross profit in 2003 compared to 2002. 32 Liquidity and Capital Resources As of December 31, 2003, NeoMedia's cash balance was $61,000, compared to $70,000 at December 31, 2002. Net cash used in operating activities was approximately $3,191,000 for the year ended December 31, 2003, compared with $535,000 for the year ended December 31, 2002. NeoMedia's net cash flow used in investing activities for the years ended December 31, 2003 and 2002, was $69,000 and $21,000, respectively. Net cash provided by financing activities for the years ended December 31, 2003 and 2002 was $3,251,000 and $492,000, respectively. During the years ended December 31, 2003 and 2002, NeoMedia's net loss totaled $5,382,000 and $7,421,000, respectively. As of December 31, 2003, NeoMedia had accumulated losses from operations of $76,147,000, had a working capital deficit of $6,526,000, and $61,000 in cash balances. The accompanying consolidated financial statements have been prepared assuming NeoMedia will continue as a going concern. Accordingly, the consolidated financial statements do not include any adjustments that might result from NeoMedia's inability to continue as a going concern. NeoMedia may obtain up to $20 million over the next two years through its Standby Equity Distribution Agreement with Cornell Capital Partners LP. As of January

30, 2004, NeoMedia had obtained approximately $3.6 million under its previous $10 million Equity Line of Credit Agreement with Cornell, and an additional $4.0 million promissory note, which is scheduled to be repaid from the proceeds of sale of common stock under the current $20 million Standby Equity Distribution Agreement with Cornell. NeoMedia also issued 40 million warrants with an exercise price of $0.05 per share to Cornell in connection with this financing. NeoMedia is also entitled to receive an additional $1.0 million from Cornell in the form of a promissory note within 15 days of filing a registration statement to register the warrants. Once the warrants are registered, and if the average closing bid price of NeoMedia's common stock for any five day period exceeds $0.10, NeoMedia can force Cornell to exercise the warrants, resulting in an additional $2.0 million cash to NeoMedia. Management believes that it has sufficient funding to sustain operations through December 31, 2004, however, there can be no assurances that the market for NeoMedia's stock will support the sale of sufficient shares of NeoMedia's common stock to raise sufficient capital to sustain operations for such a period, or that actual revenue will meet management's expectations. If necessary funds are not available, NeoMedia's business and operations would be materially adversely affected and in such event, NeoMedia would attempt to reduce costs and adjust its business plan. 33 Contractual Obligations The following table presents the Company's contractual obligations as of December 31, 2003 over the next five years and thereafter: Payments by Period (in thousands) -- Less Than 1-3 4-5 After 5 Amount 1 Year Years Years Years ---------- --------- ---------- ----------- ----------- Legal Settlements $249 $249 $--- $--- $--- Vendor Settlements & Agreements 841 760 81 --- --- Operating Leases 30 30 --- --- --- Short Term Debt 732 732 --- --- --- ---------- --------- ---------- ----------- ----------- Total Contractual Cash Obligations $1,852 $1,771 $81 $--- $--- ========== ========= ========== =========== =========== Intangible Assets At the end of each quarter, or upon occurrence of material events relating to a specific intangible item, NeoMedia performs impairment tests on each of its intangible assets, which include goodwill, capitalized patent costs, and capitalized and purchased software costs. In doing so, NeoMedia evaluates the carrying value of each intangible asset with respect to several factors, including historical revenue generated from each intangible asset, application of the assets in NeoMedia's current business plan, and projected discounted cash flow to be derived from the asset. Intangible asset balances are then adjusted to their current net realizable value based on these criteria if impaired. The Company received an independent valuation of its patent portfolio as of December 31, 2003. The independent valuation concluded that no impairment was necessary as of December 31, 2003. No impairment charges were taken during the year ended December 31, 2003. During the year ended December 31, 2002, NeoMedia recognized an impairment charge of $1.0 million relating to its PaperClick software product. Financing Agreements As of December 31, 2003 and 2002, NeoMedia was party to a commercial financing agreement with GE Access that provides short-term financing for certain computer hardware and software purchases. This arrangement allows NeoMedia to re-sell high-dollar technology equipment and software without committing cash resources to financing the purchase. NeoMedia and GE Access are currently operating under an additional arrangement under which GE Access retains 50% of NeoMedia's proceeds from sales financed by GE Access, and applies the portion of proceeds toward past due balances. This arrangement reduces by half NeoMedia's cash flow from resales of equipment and software financed by GE Access, until the balance owed to GE Access is paid in full. During October 2003, NeoMedia and GE entered into an additional agreement under which NeoMedia also makes regular payment against its past due balances. Termination of this financing relationship with GE Access could materially adversely affect NeoMedia's financial condition. Management expects the agreement to remain in place in the near future. As of December 31, 2003, the amount payable under this financing arrangement was approximately $196,000. Note Payable to Cornell Capital Partners On September 11, 2003, the Company received funding in the form of a promissory note from Cornell Capital Partners in the gross amount of $500,000 before Cornell discounts and fees. As of December 31, 2003, the Company had not made any payment against the principal of this note. Accordingly, the company has recorded the advance balance of $500,000 in "Notes Payable" on its consolidated balance sheet as of December 31, 2003. The original maturity date of this note is October 26, 2003. During January 2004, the Company reduced the balance to approximately $337,000. 34 Going Concern The accompanying consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. Through December 31, 2003, NeoMedia has not been able to generate sufficient revenues from its operations to cover its costs and operating expenses. Although NeoMedia has been able to issue its common stock or other financing for a significant portion of its expenses, it is not known whether NeoMedia will be able to continue this practice, or if revenue will increase significantly to be able to meet cash operating expenses. This, in turn, raises substantial doubt about NeoMedia's ability to continue as a going concern. Management believes that NeoMedia will be able to raise additional funds through its $20 million Standby Equity Distribution Agreement with Cornell. However, there can be no assurances that the market for NeoMedia's stock will support the sale of sufficient shares of stock to raise enough capital to sustain operations. The accompanying condensed consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties. Based on current cash balances and operating budgets, NeoMedia believes it only has sufficient financing to last until December 31, 2004. If NeoMedia's financial resources are insufficient, it may be forced to seek protection from its creditors under the United States Bankruptcy Code or analogous state statutes unless it is able to engage in a merger or other corporate finance transaction with a better capitalized entity. NeoMedia cannot predict whether additional financing will be available, its form, whether equity or debt, or be in another form, or if it will be successful in identifying entities with which it may consummate a merger or other corporate finance transactions. Critical Accounting Policies The U.S. Securities and Exchange Commission ("SEC") recently issued Financial Reporting Release No. 60, "Cautionary Advice Regarding Disclosure About Critical Accounting Policies" ("FRR 60"), suggesting companies provide additional disclosure and commentary on their most critical accounting policies. In FRR 60, the SEC defined the most critical accounting policies as the ones that are most important to the portrayal of a company's financial condition and operating results, and require management to make its most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, NeoMedia's most critical accounting policies include: inventory valuation, which affects cost of sales and gross margin; and the valuation of intangibles, which affects amortization and write-offs of goodwill and other intangibles. NeoMedia also has other key accounting policies, such as policies for revenue recognition, including the deferral of a portion of revenues on sales to distributors, and allowance for bad debt. The methods, estimates and judgments NeoMedia uses in applying these most critical accounting policies have a significant impact on the results NeoMedia reports in its consolidated financial statements. Intangible Asset Valuation. The determination of the fair value of certain acquired assets and liabilities is subjective in nature and often involves the use of significant estimates and assumptions. Determining the fair values and useful lives of intangible assets especially requires the exercise of judgment. While there are a number of different generally accepted valuation methods to estimate the value of intangible assets acquired, NeoMedia primarily uses the weighted-average probability method outlined in SFAS 144. This method requires significant management judgment to forecast the future operating results used in the analysis. In addition, other significant estimates are required such as residual growth rates and discount factors. The estimates NeoMedia has used are consistent with the plans and estimates that NeoMedia uses to manage its business, based on available historical information and industry averages. The judgments made in determining the estimated useful lives assigned to each class of assets acquired can also significantly affect NeoMedia's net operating results. 35 Allowance for Bad Debt. NeoMedia maintains an allowance for doubtful accounts for estimated losses resulting from the inability of NeoMedia's customers to make required payments. NeoMedia's allowance for doubtful accounts is based on NeoMedia's assessment of the collectibility of specific customer accounts, the aging of accounts receivable, NeoMedia's history of bad debts, and the general condition of the industry. If a major customer's credit worthiness deteriorates, or NeoMedia's customers' actual defaults exceed NeoMedia's historical experience, NeoMedia's estimates could change and impact NeoMedia's reported results. Stock-based Compensation. NeoMedia records stock-based compensation to outside consultants at fair market value in general and administrative expense. NeoMedia does not record expense relating to stock options granted to employees with an exercise price greater than or equal to market price at the time of grant. NeoMedia reports pro-forma net loss and loss per share in accordance with the requirements of SFAS 123 and 148. This disclosure shows net loss and loss per share as if NeoMedia had accounted for its employee stock options under the fair value method of those statements. Pro-forma information is calculated using the Black-Scholes pricing method at the date of grant. This option valuation model requires input of highly subjective assumptions. Because NeoMedia's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing model does not necessarily provide a reliable single measure of fair value of its employee stock options. Estimate of Litigation-based Liability. NeoMedia is defendant in certain litigation in the ordinary course of business (see "Legal Proceedings"). NeoMedia accrues liabilities relating to these lawsuits on a case-by-case basis. NeoMedia generally accrues attorney fees and interest in addition to the liability being sought. Liabilities are adjusted on a regular basis as new information becomes available. NeoMedia consults with its attorneys to determine the viability of an expected outcome. The actual amount paid to settle a case could differ materially from the amount accrued. Revenue Recognition. The Company derives revenues from two primary sources: (1) license revenues and (2) resale of software and technology equipment and service fee revenues. License fees, including Intellectual Property license, represent revenue from the licensing of NeoMedia's proprietary software tools and applications products. NeoMedia licenses its development tools and application products pursuant to non-exclusive and non-transferable license agreements. Resales of software and technology equipment represent revenue from the resale of purchased third party hardware and software products and from consulting, education, maintenance and post contract customer support services. The basis for license fee revenue recognition is substantially governed by American Institute of Certified Public Accountants ("AICPA") Statement of Position 97-2 "Software Revenue Recognition" ("SOP 97-2"), as amended. License revenue is recognized if persuasive evidence of an agreement exists, delivery has occurred, pricing is fixed and determinable, and collectibility is probable. Revenue for resale of software and technology equipment and service fee is recognized based on guidance provided in Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," as amended (SAB 101). Software and technology equipment resale revenue is recognized when all of the components necessary to run software or hardware have been shipped. Service revenues include maintenance fees for providing system updates for software products, user documentation and technical support and are recognized over the life of the contract. Software license revenue from long-term contracts has been recognized on a percentage of completion basis, along with the associated services being provided. Other service revenues, including training and consulting, are recognized as the services are performed. The Company uses stand-alone pricing to determine an element's vendor specific objective evidence (VSOE) in order to allocate an arrangement fee amongst various pieces of a multi-element contract. NeoMedia records an allowance for uncollectible accounts on a customer-by-customer basis as appropriate. 36 Disposal of Qode Business Unit On August 31, 2001, the Company signed a non-binding letter of intent to sell the assets and liabilities of its Ft. Lauderdale-based Qode business unit, which it acquired in March 2001, to The Finx Group, Inc., a holding company based in Elmsford, NY. The Finx Group was to 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. During the third and fourth quarters of 2001 and the first quarter of 2002, NeoMedia recorded a $2.6 million expense from the write-down of the Qode assets/liabilities to net realizable value. The loss for discontinued operations during the phase-out period from August 31, 2001 (measurement date) to September 30, 2001 was $439,000. No further loss is anticipated. During June 2002, the Finx Group notified NeoMedia that it did not intend to carry out the letter of intent due to capital constraints. As a result, during the year ended December 31, 2002, the Company recorded an additional expense of $1.5 million for the write-off of remaining Qode assets. As of December 31, 2003, NeoMedia had approximately $657,000 of liabilities relating to the Qode system on its books. Impairment of PaperClick Asset During the year ended December 31, 2002, NeoMedia recognized an impairment charge of approximately $1.0 million relating to its PaperClick physical-world-to-internet software solution. Effect Of Recently Issued Accounting Pronouncements In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). FIN 46 changes the criteria by which one company includes another entity in its consolidated financial statements. Previously, the criteria was based on control through voting interest. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. A company that consolidates a variable interest entity is called the primary beneficiary of that entity. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. During October 2003, the FASB issued Staff Position No. FIN 46, deferring the effective date for applying the provisions of FIN 46 until the end of the first interim or annual period ending after December 31, 2003 if the variable interest was created prior to February 1, 2003 and the public entity has not issued financial statements reporting that variable interest entity in accordance with FIN 46. 37 On December 24, 2003, the FASB issued FASB Interpretation No. 46 (Revised December 2003), "Consolidation of Variable Interest Entities," (FIN-46R) primarily to clarify the required accounting for interests in variable interest entities. FIN-46R replaces FIN-46 that was issued in January

2003. FIN-46R exempts certain entities from its requirements and provides for special effective dates for entities that have fully or partially applied FIN-46 as of December 24, 2003. In certain situations, entities have the option of applying or continuing to apply FIN-46 for a short period of time before applying FIN-46R. While FIN-46R modifies or clarifies various provisions of FIN-46, it also incorporates many FASB Staff Positions previously issued by the FASB. The Company has deferred the adoption of FIN 46 with respect to VIEs created prior to February 1, 2003. Management is currently assessing the impact, if any, FIN 46 may have on the Company; however, management does not believe there will be any material impact to the Company's financial position, results of operations or liquidity resulting from the adoption of this interpretation. In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS 149 amends and clarifies financial accounting and reporting of derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." This Statement is effective for contracts entered into or modified after June 30, 2003, except for certain hedging relationships designated after June 30, 2003. The adoption of this Statement is not expected to have a material impact on the Company's financial position, results of operations, or cash flows. In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that issuers classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). With certain exceptions, this Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this Statement is not expected to have a material impact on the Company's financial position, results of operations, or cash flows. In December 2003, the FASB issued Statement of Financial Accounting Standards (FAS) No. 132 (Revised 2003) "Employers' Disclosures about Pensions and Other Postretirement Benefits." This standard replaces FAS-132 of the same title which was previously issued in February 1998. The revised FAS-132 was issued in response to concerns expressed by financial statement users about their need for more transparency of pension information. The revised standard increases the existing GAAP disclosures for defined benefit pension plans and other defined benefit postretirement plans. However, it does not change the measurement or recognition of those plans as required under: FAS-87, "Employers' Accounting for Pensions"; FAS-88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits"; and FAS-106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." Specifically, the revised standard requires companies to provide additional disclosures about pension plan assets, benefit obligations, cash flows, and benefit costs of defined benefit pension plans and other defined benefit postretirement plans. Also, for the first time, companies are required to provide a breakdown of plan assets by category, such as debt, equity and real estate, and to provide certain expected rates of return and target allocation percentages for these asset categories. The revised FAS-132 is effective for financial statements with fiscal years ending after December 15, 2003 and for interim periods beginning after December 15, 2003. The adoption of this Statement is not expected to have a material impact on the Company's financial position, results of operations, or cash flows. 38 ITEM 7. FINANCIAL STATEMENTS The Financial Statements to this Form 10-KSB are attached commencing on page F-1. ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES None. ITEM 8A. CONTROLS AND PROCEDURES Evaluation of Disclosure Controls and Procedures. NeoMedia's chief executive officer and chief financial officer, after evaluating the effectiveness of NeoMedia's "disclosure controls and procedures" (as defined in Sections 13a-14(c) of the Securities Exchange Act of 1934) as of the end of the period reported in this annual report (the "Evaluation Date"), concluded that NeoMedia's disclosure controls and procedures were effective and designed to ensure that material information relating to NeoMedia and its consolidated subsidiaries is accumulated and would be made known to them by others within those entities as appropriate to allow timely decisions regarding required disclosures. Changes in Internal Controls. NeoMedia does not believe that there are significant deficiencies in the design or operation of its internal controls that could adversely affect its ability to record, process, summarize and report financial data. Although there were no significant changes in NeoMedia's internal controls or in other factors that could significantly affect those controls subsequent to the Evaluation Date, NeoMedia's senior management, in conjunction with its Board of Directors, continuously reviews overall company policies and improves documentation of important financial reporting and internal control matters. NeoMedia is committed to continuously improving the state of its internal controls, corporate governance and financial reporting. Limitations on the Effectiveness of Controls. NeoMedia's management, including the Chief Executive Officer and Chief Financial Officer, does not expect that its disclosure or internal controls will prevent all errors or fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected. 39 INDEPENDENT AUDITORS' REPORT To the Board of Directors and Stockholders of Neomedia Technologies, Inc. We have audited the accompanying consolidated balance sheet of Neomedia Technolgies, Inc. (a Delaware Corporation) and subsidiaries as of December 31, 2003, and the related consolidated statements of operations, stockholders' deficit, and cash flows for the years ended December 31, 2003 and 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Neomedia Technologies, Inc. as of December 31, 2003, and the results of its operations and its cash flows for the years ended December 31, 2003 and 2002 in conformity with accounting principles generally accepted in the United States of America. The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company's significant operating losses, working capital deficit, and current cash flow position raise substantial doubt about its ability to continue as a going concern. Management's plans regarding those matters also are described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. /s/ STONEFIELD JOSEPHSON, INC. CERTIFIED PUBLIC ACCOUNTANTS Irvine, California February 27, 2004 40 NEOMEDIA TECHNOLOGIES, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEET (In thousands, except share data) December 31, 2003 -------- ASSETS Current assets: Cash and cash equivalents $ 61 Trade accounts receivable, net of allowance for doubtful accounts of $49 133 Inventories, net of allowance for obsolete & slow-moving inventory of $143 3 Prepaid expenses and other current assets 356 -------- Total current assets 553 Property and equipment, net 61 Capitalized patents, net 2,415 Capitalized and purchased software costs, net 118 Other long-term assets 729 -------- Total assets $ 3,876 ======== LIABILITIES AND SHAREHOLDERS' DEFICIT Current liabilities: Accounts payable $ 2,327 Amounts due under financing agreements 196 Amounts payable under settlement agreements 772 Liabilities of discontinued business unit 657 Sales taxes payable 137 Accrued expenses 1,743 Deferred revenues and other 515 Notes payable 732 -------- Total current liabilities 7,079 Commitments and contingencies -- Shareholders' deficit: Preferred stock, $0.01 par value, 25,000,000 shares authorized, none issued and outstanding -- Common stock, $0.01 par value, 1,000,000,000 shares authorized, 247,041,675 shares issued and 243,991,257 outstanding 2,440 Additional paid-in capital 71,565 Deferred stock-based compensation (282) Accumulated deficit (76,147) Treasury stock, at cost, 201,230 shares of common stock (779) -------- Total shareholders' deficit (3,203) -------- Total liabilities and shareholders' deficit $ 3,876 ======== The accompanying notes form an integral part of these consolidated financial statements. F-2 NEOMEDIA TECHNOLOGIES, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF OPERATIONS (In thousands, except per share data) Years Ended December 31, ------------------------------ 2003 2002 ------------- ------------- NET SALES: License fees $ 414 $ 446 Resale of software and technology equipment and service fees 1,986 8,953 ------------- ------------- Total net sales 2,400 9,399 ------------- ------------- COST OF SALES: License fees 300 841 Resale of software and technology equipment and service fees 1,829 7,423 ------------- ------------- Total cost of sales 2,129 8,264 ------------- ------------- GROSS PROFIT 271 1,135 Sales and marketing expenses 523 1,009 General and administrative expenses 4,270 4,068 Research and development costs 332 775 Loss on impairment of assets -- 1,003 ------------- ------------- Loss from operations (4,854) (5,720) Loss on extinguishment of debt, net (152) -- Interest expense, net (376) (178) ------------- ------------- Loss from continuing operations (5,382)

(5,898) Loss on disposal of discontinued business unit (Note 12) -- (1,523) ------------ ------------ NET LOSS $ (5,382) $ (7,421) ============ ============ NET LOSS PER SHARE FROM CONTINUING OPERATIONS--BASIC AND DILUTED $ (0.04) $ (0.26) ============ ============ NET LOSS PER SHARE FROM DISCONTINUED OPERATIONS--BASIC AND DILUTED $ -- $ (0.07) ============ ============ NET LOSS PER SHARE--BASIC AND DILUTED $ (0.04) $ (0.33) ============ ============ Weighted average number of common shares--basic and diluted 125,029,723 22,330,485 ============ ============ The accompanying notes form an integral part of these consolidated financial statements. F-3 NEOMEDIA TECHNOLOGIES, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (In thousands) Years Ended December 31, 2003 2002 ------- ------- CASH FLOWS FROM OPERATING ACTIVITIES: Net loss ($5,382) ($7,421) Adjustments to reconcile net loss to net cash used in operating activities: Depreciation and amortization 470 1,061 Inventory reserve 13 130 Provision for doubtful accounts and notes receivable 191 -- Loss on disposal of discontinued business unit -- 1,523 Loss on impairment of assets -- 1,003 Expense associated with option and warrant repricing 773 195 Fair value of expense portion of stock-based compensation granted for professional services 1,000 685 Interest expense allocated to debt 56 23 Discount related to common stock issuance 50 -- (Gain) loss on payment of accounts payable in stock 152 -- (Increase)/decrease in value of life insurance policies (35) 63 Changes in operating assets and liabilities Trade accounts receivable, net 212 2,299 Inventory (3) -- Other current assets 273 346 Accounts payable, amounts due under financing agreements, amounts due under Settlement agreements, liabilities in excess of assets of discontinued business unit, accrued expenses and stock liability (383) (584) Deferred revenue other current liabilities (366) 142 ------- ------- Net cash used in operating activities (2,979) (535) ------- ------- CASH FLOWS FROM INVESTING ACTIVITIES: Amounts issued under notes receivable (209) -- Capitalization of software development and purchased intangible assets (28) (21) Acquisition of property and equipment (44) -- ------- ------- Net cash used in investing activities (281) (21) ------- ------- CASH FLOWS FROM FINANCING ACTIVITIES: Net proceeds from issuance of common stock, net of issuance costs of $226 250 8 Net proceeds from exercise of stock warrants 250 45 Net proceeds from exercise of stock options 156 274 Borrowings under notes payable and long-term debt 3,350 165 Repayments on notes payable and long-term debt (755) -- ------- ------- Net cash provided by financing activities 3,251 492 ------- ------- NET INCREASE IN CASH AND CASH EQUIVALENTS (9) (64) CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR 70 134 ------- ------- CASH AND CASH EQUIVALENTS, END OF YEAR $ 61 $ 70 ======= ======= SUPPLEMENTAL CASH FLOW INFORMATION: Interest paid/(received) during the year $ 6 $ 15 Income taxes paid -- -- Non-cash investing and financing activities: Value of stock granted to acquire Secure Source Technologies, Inc. 500 -- Fair value of warrants issued as a direct incremental cost of financing 93 -- Reduction in accounts payable and accruals for debt paid in stock 1,509 -- Reduction of long-term debt paid and accrued interest with stock 904 -- Fair value of stock compensation deferred to future periods 282 -- Discount recognized on the issuance of stock with notes payable 56 -- Cancellation of common stock issued in 2001 to offset stock subscription receivable -- (240) Shares issued in accordance with Equity Line of Credit to repay Notes Payable, net of issuance costs of $6,772 2,793 -- Net effect of issuance and subsequent cancellation of common stock underlying notes receivable -- (190) The accompanying notes form an integral part of these consolidated financial statements. F-4 NEOMEDIA TECHNOLOGIES, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT) (In thousands, except share data) Common Stock --- Additional Stock Deferred Paid-in Subscription Stock Shares Amount Capital Receivable Compensation -------------- -------------- -------------- -------------- --------------------- BALANCE, DECEMBER 31, 2001 18,804,917 $188 $63,029 (240) 0 Exercise of employee options 5,252,455 52 222 - - Issuance of Common Stock through private Placement, Net of $0 of issuance costs (2,945,000) (29) (203) - - Expense associated with warrant repricing - - 195 - - Fair value stock issued for professional services rendered 4,900,000 49 915 - - Exercise of Warrants 369,450 4 41 - - Stock issued to pay liabilities 2,556,987 24 319 - - Conversion of preferred stock to common stock 452,489 5 878 - - Issuance of warrants and stock with convertible debt 1,355,670 14 46 - - Stock Subscription Receivable - - - 240 - Change in Deferred Stock Compensation - - - - (231) Net Loss - - - - - ------------- ------------- -------------- -------------- --------------------- BALANCE, DECEMBER 31, 2002 30,746,968 $307 $65,442 0 (231) Shares issued to Cornell Capital Partners 98,933,244 $990 $8,575 under Equity Line of Credit (Gross) - - Fees & discounts associated with Shares issued to Cornell Capital Partners under Equity Line of Credit - (6,772) - - Issuance of Common Stock through private Placement, 25,000,000 250 50 - - Exercise of employee options

15,599,175 156 - - - Exercise of Warrants 28,904,900 289 (39) - - Expense associated with option & warrant repricing - - 773 - - Fair value of stock, options, & warrants issued for professional services rendered 4,030,424 40 385 - - Stock issued to pay past due liabilities 37,276,546 373 2,040 - - Issuance of shares to purchase Secure Source Technologies, Inc. 3,500,000 35 465 - - Issuance of warrants and stock with debt - - 19 - - Expense recognized for options issued with exercise price below market price - - 627 - Change in Deferred Stock Compensation - - - - (51) Net Loss - - - - - -------------- -------------- --------------- --------------- ---------------------- BALANCE, DECEMBER 31, 2003 243,991,257 $2,440 $71,565 - (282) -------------- -------------- --------------- --------------- ---------------------- Preferred Stock Treasury Stock -- ----------------------- Additional Total Paid-in Accumulated Stockholders' Shares Amount Capital Deficit Shares Amount Equity ------------ -------- --------- ------------- ----------- ---------- ------------ BALANCE, DECEMBER 31, 2001 452,489 $5 $878 ($63,344) 201,230 ($779) ($263) Exercise of employee options - - - - - - 274 Issuance of Common Stock through private Placement, Net of $0 of issuance costs - - - - - - (232) Expense associated with warrant repricing - - - - - - 195 Fair value stock issued for professional services rendered - - - - - - 964 Exercise of Warrants - - - - - - 45 Stock issued to pay liabilities - - - - - - 343 Conversion of preferred stock to common stock (452,489) (5) (878) - - - - Issuance of warrants and stock with convertible debt - - - - - - 60 Stock Subscription Receivable - - - - - - 240 Change in Deferred Stock Compensation - - - - - - (231) Net Loss - - - (7,421) - - (7,421) ------------ -------- --------- ------------- ----------- ---------- ------------ BALANCE, DECEMBER 31, 2002 0 $0 $0 ($70,765) 201,230 ($779) ($6,026) Shares issued to Cornell Capital Partners 9,565 under Equity Line of Credit (Gross) - - - - - - Fees & discounts associated with Shares issued to Cornell Capital Partners under Equity Line of Credit - - - - - - (6,772) Issuance of Common Stock through private Placement, - - - - - - 300 Exercise of employee options - - - - - - 156 Exercise of Warrants - - - - - - 250 Expense associated with option & warrant repricing - - - - - - 773 Fair value of stock, options, & warrants issued for professional services rendered - - - - - - 425 Stock issued to pay past due liabilities - - - - - - 2,413 Issuance of shares to purchase Secure Source Technologies, Inc. - - - - - - 500 Issuance of warrants and stock with debt - - - - - - 19 Expense recognized for options issued with exercise price below market price - - - - - 627 Change in Deferred Stock Compensation - - - - - - (51) Net Loss - - - (5,382) - - (5,382) ------------ -------- --------- ------------- ----------- ---------- ------------ BALANCE, DECEMBER 31, 2003 - $- $- ($76,147) 201,230 ($779) ($3,203) ------------ -------- --------- ------------- ----------- ---------- ------------ The accompanying notes form an integral part of these consolidated financial statements. F-5 NEOMEDIA TECHNOLOGIES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 1. BASIS OF PRESENTATION AND NATURE OF BUSINESS OPERATIONS Basis of Presentation The consolidated financial statements include the financial statements of NeoMedia Technologies, Inc. and its wholly-owned subsidiaries, NeoMedia Migration, Inc., a Delaware corporation; 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 Brasil Ltd. incorporated in Brazil and NeoMedia Technologies UK Limited incorporated in the United Kingdom, and are collectively referred to as "NeoMedia" or the "Company". The consolidated financial statements of NeoMedia are presented on a consolidated basis for all periods presented. All significant intercompany accounts and transactions have been eliminated in preparation of the consolidated financial statements. The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, which contemplate continuation of the Company as a going concern. However, the Company has reported net losses of $5,382,000 and $7421,000 for the years ended December 31, 2003 and 2002, respectively, and has an accumulated deficit of $76,147,000 as of December 31, 2003. In addition, the Company has cash balance of $61,000 and working capital deficit of $6,526,000 as of December 31, 2003. The Company cannot be certain that anticipated revenues from operations will be sufficient to satisfy its ongoing capital requirements. Management's belief is based on the Company's operating plan, which in turn is based on assumptions that may prove to be incorrect. If the Company's financial resources are insufficient the Company may require additional financing in order to execute its operating plan and continue as a going concern. The Company cannot predict whether this additional financing will be in the form of equity, debt, or another form. The Company may not be able to obtain the necessary additional capital on a timely basis, on acceptable terms, or at all. In any of these events, the Company may be unable to implement its current plans for expansion, repay its debt obligations as they become due or respond to competitive pressures, any of which circumstances would have a material adverse effect on its business, prospects, financial condition and results of operations. Should these financing sources fail to materialize, management would seek alternate funding sources through sale of common and/or preferred stock. Management's plan is to secure adequate funding to bridge to revenue generation from the Company's valuable intellectual property portfolio and PaperClickTM internet "switching" software. On February 6, 2004, NeoMedia acquired CSI International, Inc., ("CSI") of Calgary, Alberta, Canada, a private technology products company in the micro paint repair industry. NeoMedia paid 7,000,000 shares of its common stock, plus $2.5 million cash in exchange for all outstanding shares of CSI. NeoMedia has centralized the administrative functions in its Ft. Myers, Florida headquarters, and maintains the sales and operations office in Calgary, Alberta, Canada. Through the acquisition of CSI, the Company expects the revenue for 2004 to be substantially higher than that for 2003 and expects this division will generate positive cash in 2004. F-6 Nature of Business Operations During the yearss ended December 31, 2003 and 2002, the Company was structured and evaluated by its Board of Directors and Management as two distinct business units: NeoMedia Internet Switching Software (NISS), and NeoMedia Consulting and Integration Services (NCIS) On February 6, 2004, the Company acquired CSI International, Inc. ("CSI"), of Calgary, Alberta, Canada, a private technology products company in the micro paint repair industry. NeoMedia has centralized the administrative functions in its Ft. Myers, Florida headquarters, and maintains the sales and operations office in Calgary, Alberta, Canada. CSI-related operations will be evaluated as a separate business unit during the year ended December 31, 2004. NeoMedia Internet Switching Software (NISS). 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 NeoMedia's linking "switch" and application platforms. NISS also manages the Company's intellectual property portfolio, including the identification and execution of licensing opportunities surrounding the patents. NeoMedia Consulting and Integration Services (NCIS). 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. Systems integration services also identifies prospects for custom applications based on NeoMedia's products and services. The operations are based in Lisle, Illinois. 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Estimates The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Cash and Cash Equivalents For the purposes of the consolidated balance sheets and consolidated statements of cash flows, all highly liquid investments with original maturities of three months or less are considered cash equivalents. Financial Instruments The carrying amount of the Company's cash equivalents, accounts receivable, prepaid expenses, other current assets, accounts payable and accrued expenses, accrued salaries and benefits, and payable to merchants approximates their estimated fair values due to the short-term maturities of those financial instruments. Rates currently available to the Company for debt with similar terms and remaining maturities are used to estimate fair value of existing debt. F-7 Accounts Receivable The Company reports accounts receivable at net realizable value. The Company's terms of sale provide the basis for when accounts become delinquent or past due. The Company provides an allowance for doubtful accounts equal to the estimated uncollectible amounts. The Company's estimate is based on historical collection experience and a review of the current status of accounts receivable. Receivables are generally charged off and sent to a collections agency after ninety days past due. It is at least reasonably possible that the Company's estimate of the allowance for doubtful accounts will change in the near-term. At December 31, 2003, the allowance for doubtful accounts was $49,000. Inventories Inventories are stated at the lower of cost or market, and at December 31, 2003 was comprised of purchased computer technology resale products. Cost is determined using the first-in, first-out method. At December 31, 2003, the reserve for obsolescence was $143,000. Property and Equipment Property and equipment are carried at cost less allowance for accumulated depreciation. Repairs and maintenance are charged to expense as incurred. Depreciation is generally computed using the straight-line method over the estimated useful lives of the related assets. Upon retirement or sale, cost and accumulated depreciation are removed from the accounts and any gain or loss is reflected in the consolidated statements of operations. The cost of normal maintenance and repairs is charged to operations as incurred. Material expenditures, which increase the life of an asset, are capitalized and depreciated over the estimated remaining life of the asset. The estimated service lives of property and equipment are as follows:

Furniture and fixtures 7 years Computer equipment 3 to 5 years Capitalized Patents Patents (including patents pending and intellectual property) are stated at cost, less accumulated amortization. Patents are generally amortized over periods ranging from five to seventeen years. Capitalized and Purchased Software Costs Intangible assets consist of capitalized software development costs and patents. Software development costs are accounted for in accordance with Statement of Accounting Standards (SFAS) No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed." Costs associated with the planning and designing phase of software development, including coding and testing activities necessary to establish technological feasibility, are classified as research and development and expensed as incurred. Once technological feasibility has been determined, additional costs incurred in development, including coding, testing, quality assurance and documentation are capitalized. Once a product is made available for sale, capitalization is stopped unless the related costs are associated with a technologically feasible enhancement to the product. Amortization of purchased and developed software is provided on a product-by-product basis over the estimated economic life of the software, generally three years, using the straight-line method. F-8 In accordance with SFAS No. 86, at the end of each quarterly reporting period, the Company evaluates each of its software products for impairment by adjusting the unamortized capitalized costs of each computer software product to its net realizable value. Net realizable value is equal to the estimated future gross revenues from each product reduced by the estimated future costs of completing and disposing of that product, including the costs of performing maintenance and customer support required to satisfy the Company's responsibility set forth at the time of sale. It is reasonably possible that the estimates underlying the impairment analysis could change in the near term, and the effect of the change could be material to the consolidated financial statements. Evaluation of Long-Lived Assets In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed of." Although retaining many of the fundamental recognition and measurement provisions of SFAS 121, the new rules significantly change the criteria that would have to be met to classify an asset as held-for-sale. The statement also supersedes certain provisions of Accounting Principles Board Opinion No. 30, "Reporting the Results of Operations--Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," and will require expected future operating losses from discontinued operations to be displayed in discontinued operations in the period or periods in which the losses are incurred rather than as of the measurement date, as presently required. NeoMedia adopted this new statement on January 1, 2002, and concluded that the effect of adopting this statement had no material impact on NeoMedia's financial position, results of operations, or cash flows. Amounts Due Under Settlement Agreements NeoMedia is party to various settlement agreements with certain of its vendors relating to past due accounts payable. The settlement agreements generally call for monthly payment installments against such past due amounts. Revenue Recognition NeoMedia derives revenues from two primary sources: (1) license revenues and (2) resale of software and technology equipment and service fee revenues. License fees, including Intellectual Property license, represent revenue from the licensing of NeoMedia's proprietary software tools and applications products. NeoMedia licenses its development tools and application products pursuant to non-exclusive and non-transferable license agreements. Resales of software and technology equipment represent revenue from the resale of purchased third party hardware and software products and from consulting, education, maintenance and post contract customer support services. The basis for license fee revenue recognition is substantially governed by American Institute of Certified Public Accountants ("AICPA") Statement of Position 97-2 "Software Revenue Recognition" ("SOP 97-2"), as amended. License revenue is recognized if persuasive evidence of an agreement exists, delivery has occurred, pricing is fixed and determinable, and collectibility is probable. Revenue for resale of software and technology equipment and service fee is recognized based on guidance provided in Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," as amended (SAB 101). Software and technology equipment resale revenue is recognized when all of the components necessary to run software or hardware have been shipped. Service revenues include maintenance fees for F-9 providing system updates for software products, user documentation and technical support and are recognized over the life of the contract. Software license revenue from long-term contracts has been recognized on a percentage of completion basis, along with the associated services being provided. Other service revenues, including training and consulting, are recognized as the services are performed. The Company uses stand-alone pricing to determine an element's vendor specific objective evidence (VSOE) in order to allocate an arrangement fee amongst various pieces of a multi-element contract. NeoMedia records an allowance for uncollectible accounts on a customer-by-customer basis as appropriate. Shipping and Handling Costs Shipping and handling costs are passed through to the Company's customers, and are netted in cost of goods sold. Research and Development Costs associated with the planning and designing phase of software development, including coding and testing activities, and related overhead, necessary to establish technological feasibility of the Company's internally-developed software products, are classified as research and development and expensed as incurred. Stock Based Compensation The Company accounts for stock-based compensation in accordance with Accounting Principles Board ("APB") Opinion No. 25. "Accounting for Stock Issued to Employees," and complies with the disclosure provisions of SFAS No. 123. "Accounting for Stock-Based Compensation." Under APB No. 25, compensation cost is recognized over the vesting period based on the excess, if any, on the date of grant of the fair value of the Company's shares over the employee's exercise price. When the exercise price of the option is less than the fair value price of the underlying shares on the grant date, deferred stock compensation is recognized and amortized to expense in accordance with Financial Accounting Standards Board ("FASB") Interpretation No. 44 over the vesting period of the individual options. Accordingly, if the exercise price of the Company's employee options equals or exceeds the market price of the underlying shares on the date of grant no compensation expense is recognized. Options or shares awards issued to non-employees and directors are valued using the Black-Scholes pricing model and expensed over the period services are provided. In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure," which amends, SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 expands the disclosure requirements of SFAS No. 123 to require more prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The transition provisions of SFAS No. 148 are effective for fiscal years ended after December 15, 2002. The transition provisions do not currently have an impact on the Company's consolidated financial position and results of operations as the Company has not elected to adopt the fair value-based method of accounting for stock-based employee compensation under SFAS NO. 123. The disclosure provisions of SFAS No. 148 are effective for financial statements for interim periods beginning after December 15, 2002. The Company adopted the disclosure requirements in the first quarter of 2003. The Company accounts for its stock option plans under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock-based employee compensation cost is reflected in net loss, except when options granted under those plans had an exercise price less than the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net loss and loss per share if the company had applied the fair value recognition provisions of FASB Statement No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation. F-10 Years Ended December 31, -------------------- 2003 2002 ------- ------- Net Loss, as reported ($5,382) ($7,421) Compensation recognized under APB 25 623 -- Compensation recognized under SFAS 123 (962) (1,277) ------- ------- Pro-forma net loss ($5,721) ($8,698) ======= ======= Net Loss per share: Basic and diluted - as reported ($ 0.04) ($ 0.33) ======= ======= Basic and diluted - pro-forma ($ 0.05) ($ 0.39) ======= ======= For grants in 2003 and 2002, the following assumptions were used: (i) no expected dividends; (ii) a risk-free interest rate of 4.5%; (iii) expected volatility ranging from 253% to 457% for 2003 and 135% to 211% for 2002, and (iv) an expected life of the shorter of 3 years or the stated life of the option for options granted in 2003, and 5 years or the stated life of the option for options granted in 2002. The fair-value was determined using the Black-Scholes option-pricing model. The estimated fair value of grants of stock options and warrants to non-employees of NeoMedia is charged to expense in the consolidated financial statements. These options vest in the same manner as the employee options granted under each of the option plans as described above. Income Taxes In accordance with SFAS No. 109, "Accounting for Income Taxes", income taxes are accounted for using the assets and liabilities approach. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities, and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be recognized. The Company has recorded a 100% valuation allowance as of December 31, 2003. Computation of Net Loss Per Share Basic net loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. The Company has excluded all outstanding stock options and warrants from the calculation of diluted net loss per share because these securities are anti-dilutive for all years presented. The shares excluded from the calculation of diluted net loss per share are detailed in the table below: December 31, 2003 December 31, 2002 ---------------- ---------------- Outstanding Stock Options 33,512,507 10,801,219 Outstanding Warrants 26,195,000 7,433,758 F-11 Comprehensive Income For the years ended December 31, 2003 and 2002, the Company did not have other comprehensive income and therefore has not included the statement of comprehensive income in the accompanying consolidated financial statements. Reclassifications Certain reclassifications have been made to the 2002 consolidated financial statements to conform to the 2003 presentation. Recent Accounting Pronouncements In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN 46). FIN 46 changes the criteria by which one company includes another entity in its consolidated financial statements. Previously, the criteria were based on control through voting interest. FIN 46 requires a variable interest entity to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or entitled to receive a majority of the entity's residual returns or both. A company that consolidates a variable interest entity is called the primary beneficiary of that entity. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Certain of the disclosure requirements apply in all financial statements issued after January 31, 2003, regardless of when the variable interest entity was established. During October 2003, the FASB issued Staff Position No. FIN 46, deferring the effective date for applying the provisions of FIN 46 until the end of the first interim or annual period ending after December 31, 2003 if the variable interest was created prior to February 1, 2003 and the public entity has not issued financial statements reporting that variable interest entity in accordance with FIN 46. On December 24, 2003, the FASB issued FASB Interpretation No. 46 (Revised December 2003), "Consolidation of Variable Interest Entities," (FIN-46R) primarily to clarify the required accounting for interests in variable interest entities. FIN-46R replaces FIN-46 that was issued in January 2003. FIN-46R exempts certain entities from its requirements and provides for special effective dates for entities that have fully or partially applied FIN-46 as of December 24, 2003. In certain situations, entities have the option of applying or continuing to apply FIN-46 for a short period of time before applying FIN-46R. While FIN-46R modifies or clarifies various provisions of FIN-46, it also incorporates many FASB Staff Positions previously issued by the FASB. The Company has deferred the adoption of FIN 46 with respect to VIEs created prior to February 1, 2003. Management is currently assessing the impact, if any, FIN 46 may have on the Company; however, management does not believe there will be any material impact to the Company's financial position, results of operations or liquidity resulting from the adoption of this interpretation. In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS 149 amends and clarifies financial accounting and reporting of derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS 133, "Accounting for Derivative Instruments and Hedging Activities." This Statement is effective for contracts entered into or modified after June 30, 2003, except for certain hedging relationships designated after June 30, 2003. The adoption of this Statement is not expected to have a material impact on the Company's financial position, results of operations, or cash flows. F-12 In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that issuers classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). With certain exceptions, this Statement is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this Statement is not expected to have a material impact on the Company's financial position, results of operations, or cash flows. In December 2003, the FASB issued Statement of Financial Accounting Standards (FAS) No. 132 (Revised 2003) "Employers' Disclosures about Pensions and Other Postretirement Benefits." This standard replaces FAS-132 of the same title which was previously issued in February 1998. The revised FAS-132 was issued in response to concerns expressed by financial statement users about their need for more transparency of pension information. The revised standard increases the existing GAAP disclosures for defined benefit pension plans and other defined benefit postretirement plans. However, it does not change the measurement or recognition of those plans as required under: FAS-87, "Employers' Accounting for Pensions"; FAS-88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits"; and FAS-106, "Employers' Accounting for Postretirement Benefits Other Than Pensions." Specifically, the revised standard requires companies to provide additional disclosures about pension plan assets, benefit obligations, cash flows, and benefit costs of defined benefit pension plans and other defined benefit postretirement plans. Also, for the first time, companies are required to provide a breakdown of plan assets by category, such as debt, equity and real estate, and to provide certain expected rates of return and target allocation percentages for these asset categories. The revised FAS-132 is effective for financial statements with fiscal years ending after December 15, 2003 and for interim periods beginning after December 15, 2003. The adoption of this Statement is not expected to have a material impact on the Company's financial position, results of operations, or cash flows. 3. EQUITY LINE OF CREDIT WITH CORNELL CAPITAL PARTNERS ("CORNELL") On February 11, 2003, NeoMedia and Cornell entered into an Equity Line of Credit Agreement under which Cornell agreed to purchase up to $10 million of NeoMedia's common stock over a two-year period, with the timing and amount of the purchase at the Company's discretion. The maximum amount of each purchase was $150,000 with a minimum of seven days between purchases. The shares were valued at 98% of the lowest closing bid price during the five-day period following the delivery of a notice of purchase by NeoMedia. The Company paid 5% of the gross proceeds of each purchase to Cornell During the year ended December 31, 2003, the Company sold 98,933,244 shares of its common stock to Cornell under the Equity Line of Credit. The following table summarizes funding received from Cornell during the year ended December 31, 2003: Year Ended First Second Third Fourth December 31, Quarter Quarter Quarter Quarter 2003 ------------ ------------ ------------ ------------ ------------ Number of shares sold to Cornell 3,990,342 27,873,902 56,069,000 11,000,000 98,933,244 Gross Proceeds from sale of shares to Cornell $ 84,000 $ 633,000 $ 7,088,000 $ 1,760,000 $ 9,565,000 Less: discounts and fees* (29,000) (189,000) (5,429,000) (1,125,000) ($6,772,000) ------------ ------------ ------------ ------------ ------------ Net Proceeds from sale of shares to Cornell $ 55,000 $ 444,000 $ 1,659,000 $ 635,000 $ 2,793,000 ------------ ------------ ------------ ------------ ------------ F-13 * - Per Equity line of Credit Agreement, stock is valued at 98% of the lowest closing bid price during the week it is sold As of December 31, 2003, the Company had a promissory note payable to Cornell in the amount of $500,000 On October 27, 2003, the Company and Cornell entered into a $20 million Standby Equity Distribution Agreement. The terms of the agreement are identical to the terms of the previous Equity Line of Credit, except that the maximum "draw" under the new agreement is $280,000 per week, not to exceed $840,000 in any 30-day period, and Cornell will purchase up to $20 million of the Company's common stock over a two-year period. As a consideration fee for Cornell to enter into the agreement, the Company issued 10 million warrants to Cornell with an exercise price of $0.05 per share, and a term of five years. Cornell exercised the warrants in January 2004, resulting in $500,000 cash receipts to the Company. In November 2003, the Company filed a Form SB-2 to register 200 million shares under this $20 million Standby Equity Distribution Agreement. In January 2004, the Form SB-2 was declared effective by the Securities and Exchange Commission. 4. PROPERTY AND EQUIPMENT As of December 31, 2003, property and equipment consisted of the following: (dollars in thousands) ------------- 2003 Furniture and fixtures $266 Equipment 41 ------------- Total 307 Less: accumulated depreciation Furniture and fixtures (237) Equipment (9) ------------- Total property and equipment, net $61 ============= Depreciation expense was $83,000 and $108,000 for the years ended December 31, 2003 and 2002, respectively. F-14 5. INTANGIBLE ASSETS As of December 31, 2003, intangible assets consisted of the following: (dollars in thousands) ------------ 2003 ----------- Capitalized and purchased software costs $575 Patents and related costs 3,566 ------------ Total 4,141 Less: accumulated amortization Capitalized and purchased software costs (456) Patents and related costs (1,152) ------------ Intangible assets, net $2,533 ============ Capitalized patent activity for the year ended December 31, 2003 was as follows: (dollars in thousands) ------------ 2003 ------------ Beginning balance $2,244 Additions 22 Acquisition of Secure Source Technologies, Inc. Patents 422 Amortization (273) ------------ Ending balance $2,415 ============ Amortization expense of capitalized patents was $273,000 and $276,000 for the years ended December 31, 2003 and 2002, respectively. The weighted-average amortization period of capitalized patents as of December 31, 2003 was 15.8 years. Capitalized and purchased software activity for the year ended December 31, 2003 was as follows: (dollars in thousands) ------------ 2003 ------------ Beginning balance $149 Additions 6 Acquisition of Secure Source Technologies, Inc. software 77 Amortization (114) ------------ Ending balance $118 ============ Amortization expense of capitalized and purchased software costs was $114,000 and $677,000 for the years ended December 31, 2003 and 2002, respectively. The weighted-average amortization period of capitalized and purchased software costs as of December 31, 2003 was 6.1 years. During the year ended December 31, 2002, the

Company recognized an impairment charge of $1.0 million relating to its PaperClick F-15 physical-world-to-internet software solution in its NISS business unit. The impairment charge was the result of a funding shortage during 2002 that forced the Company to terminate the majority of its workforce, including the selling, marketing, and development functions supporting PaperClick. During 2003, the Company reinstituted its PaperClick selling, marketing and development efforts. As of December 31, 2003, the Company estimated future amortization expense of capitalized patents and software for the next five years to be: (In Thousands) ------------- 2004 $353 2005 275 2006 228 2007 211 2008 187 6. ALLOWANCE FOR DOUBTFUL ACCOUNTS AND INVENTORY RESERVE Allowance for doubtful accounts activity for the year ended December 31, 2003 was as follows: (dollars in thousands) ------------------ 2003 ------------------ Beginning balance $55 Bad debt expense - Write-off of uncollectible accounts - Collection of accounts previously written off (18) Adjustment to general allowance 12 ------------------ Ending balance $49 ================== Inventory reserve activity for the year ended December 31, 2003 was as follows: (dollars in thousands) ------------------ 2003 ------------------ Beginning balance $130 Allowance for slow-moving parts inventory 13 ------------------ Ending balance $143 ================== 7. FINANCING AGREEMENTS Resale Financing Arrangement As of December 31, 2003, the Company was party to a commercial financing agreement with GE Access that provides short-term financing for certain computer hardware and software purchases. This arrangement allows the Company to re-sell high-dollar technology equipment and software without committing cash resources to financing the purchase. The Company and GE Access are currently operating under an additional arrangement under which GE Access retains 50% of the Company's proceeds from sales financed by GE Access, and applies the portion of proceeds toward past due balances. This arrangement reduces by half the Company's cash flow from resales of equipment and software financed by GE Access, until the balance owed to GE Access is paid in full. During October 2003, the Company and GE entered into an additional agreement under which the Company also makes regular payment against its past due balances. Termination of the Company's financing relationship with GE Access could have a material adverse effect the Company's financial condition. Management expects the agreement to remain in place in the near future. As of December 31, 2003 and 2002, the amount payable under this financing arrangement was approximately $196,000 and $430,000, respectively. F-16 8. NOTES PAYABLE On February 26, 2002, the Company borrowed $10,000 from William E. Fritz under a note payable bearing interest at 8% per annum. The note was repaid in April 2003. During March 2002, the Company borrowed $190,000 from William E. Fritz under a note payable bearing interest at 8% per annum with a term of 16 days. The note was repaid during March 2002. On April 5, 2002, the Company borrowed $11,000 from William E. Fritz under a note payable bearing interest at 8% per annum. The note was repaid in April 2003. During November 2002, NeoMedia issued Convertible Secured Promissory Notes with an aggregate face value of $60,000 to 3 separate parties, including Charles W. Fritz, Chairman of the Board of Directors of NeoMedia; William E. Fritz, an outside director; and James J. Keil, an outside director. The notes bear interest at a rate of 15% per annum, and matured at the earlier of i.) four months, or ii.) the date the shares underlying the Cornell Equity Line of Credit were registered with the SEC. The notes were convertible, at the option of the holder, into either cash or shares of NeoMedia common stock at a 30% discount to either market price upon closing, or upon conversion, whichever is lower. NeoMedia also granted to the holders an additional 1,355,670 shares of its common stock and 60,000 warrants to purchase shares of its common stock at $0.03 per share, with a term of three years. The warrants and shares were issued in January 2003. In addition, since this debt is convertible into equity at the option of the note holder at beneficial conversion rates, an embedded beneficial conversion feature was recorded as a debt discount and amortized using the effective interest rate over the life of the debt in accordance with EITF 00-27. Total cost of beneficial conversion feature, fair value of the stock and cost of warrants issued exceed the face value of the notes payable, therefore, only $60,000, the face amount of the note, was recognizable as debt discount, and amortized over the life of the notes payable. During March 2003, two of the affiliated parties, Mr. William Fritz and Mr. Keil, agreed to extend the maturity date due to the Company's capital constraints. The Company repaid Charles Fritz's note in full during March 2003, and repaid James J. Keil's note in full during April 2003. The Company paid $30,000 of the principal on William Fritz's note during April 2003, and entered into a new note with Mr. Fritz for the remaining $10,000. The new note bears interest at a rate of 10% per annum and matures in April 2004. The new note also includes a provision under which, as consideration for the loan, Mr. Fritz will receive a 3% royalty on all future revenue generated from the Company's intellectual property. On December 2, 2002, the Company issued to Michael Kesselbrenner, a private investor, a Promissory Note in the principal amount of $165,000, bearing interest at a rate of 12% per annum, with a maturity of 150 days. The investor only funded to the Company $84,000 of the principal amount of the note. The Company repaid this note during March 2003, and the shares which had been held in escrow as collateral for the loan were returned. The Company has not incurred further obligation under this note agreement. On March 13, 2003, the Company borrowed from Cornell the gross amount of $262,000 before Cornell discounts and fees. As of December 31, 2003, the Company had sold 18,535,039 shares to Cornell under the Equity Line of Credit and the proceeds were used to repay this obligation in full. F-17 On May 27, 2003, the Company borrowed from Cornell the gross amount of $245,000 before Cornell discounts and fees. As of December 31, 2003, the Company had sold 8,922,467 shares to Cornell under the Equity Line of Credit and the proceeds were used to repay this obligation in full. On June 24, 2003, the Company borrowed from Cornell the gross amount of $400,000 before Cornell discounts and fees. As of December 31, 2003, the Company had sold 18,426,808 shares to Cornell under the Equity Line of Credit and the proceeds were used to repay this obligation in full. On July 9, 2003, the Company borrowed $25,000 from William E. Fritz, one of its outside directors. This amount was added to the principal of the $10,000 note payable to Mr. Fritz entered into during April 2003, with all other terms of the note remaining the same. As consideration for the loan, the Company granted Mr. Fritz 2,500,000 warrants to purchase shares of the Company's common stock at an exercise price of $0.01 per share. The warrants had a fair value of approximately $74,000. In accordance with EITF 00-27, the Company recorded the relative fair value of the warrants as a discount against the note, and is amortizing the discount over the life of the note. The note matures in April 2004. On July 21, 2003, the Company borrowed from Cornell the gross amount of $200,000 before Cornell discounts and fees. As of December 31, 2003, the Company had sold 10,806,998 shares to Cornell under the Equity Line of Credit and the proceeds were used to repay this obligation in full. On August 1, 2003, the Company borrowed from Cornell the gross amount of $200,000 before Cornell discounts and fees. As of December 31, 2003, the Company had sold 5,915,410 shares to Cornell under the Equity Line of Credit and the proceeds were used to repay this obligation in full. On August 29, 2003, the Company borrowed $50,000 from William E. Fritz, one of its outside directors, under an unsecured note payable. The note was paid in full during September 2003. On September 2, 2003, the Company borrowed from Cornell the gross amount of $200,000 before Cornell discounts and fees. As of December 31, 2003, the Company had sold 5,919,784 shares to Cornell under the Equity Line of Credit and the proceeds were used to repay this obligation in full. On September 11, 2003, the Company received funding in the form of a promissory note from Cornell in the gross amount of $500,000 before Cornell discounts and fees. As of December 31, 2003, the Company had not made any payment against the principal of this note. Accordingly, the company has recorded the advance balance of $500,000 in "Notes Payable" on its condensed consolidated balance sheet as of December 31, 2003. During January 2004, the Company sold 1,408,992 shares to Cornell, reducing the balance to approximately $337,000. The Company has the option to repay any remaining principal in cash. On September 29, 2003, the Company borrowed from Cornell the gross amount of $1,500,000 before Cornell discounts and fees. As of December 31, 2003, the Company had sold 26,000,000 shares to Cornell under the Equity Line of Credit and the proceeds were used to repay this obligation in full. 9. LONG-TERM DEBT In October 1994, the Company purchased, via seller financing, certain computer software from International Digital Scientific, Inc. ("IDSI"). The aggregate purchase price was $2,000,000 and was funded by the seller with an uncollateralized note payable, without interest, in an amount equal to the greater of: (i) 5% of the collected gross revenues of NeoMedia Migration for the preceding month; or (ii) the minimum installment payment as defined, until paid in full. The minimum installment payment is the amount necessary to provide an average monthly payment for the most recent twelve month period of $16,000 per month. The present value of $2,000,000 discounted at 9% (the Company's then incremental borrowing rate) for 125 months was approximately $1,295,000, the capitalized cost of the assets acquired. The discount was accreted to interest expense over the term of the note. The software acquired was amortized over its estimated useful life of three years. F-18 On October 21, 2002, IDSI filed a demand for arbitration relating to past due payments on the note payable. On October 31, 2003, the Company paid off all past due and future obligations under the note to IDSI through the issuance of 8,000,000 shares of NeoMedia common stock. The Company has no future obligation under the note. The Company incurred a loss of $187,000 which is included in the Loss on Extinguishment of Debt. 10. CONCENTRATIONS OF CREDIT RISK Financial instruments that potentially subject NeoMedia to concentrations of credit risk consist primarily of trade accounts receivable with customers. NeoMedia extends credit to its customers as determined on an individual basis and has included an allowance for doubtful accounts of $49,000 in its December 31, 2003 consolidated balance sheet. In addition, a single company supplies the majority of the Company's resold equipment and software, which is re-marketed to this customer. Accordingly, the loss of this customer or supplier would materially adversely affect the Company's operations. During 2004, the Company will attempt to diversify its customer base to offset the decrease in sales to SBC/Ameritech. Revenue generated from the remarketing of computer software and technology equipment has accounted for a significant percentage of NeoMedia's revenue. Such sales accounted for approximately 83% and 87% of NeoMedia's revenue for the years ended December 31, 2003 and 2002, respectively. 11. ACQUISITIONS Secure Source Technologies, Inc. ("SST") On October 8, 2003, the Company acquired 100% ownership of SST, a provider of security solutions and covert security technology for the manufacturing and financial services industries, in exchange for 3.5 million shares of the Company's common stock. With the purchase of SST, the Company acquired additional patents that compliment its existing intellectual property portfolio, as well as a security software platform, and computer equipment. Prior to the acquisition, SST was inactive and had minimal operating activities. The acquisition was accounted for under the purchase method. The actual purchase price was based on the fair value of the Company's stock on the dates of the grant. The purchase price was allocated as follows: (Dollars in Thousands) -------------- Value of 3.5 Million Shares Issued (Purchase Price) $500 Assets Purchased: Computer Equipment 1 Software Platform 77 Patents 422 -------------- Total Purchase Price Allocation $500 -------------- The allocation of the purchase price is preliminary and is subject to revision, which is not expected to be material, based on the final valuation of the net assets acquired. Merger related cost was expensed as incurred. F-19 The proforma financial information is not presented as this acquisition was not considered significant or material to the combined financial statements on the date of the acquisition. The values assigned to intangible assets are subject to amortization. The acquired software platform has no residual value and a weighted-average amortization period of 3 years. The acquired patents have no residual value and a weighted-average amortization period of 11.1 years. The results of SST are included in the consolidated financial statements for the period October 8, 2003 through December 31, 2003. Loch Energy, Inc. On March 7, 2003, NeoMedia announced that that it had reached an agreement in principle to acquire and merge with Loch, an oil and gas provider based in Humble, Texas. On October 1, 2003, NeoMedia discovered that the royalty interest from future sales of oil owned by Loch were oversold, which would likely result in materially lower projected available cashflow from Loch's operations. This projected available cashflow was the basis for the proposed acquisition by NeoMedia. On October 2, 2003, NeoMedia's Board of Directors voted to cancel the Memorandum of Terms signed on March 13, 2003, and terminate the acquisition and merger. 12. DISPOSAL OF QODE BUSINESS UNIT On August 31, 2001, the Company signed a non-binding letter of intent to sell the assets and liabilities of its former Ft. Lauderdale-based Qode business unit, which it acquired in March 2001, to The Finx Group, Inc., a holding company based in Elmsford, NY. The Finx Group was to assume $620,000 in Qode payables and $800,000 in long-term leases in exchange for the issuance of 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. During the third and fourth quarters of 2001 and the first quarter of 2002, the company recorded a $2.6 million expense from the write-down of the Qode assets/liabilities to net realizable value. During June 2002, the Finx Group notified the Company that it did not intend to carry out the letter of intent due to capital constraints. As a result, during the year ended December 31, 2002, the Company recorded an additional expense of $1.5 million for the write-off of remaining Qode assets. As of December 31, 2003, the Company had approximately $769,000 of liabilities relating to the Qode system remaining on its books. 13. 2000 EXECUTIVE INCENTIVE During the year ended December 31, 2003, the Company satisfied a portion of its 2000 accrued executive incentive obligation through the issuance of common stock to current and former employees who had participated in the plan. The Company relieved approximately $592,000 of the liability through the issuance of approximately 5.4 million shares during the year ended December 31, 2003. The excess of the fair value of the common stock issued over the outstanding accrued bonuses was included in the loss on extinguishment of debt. F-20 14. INCOME TAXES For the years ended December 31, 2003 and 2002, the components of income tax expense were as follows: 2003 2002 ------ ------ (In thousands) Current $ -- $ -- Deferred -- -- ------ ------ Income tax expense/(benefit) $ -- $ -- ====== ====== As of December 31, 2003, the types of temporary differences between the tax basis of assets and liabilities and their financial reporting amounts which gave rise to deferred taxes, and their tax effects were as follows: 2003 2002 -------- -------- Accrued employee benefits $ 8 $ 26 Provisions for doubtful accounts 20 22 Capitalized software development costs and fixed assets 740 821 Net operating loss carryforwards (NOL) 27,014 25,134 Accruals 578 468 Write-off of long-lived assets 2,070 2,070 State taxes 107 95 Alternative minimum tax credit carryforward 45 45 -------- -------- Total deferred tax assets 30,582 28,681 Valuation Allowance (30,582) (28,681) -------- -------- Net deferred income tax asset $ -- $ -- ======== ======== Because it is more likely than not that NeoMedia will not realize the benefit of its deferred tax assets, a valuation reserve has been established against them. For the years ended December 31, 2003 and 2002, the income tax benefit differed from the amount computed by applying the statutory federal rate of 34% as follows: 2003 2002 ------- ------- Benefit at federal statutory rate $(1,830) $(2,523) State income taxes, net of federal (213) (294) Permanent and other, net 142 (609) Change in valuation allowance 1,901 3,426 ------- ------- Income tax expense/(benefit) $ -- $ -- ======= ======= As of December 31, 2003, NeoMedia had net operating loss carryforwards for federal tax purposes totaling approximately $68 million which may be used to offset future taxable income, or, if unused expire between 2011 and 2020. As a result of certain of NeoMedia's equity activities, NeoMedia anticipates that the annual usage of its pre-1998 net operating loss carryforwards should be further restricted pursuant to the provisions of Section 382 of the Internal Revenue Code. F-21 15. TRANSACTIONS WITH RELATED PARTIES During August 2003, the Company borrowed $50,000 from William E. Fritz, one of its outside directors, under an unsecured note payable with a term of 30 days. The note was repaid in full during September 2003. During July 2003, the Company borrowed $25,000 from William E. Fritz, one of its outside directors. This amount was added to the principal of a $10,000 note payable to Mr. Fritz that matures in April 2004, with all other terms of the note remaining the same. As consideration for the loan, the Company granted Mr. Fritz 2,500,000 warrants to purchase shares of its common stock at an exercise price of $0.01 per share. During April 2003, the Company entered into a consulting agreement with William Fritz, an outside director, for consulting and advisement services relating to the merger with Loch Energy, Inc., and to the subsequent implementation of various management programs surrounding the business. The agreement called for total payments of $250,000 over a period of one year. During August 2003, the Company paid the consulting contract in full. During September 2003, the consulting contract was rescinded and the full $250,000 was returned to us. During April 2003, the Company's Board of Directors approved the payment in full of approximately $154,000 of liabilities owed by NeoMedia to Charles W. Fritz, the Company's Founder and Chairman of the Board of Directors, through the issuance of 15,445,967 shares of common stock. The Company recognized a discount expense in general and administrative expenses of approximately $15,000 relating to this transaction with Mr. Fritz. During April 2003, the Company sold 25,000,000 shares of its common stock, par value $0.01, in a private placement at a price of $0.01 per share to William Fritz. In connection with the sale, the Company also granted 25,000,000 warrants to purchase shares of NeoMedia common stock at an exercise price of $0.01 per share. The warrants had a fair value of $298,000 and have been recorded as a cost of issuance. The Company recognized a discount expense in general and administrative expenses of approximately $50,000 relating to this transaction with Mr. Fritz. On August 6, 2003, Mr. Fritz exercised his warrants and purchased 25,000,000 additional shares of common stock at a price of $0.01 per share. During November 2002, the Company issued Convertible Secured Promissory Notes with an aggregate face value of $60,000 to 3 separate parties, including Charles W. Fritz, Chairman of the Board of Directors of NeoMedia; William E. Fritz, an outside director; and James J. Keil, an outside director. The notes had an interest rate of 15% per annum, and matured at the earlier of i.) four months, or ii.) the date the shares underlying the Cornell Equity Line of Credit were registered with the SEC. The notes were convertible, at the option of the holder, into either cash or shares of the Company's common stock at a 30% discount to either market price upon closing, or upon conversion, whichever is lower. The Company also granted to the holders an additional 1,355,670 shares of its common stock and 60,000 warrants to purchase shares of its common stock at $0.03 per share, with a term of three years. The warrants and shares were issued in January 2003. In addition, since this debt is convertible into equity at the option of the note holder at beneficial conversion rates, an embedded beneficial conversion feature was recorded as a debt discount and amortized using the effective interest rate over the life of the debt in accordance with EITF 00-27. Total cost of beneficial conversion feature, fair value of the stock and cost of warrants issued exceed the face value of the notes payable, therefore, only $60,000, the face amount of the note, was recognizable as debt discount, and amortized over the life of the notes payable. During March 2003, two of the affiliated parties, Mr. William Fritz and Mr. Keil, agreed to extend the maturity date due to NeoMedia's capital constraints. The Company repaid Charles Fritz's note in full during March 2003, and repaid James J. Keil's note in full during April 2003. The Company paid $30,000 of the principal on William Fritz's note during April 2003, and entered into a new note with Mr. Fritz for the remaining $10,000. The new note bears interest at a rate of 10% per annum and matures in April 2004. The new note also includes a provision under which, as consideration for the loan, Mr. Fritz will receive a 3% royalty on all future revenue generated from the Company's intellectual property. F-22 During April 2002, the Company borrowed $11,000 from William E. Fritz under a note payable bearing interest at 8% per annum with a term of 60 days. The note was repaid in April 2003. During March 2002, the Company borrowed $190,000 from William E. Fritz under a note payable bearing interest at 8% per annum with a term of 16 days. The note was repaid during March 2002. During February 2002, the Company borrowed $10,000 from William E. Fritz under a note payable bearing interest at 8% per annum with a term of 30 days. The note was repaid in April 2003. During October 2001, the Company borrowed $4,000 from Charles W. Fritz, NeoMedia's Chairman, its former Chief Executive Officer and a director, under a note payable bearing interest at 10% per annum with a term of six months. The note was repaid in April 2003. The Company believes that all of the above transactions were conducted at "arm's length", representing what NeoMedia believes to be fair market value for those services. 16. COMMITMENTS AND CONTINGENCIES NeoMedia leases its office facilities and certain office and computer equipment under various operating leases. These leases provide for minimum rents and generally include options to renew for additional periods. For the years ended December 31, 2003 and 2002, NeoMedia's rent expense was $265,000 and $853,000, respectively. NeoMedia is party to various payment arrangements with its vendors that call for fixed payments on past due liabilities. NeoMedia is also party to various consulting agreements that carry payment obligations into future years. The following is a schedule of the future minimum payments under non-cancelable operating leases in effect as of December 31, 2003: Payments (In Thousands) 2004 $ 30 Thereafter -- ---------- Total $ 30 ========== As of December 31, 2003, none of the Company's employees were under contract. Additionally, as of December 31, 2003, the Company was not a party to any long-term consulting agreements that are to be paid in cash. Legal Proceedings The Company is involved in various legal actions arising in the normal course of business, both as claimant and defendant. While it is not possible to determine with certainty the outcome of these matters, it is the opinion of management that the eventual resolution of the following legal actions could have a material adverse effect on the Company's financial position or operating results. F-23 AirClic, Inc. Litigation On September 6, 2001, AirClic, Inc. 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 pursuant to the terms of a Secured Promissory Note made on July 11, 2003 and a non-binding Letter of Intent dated July 3, 2001 between AirClic and the Company. The note was secured by substantially all of the Company's intellectual property, including the core physical world-to-Internet technologies. In the suit, the Company acknowledged its obligations under the note but filed a counterclaim against AirClic seeking damages for fraud, negligent misrepresentation and promissory estoppel. On October 3, 2003, the Company paid AirClic the principal plus interest in the approximate amount of $610,000. On December 5, 2003, the Company paid an additional $115,000 in legal fees and entered into a settlement agreement with AirClic under which the suit was dismissed. The Company has no further obligation relating to this matter. On January 23, 2004, NeoMedia filed a patent infringement lawsuit against AirClic, Scanbuy, Inc., and LScan Technologies, Inc. The suit claims that each of the parties has manufactured, or has manufactured for it, and has used, or actively induced others to use, technology which allows customers to use a built-in UPC bar code scanner to scan individual items and access information. The Complaint states that AirClic, Scanbuy and LScan have had actual and constructive notice of the existence of the patents-in-suite, and, despite such notice, failed to cease and desist their acts of infringement, and continue to engage in acts of infringement of the patents in suit. NeoMedia's Complaint seeks compensatory damages for infringement by AirClic, Scanbuy and LScan, with those damages to be trebled due to the willful and wanton nature of the infringement. NeoMedia also seeks to preliminarily and permanently enjoin AirClic, Scanbuy and LScan from their infringing activities. Other Litigation 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. On September 6, 2002, the Company settled this suit for $133,000 of NeoMedia common stock, to be valued at the time of registration of the shares. The Company's stock was trading at approximately $0.05 at that time. The Company included for registration 2.7 million shares in the name of Ripfire in its form S-1 that was declared effective by the SEC on February 14, 2003. The Company's stock was trading at approximately $0.02 on February 14, 2003. The actual number of shares to be issued to Ripfire per the pricing outlined in the agreement was approximately 9.8 million. On March 31, 2003, the Company issued the 2.7 million shares of common stock that had been registered in the S-1 to Ripfire. The Company is attempting to negotiate settlement of the remaining balance. The Company had a remaining accrued liability of $106,000 relating to this matter as of December 31, 2003. 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. In October 2003, the

Company settled this matter for $10,000 cash payments over time, plus 3,000,000 shares of common stock. The Company had accrued a liability of $7,000 as of December 31, 2003. F-24 On July 27, 2002, the Company's former General Counsel filed suit in U.S. District Court, Ft. Myers division, seeking payment of the 2000 executive incentive, severance and unpaid vacation days in the amount of approximately $154,000. In June 2001, the Company's compensation committee approved an adjustment to the 2000 executive incentive plan that reduced the executive incentive payout as a result of the write-off of the Digital:Convergence intellectual property license contract in the second quarter of 2001. As a result, the Company reduced the accrual for such payout by an aggregate of approximately $1.1 million in the second quarter of 2002. The plaintiff was seeking payment of the entire original incentive payout. On November 12, 2002, NeoMedia settled the lawsuit. The settlement calls for cash payments totaling approximately $90,000 over a period of ten months, plus 250,000 vested options to purchase shares of NeoMedia common stock at an exercise price of $0.01 with a term of five years. The Company had a liability of approximately $3,000 relating to this matter as of December 31, 2003. On September 12, 2002, R. R. Donnelley & Sons Company filed a summons in the Circuit Court of The Twentieth Judicial Circuit in and for Lee County, Florida, seeking payment of approximately $92,000 in past due professional services bills, plus interest and attorney fees. During July 2003, the Company settled the suit for cash payments over a period of approximately one year. The Company had an accrued liability of approximately $82,000 relating to this matter as of December 31, 2003. On October 28, 2002, Merrick & Klimek, P.C., filed a complaint against the Company seeking payment of approximately $170,000 in past due legal services. The amount in question is subject to an unsecured promissory note that matured unpaid on February 28, 2002. On May 1, 2003, the Company settled the suit for cash payments totaling approximately $196,000, to be paid at a rate of $30,000 per quarter until the balance is satisfied. If the balance is paid within one year of the settlement, the Company will not pay interest charges. The Company had a remaining liability of approximately $116,000 relating to this matter as of December 31, 2003. On November 11, 2002, Avnet/Hallmark Computer Marketing Group filed a complaint against the Company seeking payment of approximately $66,000 in past due amounts relating to hardware and software re-sold by the Company. During December 2002, the Company made payment of approximately $30,000 to Avnet/Hallmark, reducing the balance owed to approximately $37,000. On April 1, 2003, the plaintiff received a judgment from the circuit court for the remaining balance. The Company has agreed to a payment plan for the balance over a period of approximately nine months. The Company had a liability of approximately $17,000 relating to this matter as of December 31, 2003. On February 6, 2003, Allen Norton & Blue, P.A., filed a complaint against the Company seeking payment of approximately $25,000 in past due legal services. The Company has agreed to a payment plan relating to this matter under which the balance will be paid over approximately 12 months. The Company had a liability of approximately $13,000 relating to this matter as of December 31, 2003. On April 18, 2003, a former participant in the Company's 2001 self-insured health plan sued the Company to recover approximately $46,000 in unpaid health claims from 2001. On December 1, 2003, the Company settled this suit for cash payments over a period of approximately one year. The Company had accrued approximately $36,000 as of December 31, 2003. On January 26, 2004, Day West & Associates, Inc., filed a complaint against the Company seeking payment of approximately $6,000 in past due legal services. The Company is attempting to negotiate settlement of the suit. The Company had not accrued any liability relating to his matter as of December 31, 2003. F-25 17. DEFINED CONTRIBUTION SAVINGS PLAN NeoMedia maintains a defined contribution 401(k) savings plan. Participants may make elective contributions up to established limits. All amounts contributed by participants and earnings on these contributions are fully vested at all times. The plan provides for matching and discretionary contributions by NeoMedia, although no such contributions to the plan have been made to date. 18. STOCK OPTIONS AND WARRANTS Effective February 1, 1996, NeoMedia adopted the 1996 Stock Option Plan making available for grant to employees of NeoMedia options to purchase up to 1,500,000 shares of NeoMedia's common stock. The stock option committee of the board of directors has the authority to determine to whom options will be granted, the number of options, the related term, and exercise price. The option exercise price shall be equal to or in excess of the fair market value per share of NeoMedia's common stock on the date of grant. These options granted expired ten years from the date of grant. These options vest 100% one year from the date of grant. Effective March 27, 1998, NeoMedia adopted the 1998 Stock Option Plan making available for grant to employees of NeoMedia options to purchase up to 8,000,000 shares of NeoMedia's common stock. The stock option committee of the board of directors has the authority to determine to whom options will be granted, the number of options, the related term, and exercise price. The option exercise price may be less than the fair market value per share of

NeoMedia's common stock on the date of grant. Options generally vest 20% upon grant and 20% per year thereafter. The options expire ten years from the date of grant. Effective June 6, 2002, NeoMedia adopted its 2002 Stock Option Plan. The 2002 Stock Option Plan provides for authority for the stock option committee of the board of directors to grant non-qualified stock options with respect to a maximum of 10,000,000 shares of common stock. The option exercise price may be less than the fair market value per share of NeoMedia's common stock on the date of grant, and may be granted with any vesting schedule as approved by the stock option committee. Effective September 24, 2003, NeoMedia adopted its 2003 Stock Option Plan. The 2003 Stock Option Plan provides for authority for the Board of Directors to the grant non-qualified stock options with respect to a maximum of 150,000,000 shares of common stock. On October 17, 2003, NeoMedia filed a Form S-8 to register all 150,000,000 shares underlying the options in the 2003 Stock Option Plan. The following table summarizes the status of NeoMedia's 2003, 2002, 1998 and 1996 stock option plans as of and for the years ended December 31, 2003 and 2002: 2003 2002 ----------------------- ----------------------- Weighted Weighted Average Average Exercise Exercise Shares Price Shares Price ----------------------- ----------------------- (In (In thousands) thousands) Outstanding at beginning of year 10,801 $1.11 4,214 $2.96 Granted 39,018 $0.01 12,306 $0.06 Exercised (15,605) $0.01 (5,252) $0.07 Forfeited (702) $1.26 (467) $2.75 ----------------------- ----------------------- Outstanding at end of year 33,512 $0.23* 10,801 $1.11 ======================= ======================= Options exercisable at year-end 33,512 10,272 Weighted-average fair value of options granted during the year $0.10 $0.10 Available for grant at the end of the year 114,025 2,319 * - Includes 3,644,382 options that have a restated exercise price of $0.01 under option repricing program that extends through June 30, 2004. For purposes of this table,options subject to repricing are show at their original exercise price. The following table summarizes information about NeoMedia's stock options outstanding as of December 31, 2003: Options Outstanding Options Exercisable --- --------------------------- Weighted- Weighted- Weighted- Average Average Average Remaining Exercise Exercise Range of Number Contractual Number Exercise Prices Outstanding Life Price Exercisable Price -------------- ---------- ---- ----- ---------- ----- (In thousands) (In thousands) $-- to $0.10 31,068 9.7 years $0.01 31,068 $0.01 0.11 to 0.84 742 6.2 years $0.24 742 $0.24 0.85 to 3.63 955 5.6 years $2.99 955 $2.99 3.64 to 5.13 437 6.1 years $4.83 437 $4.83 5.14 to 7.31 310 4.3 years $7.29 310 $7.29 --- --------------------------- $ -- to $7.31 33,512 9.4 years $0.23 33,512 $0.23 === =========================== In March 2002, the Company issued 2,946,310 options to buy shares of its common stock to two outside consultants at a price of $0.17 per share for consulting services rendered over a six-month period, and recognized approximately $407,000 in expense in the 2002 consolidated financial statements. The options vested 100% upon grant. The options were all exercised during 2002 and 2003. F-26 In June 2002, the Company issued 3,000,000 options to buy shares of the Company's common stock to an outside consultant at a price of $0.01 per share for consulting services rendered over a one-year period, and recognized approximately $125,000 in general and administrative expense in the 2002 consolidated financial statements. The options vested 100% upon grant. All 3,000,000 options were exercised during 2002, resulting in proceeds to the Company of $30,000. In December 2002, the Company issued 2,000,000 options to buy shares of the Company's common stock to two outside consultant at a price of $0.01 per share for consulting services rendered over a twelve-month period. The Company recognized approximately $57,000 and $5,000 in general and administrative expense in the accompanying consolidated financial statements for the years ended December 31, 2003 and 2002, respectively. The options vested 100% upon grant. All 2,000,000 options were exercised during 2003. In June 2003, the Company issued 375,000 options to buy shares of the Company's common stock to two outside consultants at a price of $0.01 per share for consulting services rendered. The Company recognized approximately $13,000 in general and administrative expense in the accompanying consolidated financial statements for the year ended December 31, 2003. In October 2003, the Company issued 125,000 options to buy shares of the Company's common stock to two outside consultants at a price of $0.01 per share for consulting services rendered. The Company recognized approximately $13,000 in general and administrative expense in the accompanying consolidated financial statements for the year ended December 31, 2003. In October 2003, the Company issued 1,000,000 options to buy shares of the Company's common stock to an outside consultant at a price of $0.01 per share for consulting to be provided over a period of one year. The options were valued at approximately $102,000, of which the Company recognized approximately $20,000 in general and administrative expense in the accompanying consolidated financial statements for the year ended December 31, 2003. In October 2003, the Company issued 500,000 options to buy shares of the Company's common stock to an outside consultant at a price of $0.01 per share for consulting to be provided over a period of one year. The options were valued at approximately $51,000, of which the Company recognized approximately $10,000 in general and administrative expense in the accompanying consolidated financial statements for the year ended December 31, 2003. In November 2003, the Company issued 50,000 options to buy shares of the Company's common stock to an outside consultant at a price of $0.06 per share for consulting services rendered. The Company recognized approximately $7,000 in general and administrative expense in the accompanying consolidated financial statements for the year ended December 31, 2003. In November 2003, the Company issued 150,000 options to buy shares of the Company's common stock to an outside consultant at a price of $0.16 per share for consulting services rendered. The Company recognized approximately $3,000 in general and administrative expense in the accompanying consolidated financial statements for the year ended December 31, 2003. In December 2003, the Company issued 50,000 options to buy shares of the Company's common stock to an outside consultant at a price of $0.052 per share for consulting services rendered. The Company recognized approximately $7,000 in general and administrative expense in the accompanying consolidated financial statements for the year ended December 31, 2003. In December 2003, the Company issued 43,125 options to buy shares of the Company's common stock to an outside consultant at a price of $0.01 per share for consulting services rendered. The Company recognized approximately $6,000 in general and administrative expense in the accompanying consolidated financial statements for the year ended December 31, 2003. F-27 Warrants Warrant activity as of December 31, 2003 and 2002 was as follows: Warrants Outstanding as of December 31, 2001 Warrants Outstanding as of December 31, 2001 3,239,897 Warrants issued 5,000,000 Warrants exercised (369,450) Warrants expired (436,689) ----------- Warrants Outstanding as of December 31, 2002 7,433,758 Warrants issued 48,060,000 Warrants exercised (28,904,900) Warrants expired (393,858) ----------- Warrants Outstanding as of December 31, 2003 26,195,000 =========== The following table summarizes information about warrants outstanding at December 31, 2003, all of which are exercisable: Weighted- Weighted- Average Average Remaining Exercise Range of Warrants Contractual Exercise Prices Outstanding Life Price ----------------- ------------- ----------------- ------------- (In thousands) $--- to $0.05 24,560 4.6 years $0.03 0.06 to 3.56 225 4.6 years $3.47 3.57 to 6.54 1,410 1.8 years $6.00 ----------------- ------------- ----------------- ------------- $--- to $6.54 26,195 4.5 years $0.38 ================== ============= ================= ============= In June 2002, the Company issued 2,000,000 warrants to an outside consultant at an exercise price of $0.00. During 2002, the Company recognized an expense of approximately $100,000 related to this transaction, which is included in general and administrative expense in the accompanying consolidated statements of operations. The Company used the Black-Scholes option-pricing model to value the shares, with the following assumptions: (i) no expected dividends (ii) a risk-free interest rate of 4.5% (iii) expected volatility of 135% and (iv) an expected life of 1 year. All 2,000,000 warrants were exercised during the year ended December 31, 2003. In June 2002, the Company issued 1,500,000 warrants to buy shares of the Company's common stock at a price of $0.05 per share to Charles W. Fritz, the Company's Chairman of the Board and former CEO, as replacement for warrants exercised in the Company's warrant repricing program for which Mr. Fritz received no profit. The Company recognized approximately $66,000 in expense in the 2002 consolidated financial statements relating to the warrant issuance. All 1,500,000 warrants were outstanding as of December 31, 2003. F-28 In June 2002, the Company issued 1,500,000 warrants to buy shares of the Company's common stock at a price of $0.05 per share to an outside consultant, as replacement for warrants exercised in the Company's warrant repricing program for which the outside consultant received no profit. The Company recognized approximately $66,000 in expense in the 2002 consolidated financial statements relating to the warrant issuance. All 1,500,000 warrants were outstanding as of December 31, 2003. During January 2003, the Company granted 40,000, 10,000, and 10,000 warrants with an exercise price of $0.03 per share to William E Fritz, Charles W. Fritz, and James J. Keil, respectively, in connection with funding provided to the Company by these individuals during November 2002. During February 2003, the Company granted 500,000 warrants to GE Access, its primary equipment supplier, as payment of interest relating to a commercial credit agreement between GE Access and NeoMedia. The Company recognized approximately $7,000 in interest expense in the 2003 consolidated financial statements relating to the warrant issuance. The warrants were not exercised as of December 31, 2003. During April 2003, the Company granted 25,000,000 warrants to purchase shares of NeoMedia common stock at an exercise price of $0.01 per share to William E. Fritz, an outside director, in connection with financing provided to the Company by Mr. Fritz. The warrants were not exercised as of December 31,

2003. During July 2003, the Company granted 2,500,000 warrants to purchase shares of NeoMedia common stock at an exercise price of $0.01 per share to William E. Fritz, an outside director, in connection with financing provided to the Company by Mr. Fritz. The warrants were not exercised as of December 31, 2003. During September 2003, the Company granted 10,000,000 warrants to purchase shares of NeoMedia common stock at an exercise price of $0.01 per share to an outside consultant for consulting, advisory, and financing services performed during the third and fourth quarters of 2003. The Company recognized approximately $93,000 in expense in the 2003 consolidated financial statements relating to the warrant issuance. The warrants were not exercised as of December 31, 2003. During October 2003, the Company granted to Cornell 10,000,000 warrants to purchase shares of the Company's common stock at an exercise price of $0.05 per share, in connection with the $20 million Standby Equity Distribution Agreement entered into between the Company and Cornell. The warrants were not exercised as of December 31, 2003. Cornell exercised the warrants during January 2004. Option and Warrant Repricing Programs In June 2002, the Company repriced 3 million of its common stock warrants from $0.12 to $0.05 per share. All of the warrants were exercised immediately. The Company recognized an expense of $132,000 related to this repricing during the year ended December 31, 2002. In April 2002, in order to encourage the exercise of options, NeoMedia's Board of Directors adopted an option repricing program. Under the program, those persons holding options granted under the 1996, 1998 and 2002 Stock Option Plans, to the extent their options were exercisable during the period ending October 9, 2002, were allowed to exercise the option at a price which is the greater of $0.12 per share or 50% of the last sale price of a share of NeoMedia common stock on the OTC Bulletin Board on the trading date immediately preceding the date of exercise. No options were exercised under the program and no expense was recognized relating to the program. During March 2002, the Company repriced approximately1.2 million of its common stock warrants for a period of six months. During the term of the warrant repricing program, participating holders were entitled to exercise qualified warrants at an exercise price per share equal to the greater of (1) $0.12 or (2) 50% of the last sale price of shares of Common Stock on the OTCBB, on the trading date immediately preceding the date of exercise. Approximately 370,000 warrants were exercised in connection with the program, and NeoMedia recognized approximately $63,000 in expense relating to the repricing during the year ended December 31, 2002. F-29 During April 2003, the Company repriced approximately 1.9 million warrants held by Thornhill Capital LLC, an outside consultant to the Company. Of the 1.9 million warrants, 1.5 million had an exercise price of $0.05 per share, and approximately 0.4 million had an exercise price of $2.09 per share. All 1.9 million warrants were repriced to $0.00 per share. The Company recognized an expense of approximately $27,000 related to this transaction during the second quarter of 2003. These warrants were exercised immediately after the repricing. During May 2003, the Company re-priced approximately 8.0 million stock options under a 6-month repricing program. Under the terms of the program, the exercise price for outstanding options under the Company's 2002, 1998, and 1996 Stock Option Plans was restated to $0.01 per share for a period of 6 months. In accordance with FASB Interpretation, FIN 44, Accounting for Certain Transactions Involving Stock Transactions, the award has been accounted for as variable from May 19, 2003 through the period ended December 31, 2003. Accordingly, the Company recognized approximately $746,000 as compensation in general and administrative expense during the year ended December 31, 2003. Approximately 4.4 million options were exercised under the repricing program during the year ended December 31, 2003. During December 2003, the deadline for the option repricing was extended to June 30, 2004 by the Stock Option Committee of NeoMedia's Board of Directors. 19. SEGMENT INFORMATION Beginning with the year ended December 31, 1999, the Company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information" (SFAS 131). SFAS 131 supersedes Financial Accounting Standards Board's SFAS No. 14, "Financial Reporting for Segments of a Business Enterprise." SFAS 131 establishes standards for the way that business enterprises report information about operating segments in annual financial statements. SFAS 131 also establishes standards for related disclosures about products and services, geographic areas and major customers. The Company is organized into two business segments: (a) NeoMedia ISS, and (b) NeoMedia CIS. Performance is evaluated and resources allocated based on specific segment requirements and measurable factors. Management uses the Company's internal income statements to evaluate each business unit's performance. Assets of the business units are not available for management of the business segments or for disclosure. F-30 Operational results for the two segments for the years ended December 31, 2003 and 2002 are presented below (in thousands): (in thousands) ------------------------- Years Ended December 31, ------------------------- 2003 2002 ------------ ------------ Net Sales: NeoMedia Consulting & Integration Services $2,354 $9,370 NeoMedia Internet Switching Service 46 29 ------------ ----------- $2,400 $9,399 ------------

------------ Net Loss: NeoMedia Consulting & Integration Services ($4,331) ($1,275) NeoMedia Internet Switching Service (1,051) (6,146) ------------- ------------ ($5,382) ($7,421) ------------- ------------ Identifiable Assets NeoMedia Consulting & Integration Services $426 NeoMedia Internet Switching Service 2,537 Corporate 913 ------------- $3,876 ------------- 20. COMMON STOCK Holders of common stock are entitled to one vote for each share held of record on each matter submitted to a vote of stockholders. Holders of the common stock do not have cumulative voting rights, which means that the holders of more than one half of NeoMedia's outstanding shares of common stock, subject to the rights of the holders of preferred stock, can elect all of NeoMedia's directors, if they choose to do so. In this event, the holders of the remaining shares of common stock would not be able to elect any directors. Subject to the prior rights of any class or series of preferred stock which may from time to time be outstanding, if any, holders of common stock are entitled to receive ratably, dividends when, as, and if declared by the Board of Directors out of funds legally available for that purpose and, upon NeoMedia's liquidation, dissolution, or winding up, are entitled to share ratably in all assets remaining after payment of liabilities and payment of accrued dividends and liquidation preferences on the preferred stock, if any. Holders of common stock have no preemptive rights and have no rights to convert their common stock into any other securities. The outstanding common stock is duly authorized and validly issued, fully-paid, and nonassessable. On June 6, 2002, the Company's shareholders voted to increase the number of shares of common stock, par value $0.01 per share, that the Company is authorized to issue from 50,000,000 to 200,000,000 and the number of share of preferred stock, par value $0.01 per share, that the Company is authorized to issue from 10,000,000 to 25,000,000. On September 24, 2003, the Company's shareholders voted to (i) increase the number of shares of common stock, par value $0.01 per share, that the Company is authorized to issue from 200,000,000 to 1,000,000,000; and (ii) implement the 2003 Stock Option Plan, under which NeoMedia is authorized to grant to employeees, directors, and consultants up to 150,000,000 options to purchase shares of its common stock. On October, 30, 2003, the Company's Board of Directors approved the 2003 Stock Incentive Plan, under which the Company can issue up to 30 million shares of stock to employees, non-employee directors, consultants for incentive purposes. F-31 On February 11, 2003, NeoMedia and Cornell entered into an Equity Line of Credit Agreement under which Cornell agreed to purchase up to $10 million of NeoMedia's common stock over a two-year period, with the timing and amount of the purchase at the Company's discretion. The maximum amount of each purchase was $150,000 with a minimum of seven days between purchases. The shares were valued at 98% of the lowest closing bid price during the five-day period following the delivery of a notice of purchase by NeoMedia. The Company paid 5% of the gross proceeds of each purchase to Cornell On October 27, 2003, the Company and Cornell entered into a $20 million Standby Equity Distribution Agreement. The terms of the agreement are identical to the terms of the previous Equity Line of Credit, except that the maximum "draw" under the new agreement is $280,000 per week, not to exceed $840,000 in any 30-day period, and Cornell will purchase up to $20 million of the Company's common stock over a two-year period. As a consideration fee for Cornell to enter into the agreement, the Company issued 10 million warrants to Cornell with an exercise price of $0.05 per share, and a term of five years. Cornell exercised the warrants in January 2004, resulting in $500,000 cash receipts to the Company. 21. PREFERRED STOCK The Company's Preferred Stock is currently comprised of 25,000,000 shares, par value $0.01 per share, of which 200,000 shares are designated as Series A Preferred Stock, none of which are issued or outstanding, and, following the conversion into common stock of 452,489 shares of Series A Convertible Preferred Stock issued to About.com, 47,511 shares are designated as Series A Convertible Preferred Stock, none of which are issued and outstanding, and 100,000 shares of Series B 12% Convertible Redeemable Preferred Stock, none of which are issued and outstanding. The Company has no present agreements relating to or requiring the designation or issuance of additional shares of preferred stock. 22. SUBSEQUENT EVENTS On January 2, 2004, NeoMedia filed a patent infringement lawsuit against Virgin(R) Entertainment Group, Inc., Virgin Megastore Online and Virgin Megastore ("Virgin"). The Complaint for Patent Infringement and Damages was filed in the United States District Court for the Northern District of Illinois, Eastern Division, by Baniak Pine & Gannon, the Company's intellectual property law firm. The Complaint claims that Virgin has infringed four of NeoMedia's patents - U.S. Patents Nos. 5,933,829, 5,978,773, 6,108,656, and 6,199,048. The Complaint alleges that the Virgin Megaplay Stations located in Virgin's Megastores infringe NeoMedia's patents by using Virgin's Megascan technology to allow customers to scan UPC codes from in-store CDs and DVDs to access Internet-based product information, such as music and movie previews, and album and video art. The Complaint also alleges that Virgin had notice of NeoMedia's patents since the latter part of 2002 or before, yet it continued with its infringing activities. NeoMedia's Complaint seeks compensatory damages for Virgin's infringement, with those damages to be trebled due to the willful and wanton nature of the infringement. NeoMedia also seeks to preliminarily and permanently enjoin Virgin from its infringing activities. On January 20, 2004, the Company borrowed from Cornell the gross amount of $4,000,000 before Cornell discounts and fees. Cornell has also committed to fund an additional $1,000,000 in the form of a promissory note. As consideration for the advance, the Company granted to Cornell 40,000,000 warrants to purchase shares of NeoMedia stock with an exercise price of $0.05 per share. The additional $1,000,000 promissory note will be funded within 15 days of the filing of a registration statement by the Company to register the warrants. Upon registration of the warrants, if the average closing bid price of NeoMedia's common stock for any five day period exceeds $0.10, the Company has the option to force Cornell to exercise the warrants, resulting in additional funds to the Company of $2,000,000. Of the $4,000,000 funding, $2,500,000 was used to fund the acquisition of CSI International, Inc. during February 2004. As of February 2, 2004, the Company had sold to Cornell 2,868,313 shares under the Standby Equity Distribution Agreement, reducing the balance payable to $3,680,000. All assets of the Company are pledged as collateral for the note, which matures on June 18, 2004. The note has a 60-day cure period after maturity during which the Company can cure any defaults without penalty. The note accrues interest at a rate of 24% upon default only. The Company has the option to repay any remaining principal in cash. F-32 On January 23, 2004, NeoMedia filed a patent infringement lawsuit against AirClic, Scanbuy, Inc., and LScan Technologies, Inc. The suit claims that each of the parties has manufactured, or has manufactured for it, and has used, or actively induced others to use, technology which allows customers to use a built-in UPC bar code scanner to scan individual items and access information. The Complaint states that AirClic, Scanbuy and LScan have had actual and constructive notice of the existence of the patents-in-suite, and, despite such notice, failed to cease and desist their acts of infringement, and continue to engage in acts of infringement of the patents in suit. NeoMedia's Complaint seeks compensatory damages for infringement by AirClic, Scanbuy and LScan, with those damages to be trebled due to the willful and wanton nature of the infringement. NeoMedia also seeks to preliminarily and permanently enjoin AirClic, Scanbuy and LScan from their infringing activities. On February 6, 2004, NeoMedia acquired CSI International, Inc., of Calgary, Alberta, Canada, a private technology products company in the micro paint repair industry. NeoMedia paid 7,000,000 shares of its common stock, plus $2.5 million cash in exchange for all outstanding shares of CSI. NeoMedia has centralized the administrative functions in its Ft. Myers, Florida headquarters, and maintains the sales and operations office in Calgary, Alberta, Canada. On December 9, 2003, NeoMedia signed a non-binding letter of intent to acquire Triton Global Business Services Inc. and its parent company, BSD Software Inc. (Pink Sheets: BSDS), both of Calgary, Alberta, Canada. Triton, formed in 1998 and acquired by BSD in 2002, is an Internet Protocol-enabled provider of live and automated operator calling services, e-business support, billing and clearinghouse functions and information management services to telecommunications, Internet and e-business service providers. The LOI outlined terms, including an exchange of one share of NeoMedia common stock for each share of BSD Software, not to exceed 40 million shares. The transaction is contingent upon, among other things, satisfactory due diligence investigation by both companies, approval by NeoMedia's Board of Directors, approval by BSD Software's Board of Directors and shareholders, and any required regulatory approvals. As of February 27, 2004, the Company has not yet entered into any definitive purchase agreement with BSD. F-33 PART III ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS; COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT Directors and Executive Officers As of January 30, 2004, NeoMedia's directors and executive officers were: Name Age Position ---- --- -------- Charles W. Fritz 47 Chairman of the Board of Directors President, Chief Operating Officer, Acting Chief Charles T. Jensen 60 Executive Officer and Director David A. Dodge 28 Vice-President, Chief Financial Officer and Controller William E. Fritz 73 Secretary and Director James J. Keil 76 Director A. Hayes Barclay 73 Director The following is certain summary information with respect to the directors and executive officers of NeoMedia: Charles W. Fritz is a founder of NeoMedia and has served as an officer and as a Director of NeoMedia since NeoMedia's inception. On August 6, 1996, Mr. Fritz was appointed Chief Executive Officer and Chairman of the Board of Directors. On April 2, 2001, Mr. Fritz was appointed as President where he served until June 2002. Mr. Fritz is currently a member of the Compensation Committee. Prior to founding NeoMedia, Mr. Fritz was an account executive with IBM Corporation from January 1986 to January 1988, and Director of Marketing and Strategic Alliances for the information consulting group from February 1988 to January 1989. Mr. Fritz holds an M.B.A. from Rollins College and a B.A. in finance from the University of Florida. Mr. Fritz is the son of William E. Fritz, a Director of NeoMedia. Charles T. Jensen was Chief Financial Officer, Treasurer and Vice-President of NeoMedia since May 1, 1996. Mr. Jensen has been a

Director since August 6, 1996, and currently is a member of the Compensation Committee. During June 2002, Mr. Jensen was promoted to President, Chief Operating Officer, and Acting Chief Executive Officer. Prior to joining NeoMedia in November 1995, Mr. Jensen was Chief Financial Officer of Jack M. Berry, Inc., a Florida corporation which grows and processes citrus products, from December 1994 to October 1995, and at Viking Range Corporation, a Mississippi corporation which manufactures gas ranges, from November 1993 to December 1994. From December 1992 to February 1994, Mr. Jensen was Treasurer of Lin Jensen, Inc., a Virginia corporation specializing in ladies clothing and accessories. Prior to that, from January 1982 to March 1993, Mr. Jensen was Controller and Vice-President of Finance of The Pinkerton Tobacco Co., a tobacco manufacturer. Mr. Jensen holds a B.B.A. in accounting from Western Michigan University and is a Certified Public Accountant. III-1 David A. Dodge joined NeoMedia in 1999 as the Financial Reporting Manager. Since then, Mr. Dodge has acted as NeoMedia's Director of Financial Planning and Controller, and currently holds the title of Vice President, Chief Financial Officer and Controller. Prior to joining NeoMedia in 1999, Mr. Dodge was an auditor with Ernst & Young LLP for 2 years. Mr. Dodge holds a B.A. in economics from Yale University and an M.S. in accounting from the University of Hartford, and is also a Certified Public Accountant. William E. Fritz is a founder of NeoMedia and has served as Secretary and Director of NeoMedia since NeoMedia's inception. Mr. Fritz also served as Treasurer of NeoMedia from its inception until May 1, 1996. Since February 1981, Mr. Fritz has been an officer and either the sole stockholder or a majority stockholder of G.T. Enterprises, Inc. (formerly Gen-Tech, Inc.), D.M., Inc. (formerly Dev-Mark, Inc.) and EDSCO, three railroad freight car equipment manufacturing companies. Mr. Fritz holds a B.S.M.E. and a Bachelor of Naval Science degree from the University of Wisconsin. Mr. Fritz is the father of Charles W. Fritz, NeoMedia's former Chief Executive Officer and Chairman of the Board of Directors. James J. Keil has been a Director of NeoMedia since August 6, 1996. Mr. Keil currently is a member of the Compensation Committee, the Stock Option Committee and the Audit Committee. He is founder and President of Keil & Keil Associates, a business and marketing consulting firm located in Washington, D.C., specializing in marketing, sales, document application strategies, recruiting and electronic commerce projects. Prior to forming Keil & Keil Associates in 1990, Mr. Keil worked for approximately 38 years at IBM Corporation and Xerox Corporation in various marketing, sales and senior executive positions. From 1989-1995, Mr. Keil was on the Board of Directors of Elixir Technologies Corporation (a non-public corporation), and from 1990-1992 was the Chairman of its Board of Directors. From 1992-1996, Mr. Keil served on the Board of Directors of Document Sciences Corporation. Mr. Keil holds a B.S. degree from the University of Dayton and did Masters level studies at the Harvard Business School and the University of Chicago in 1961/62. A. Hayes Barclay has been a Director of NeoMedia since August 6, 1996, and currently is a member of the Stock Option Committee and the Audit Committee. Mr. Barclay has practiced law for approximately 37 years and, since 1967, has been an officer, owner and employee of the law firm of Barclay & Damisch, Ltd. and its predecessor, with offices in Chicago, Wheaton and Arlington Heights, Illinois. Mr. Barclay holds a B.A. degree from Wheaton College, a B.S. from the University of Illinois and a J.D. from the Illinois Institute of Technology - Chicago Kent College of Law. Election Of Directors And Officers Directors are elected at each annual meeting of stockholders and hold office until the next succeeding annual meeting and the election and qualification of their respective successors. Officers are elected annually by the Board of Directors and hold office at the discretion of the Board of Directors. NeoMedia's By-Laws permit the Board of Directors to fill any vacancy and such director may serve until the next annual meeting of shareholders and the due election and qualification of his successor. Meetings Of The Board Of Directors During the fiscal year ended December 31, 2003, the Company's Board of Directors held 5 meetings. All members of the Board of Directors attended at least 75% of such meetings. III-2 Committees Of The Board Of Directors NeoMedia's Board of Directors has an Audit Committee, Compensation Committee and a Stock Option Committee. The Board of Directors does not have a standing Nominating Committee. Audit Committee. The Audit Committee is responsible for nominating NeoMedia's independent accountants for approval by the Board of Directors, reviewing the scope, results and costs of the audit with NeoMedia's independent accountants, and reviewing the consolidated financial statements, audit practices and internal controls of NeoMedia. During 2003, members of the Audit Committee were non-employee directors James J. Keil and A. Hayes Barclay. During 2003, the Audit Committee held 2 meetings. Due to financial constraints, the Company does not have an audit committee financial expert serving on its audit committee. Compensation Committee. The Compensation Committee is responsible for recommending compensation and benefits for the executive officers of NeoMedia to the Board of Directors and for administering NeoMedia's Incentive Plan for Management. Charles W. Fritz, Charles T. Jensen, and James J. Keil were members of NeoMedia's

Compensation Committee during 2003. This Committee held one meeting throughout 2003. Stock Option Committee. The Stock Option Committee, which is comprised of non-employee directors, is responsible for administering NeoMedia's Stock Option Plans. A. Hayes Barclay and James J. Keil are the current members of NeoMedia's Stock Option Committee. During 2003, this Committee held one meeting. Director Compensation During October 2003, each outside director was granted 1,000,000 options at an exercise price of $0.01 per share from the 2003 Stock Option Plan. The last grant to outside directors was at NeoMedia's previous annual meeting held on June 6, 2002, at which each outside director received 100,000 options with an exercise price of $0.05 per share. NeoMedia does not have a written compensation policy for its outside directors at this time. Section 16(a) Beneficial Ownership Reporting Compliance Section 16(a) of the Securities Exchange Act of 1934 requires NeoMedia's officers and directors, and persons who own more than ten percent of a registered class of NeoMedia's equity securities, to file reports of ownership and changes in ownership with the Securities and Exchange Commission. Officers, directors and greater than ten-percent shareholders are required by SEC regulation to furnish NeoMedia with copies of all Section 16(a) forms they file. Based solely on a review of the copies of such forms furnished to NeoMedia, NeoMedia believes that during 2003 all Section 16(a) filing requirements applicable to NeoMedia's officers, directors and ten percent beneficial owners were complied with. III-3 ITEM 10. EXECUTIVE COMPENSATION The following table sets forth certain information with respect to the compensation paid to (i) NeoMedia's Chief Executive Officer and (ii) each of NeoMedia's other executive officers who received aggregate cash compensation in excess of $100,000 for services rendered to NeoMedia (collectively, "the Named Executive Officers") during the years ended December 31, 2003, 2002 and 2001: Summary Compensation Table Annual Compensation Long-term Compensation --- -- Other Securities Annual Restricted Underlying Compens- Stock Options/ LTIP All other Name and Salary Bonus ation Award(s) SARs(1) Payouts Compensation Principal Position Year ($) ($) ($) ($) (#) ($) ($) -- Charles W. Fritz 2003 $145,255 $110,322(2) $60,568 (3) - 10,000,000 - -- Chairman of the Board 2002 144,583 - 4,470 (4) - 1,800,000 - 2001 221,758 - 21,532 (4) - 400,000 - -- Charles T. Jensen 2003 162,318 91,618(2) 1,072 (4) - 10,000,000 - Chief Operating Officer, 2002 163,542 - 5,079 (4) - 800,000 - President, Acting Chief 2001 144,239 - 17,794 (4) - 240,000 - -- Executive Officer --------------- (1) Represents options granted under NeoMedia's 2003, 2002 and 1998 Stock Option Plans and warrants granted at the discretion of the Stock Option Committee of NeoMedia's Board of Directors. (2) During 2003, the Company paid past due Year 2000 Executive Incentive liability through the issuance of shares of its common stock. The amounts reported in this table represent the market value of the shares on the date of issuance. (3) During 2003, the Company paid Charles W. Fritz unpaid salary from 2002 through the issuance of shares of its common stock. The amounts reported in this table represent the market value of the shares on the date of issuance. (4) Includes automobile expenses attributable to personal use and the corresponding income tax effects, and life insurance premiums where policy benefits are payable to beneficiary of the Named Executive Officer. Employment Agreements On June 26, 2002, Charles T. Jensen was elected president and Chief Operating Officer, and also named acting CEO. The Company also promoted David Dodge, its Controller, to Vice President and Chief Financial Officer. No employment agreements are currently in place for any employees of the Company. III-4 Incentive Plan for Management Effective as of January 1, 1996, NeoMedia adopted an Annual Incentive Plan for Management ("Incentive Plan"), which provides for annual bonuses to eligible employees based upon the attainment of certain corporate and/or individual performance goals during the year. The Incentive Plan is designed to provide additional incentive to NeoMedia's management to achieve these growth and profitability goals. Participation in the Incentive Plan is limited to those employees holding positions assigned to incentive eligible salary grades and whose participation is authorized by NeoMedia's Compensation Committee which administers the Incentive Plan, including determination of employees eligible for participation or exclusion. The Board of Directors can amend, modify or terminate the Incentive Plan for the next plan year at any time prior to the commencement of such next plan year. To be eligible for consideration for inclusion in the Incentive Plan, an employee must be on NeoMedia's payroll for the last three months of the year involved. Death, total and permanent disability or retirement are exceptions to such minimum employment, and awards in such cases are granted on a pro-rata basis. In addition, where employment is terminated due to job elimination, a pro rata award may be considered. Employees who voluntarily terminate their employment, or who are terminated by NeoMedia for unacceptable performance, prior to the end of the year are not eligible to participate in the Incentive Plan. All awards are subject to any governmental regulations in effect at the time of payment. Performance goals are determined for both NeoMedia's and/or the employee's performance during the year, and if performance goals are attained, eligible employees are entitled to an award based upon a specified percentage of their base salary. The Company did not have an incentive plan for management in place for the year ended December 31, 2003. During 2003, the Company settled approximately $300,000 in past due incentive awards relating to its executive incentive plan for fiscal 2000, through the issuance of common stock. The Company has a remaining liability of approximately $80,000 as of December 31, 2003 relating to this executive incentive. During January 2004, the Company paid an additional $74,000 toward the balance through the issuance of common stock. Stock Option Plans Effective February 1, 1996 (and amended and restated effective July 18, 1996 and further amended through November 18, 1996), NeoMedia adopted its 1996 Stock Option Plan ("1996 Stock Option Plan"). The 1996 Stock Option Plan provides for the granting of non-qualified stock options and "incentive stock options" within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended, and provides for the issuance of a maximum of 1,500,000 shares of common stock. All 1,500,000 options were granted under NeoMedia's 1996 Stock Option Plan. Effective March 27, 1998, NeoMedia adopted its 1998 Stock Option Plan ("1998 Stock Option Plan"). The 1998 Stock Option Plan provides for the granting of non-qualified stock options and provides for the issuance of a maximum of 8,000,000 shares of common stock. All 8,000,000 options were granted under NeoMedia's 1998 Stock Option Plan. III-5 Effective June 6, 2002, NeoMedia adopted its 2002 Stock Option Plan. The 2002 Stock Option Plan provides for authority for the Board of Directors to the grant non-qualified stock options with respect to a maximum of 10,000,000 shares of common stock. All 10,000,000 options were granted under NeoMedia's 2002 Stock Option Plan Effective September 24, 2003, NeoMedia adopted its 2003 Stock Option Plan. The 2003 Stock Option Plan provides for authority for the Board of Directors to the grant non-qualified stock options with respect to a maximum of 150,000,000 shares of common stock. On October 17, 2003, NeoMedia filed a Form S-8 to register all 150,000,000 shares underlying the options in the 2003 Stock Option Plan. Stock Incentive Plan Effective October 31, 2003, NeoMedia adopted the 2003 Stock Incentive Plan. Under the terms of the Plan, NeoMedia has set aside up to 30,000,000 shares of common stock to be issued to pay compensation and other expenses related to employees, former employees, consultants, and non-employee directors. On November 3, 2003, NeoMedia filed a Form S-8 to register all 30,000,000 shares underlying the options in the 2003 Stock Incentive Plan. As of December 31, 2003, the Company had issued approximately 5.8 million shares under the 2003 Stock Incentive Plan. 401(k) Plan NeoMedia maintains a 401(k) Profit Sharing Plan and Trust (the "401(k) Plan"). All employees of NeoMedia who are 21 years of age and who have completed three months of service are eligible to participate in the 401(k) Plan. The 401(k) Plan provides that each participant may make elective contributions of up to 20% of such participant's pre-tax salary (up to a statutorily prescribed annual limit, which is $12,000 for 2003) to the 401(k) Plan, although the percentage elected by certain highly compensated participants may be required to be lower. All amounts contributed to the 401(k) Plan by employee participants and earnings on these contributions are fully vested at all times. The 401(k) Plan also provides for matching and discretionary contributions by NeoMedia. To date, NeoMedia has not made any such contributions. Options Granted in the Last Fiscal Year The following presents certain information on stock options for the Named Executive Officers for the year ended December 31, 2003: Percent of Number of Total Potential Realizable Value Securites Options/ at Assumed Annual Rates Underlying SARs of Stock Price Appreciation Options Granted to Exercise or for option Term Granted Employees in Base Price Expiration ------------------------------ Name (#) Fiscal Year ($/share) Date 5%($) 10%($) ------------------ ------------- ------------- -------------- ------------------ ------------------------------ Charles W. Fritz 10,000,000 16.6% $0.01 October 20, 2013 $641,473 $1,625,617 Charles T. Jensen 10,000,000 16.6% $0.01 October 20, 2013 641,473 1,625,617 III-6 Aggregate Option/SAR Exercises in Last Fiscal Year and Fiscal Year-End Options/SAR Values The following table sets forth options exercised by NeoMedia Named Executive Officers during the year ended December 31, 2003, and the number and value of all unexercised options at fiscal year end. Number of Unexercised Shares Securities Underlying Value of Unexercised In-Acquired Value Options/SARs at the-Money Options/SARs at on Exercise Realized December 31, 2003 December 31, 2003 (1) ------------------------------ ------------------------------- Name (#) ($) Exercisable Unexercisable Exercisable Unexercisable ------------------ ------------- ---------- ----------------------------- ------------------------------- Charles W. Fritz -- $ - 13,059,000 - $1,658,493 - Charles T. Jensen -- $ - 11,505,386 - $1,461,184 - (1) Based on the closing price of $0.137 of NeoMedia's common stock as quoted on OTC Bulletin Board on December 31, 2003 and the exercise price of the option/SAR. During May 2003, the Option Committee of the Company's Board of Directors repriced all outstanding stock options to an exercise price of $0.01 per share for a period of six months. The Option

Committee subsequently extended the option repricing through June 30, 2004. As a result, as of December 31, 2003, Mr. Fritz and Mr. Jensen held 3,059,000 and 1,527,386, respectively, with restated exercises prices, for which the exercise prices will revert to the original amounts if not exercised by June 30, 2004. All of the restated options were out-of-the-money at their original exercise prices. III-7 ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT The following table sets forth certain information regarding beneficial ownership of NeoMedia's common stock as of January 30, 2004, (i) by each person or entity known by NeoMedia to own beneficially more than five percent of NeoMedia's Common Stock, (ii) by each of NeoMedia's directors and nominees, (iii) by each executive officer of NeoMedia named in the Summary Compensation Table, and (iv) by all executive officers and directors of NeoMedia as a group. Amount and Nature of Percent of Beneficial Ownership (1) Class (1) ----------------------------- ------------- Charles W. Fritz (2)(3) 30,316,467 11.1% William Fritz(2)(4) 56,674,776 21.5% Charles T. Jensen(2)(5) 11,506,886 4.2% David A. Dodge(2)(6) 2,300,000 * A. Hayes Barclay(2)(7) 1,139,000 * James J. Keil(2)(8) 1,412,000 * --------------------------- ------------- Officers and Directors as a Group (6 Persons)(9) 103,349,129 35.5% --------------------------- ------------- ________ * - denotes ownership of less than one percent of issued and outstanding shares of NeoMedia's common stock. (1) Applicable percentage of ownership is based on 259,477,268 shares of common stock outstanding as of January 30, 2004, together with securities exercisable or convertible into shares of common stock within 60 days of January 30, 2004, for each stockholder. Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Shares of common stock subject to securities exercisable or convertible into shares of common stock that are currently exercisable or exercisable within 60 days of January 30, 2004, are deemed to be beneficially owned by the person holding such securities for the purpose of computing the percentage of ownership of such person, but are not treated as outstanding for the purpose of computing the percentage ownership of any other person. The common stock is the only outstanding class of equity securities of NeoMedia. (2) Address of the referenced individual is c/o NeoMedia Technologies, Inc., 2201 Second Street, Suite 402, Fort Myers, FL, 33901. (3) Charles W. Fritz is the Company's founder and the Chairman of the Board of Directors. Shares beneficially owned include 100 shares owned by each of Mr. Fritz's four minor children for an aggregate of 400 shares, 11,549,000 shares of common stock issuable upon exercise of options granted under the Company's 2003, 2002 and 1998 stock option plans, 1,510,000 shares issuable upon exercise of stock warrants, 15,714,098 shares of common stock owned by Mr. Charles W. Fritz directly, and 1,542,969 shares of common stock held by the CW/LA II Family Limited Partnership, a family limited partnership for the benefit of Mr. Fritz's family. (4) William E. Fritz, the Company's corporate secretary and a director, and his wife, Edna Fritz, are the general partners of the Fritz Family Limited Partnership and therefore each are deemed to be the beneficial owners of the 1,511,742 shares held in the Fritz Family Partnership. As trustee of each of the Chandler R. Fritz 1994 Trust, Charles W. Fritz 1994 Trust and Debra F. Schiafone 1994 Trust, William E. Fritz is deemed to be the beneficial owner of the 165,467 shares of NeoMedia held in these trusts. Additionally, Mr. Fritz is deemed to own: 51,172,567 shares held directly by Mr. Fritz or his spouse, 2,540,000 shares to be issued upon the exercise of warrants held by Mr. Fritz or his spouse, and 1,285,000 shares to be issued upon the exercise of options held by Mr. Fritz or his spouse. Mr. William E. Fritz may be deemed to be a parent and promoter of NeoMedia, as those terms are defined in the Securities Act. (5) Charles T. Jensen is President, Chief Operating Officer, Acting Chief Executive Officer, and a member of the Board of Directors. Beneficial ownership includes 11,505,386 shares of common stock issuable upon exercise of options granted under NeoMedia's stock option plans, and 1,500 shares owned by Mr. Jensen's sons. (6) David A. Dodge is Vice President, Chief Financial Officer, and Controller. Beneficial ownership includes 2,300,000 shares of common stock issuable upon exercise of options granted under NeoMedia's stock option plans. (7) A. Hayes Barclay is a member of the Board of Directors. Ownership includes 1,134,000 shares of common stock issuable upon exercise of options granted under NeoMedia's stock option plans, and 5,000 shares owned by Mr. Barclay directly. (8) James J. Keil is a member of the Board of Directors. Shares benficially owned includes 10,000 shares issuable upon exercise of warrants, and 1,402,000 shares owned by Mr. Keil directly. III-8 (9) Includes an aggregate of 27,773,386 currently exercisable options to purchase shares of common stock granted under NeoMedia's stock option plans, 4,060,000 currently exercisable warrants to purchase shares of common stock, and 71,515,743 shares owned directly by NeoMedia's officers and directors. III-9 ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS During February 2002, the Company borrowed $10,000 from William E. Fritz under a note payable bearing interest at 8% per annum with a term of 30 days. The note was repaid during April 2003. During

March 2002, the Company borrowed $190,000 from William E. Fritz under a note payable bearing interest at 8% per annum with a term of 16 days. The note was repaid during March 2002. During April 2002, the Company borrowed $11,000 from William E. Fritz under a note payable bearing interest at 8% per annum with a term of 60 days. The note was repaid during April 2003.. During November 2002, NeoMedia issued Convertible Secured Promissory Notes with an aggregate face value of $60,000 to 3 separate parties, including Charles W. Fritz, Chairman of the Board of Directors of NeoMedia; William E. Fritz, an outside director; and James J. Keil, an outside director. The notes bear interest at a rate of 15% per annum, and matured at the earlier of i.) four months, or ii.) the date the shares underlying the Cornell Equity Line of Credit were registered with the SEC. The notes were convertible, at the option of the holder, into either cash or shares of NeoMedia common stock at a 30% discount to either market price upon closing, or upon conversion, whichever is lower. NeoMedia also granted to the holders an additional 1,355,670 shares of its common stock and 60,000 warrants to purchase shares of its common stock at $0.03 per share, with a term of three years. The warrants and shares were issued in January 2003. In addition, since this debt is convertible into equity at the option of the note holder at beneficial conversion rates, an embedded beneficial conversion feature was recorded as a debt discount and amortized using the effective interest rate over the life of the debt in accordance with EITF 00-27. Total cost of beneficial conversion feature, fair value of the stock and cost of warrants issued exceed the face value of the notes payable, therefore, only $60,000, the face amount of the note, was recognizable as debt discount, and amortized over the life of the notes payable. During March 2003, two of the affiliated parties, Mr. William Fritz and Mr. Keil, agreed to extend the maturity date due to the Company's capital constraints. The Company repaid Charles Fritz's note in full during March 2003, and repaid James J. Keil's note in full during April 2003. The Company paid $30,000 of the principal on William Fritz's note during April 2003, and entered into a new note with Mr. Fritz for the remaining $10,000. The new note bears interest at a rate of 10% per annum and matures in April 2004. The new note also includes a provision under which, as consideration for the loan, Mr. Fritz will receive a 3% royalty on all future revenue generated from the Company's intellectual property. During April 2003, the Board of Directors of the Company approved the payment in full of approximately $154,000 of liabilities owed by the Company to Charles W. Fritz, the Company's Founder and Chairman of the Board of Directors, through the issuance of 15,445,967 shares of common stock. The Company recognized a discount expense in general and administrative expenses of approximately $15,000 relating to this transaction with Mr. Fritz. During April 2003, the Company sold 25,000,000 shares of its common stock, par value $0.01, in a private placement at a price of $0.01 per share. In connection with the sale, the Company also granted the purchaser 25,000,000 warrants to purchase shares of the Company's common stock at an exercise price of $0.01 per share. The warrants had a fair value of $298,000 and have been recorded as a cost of issuance. The purchaser was William E. Fritz, a member of the Company's Board of Directors. Proceeds to the Company from sale of the shares were $250,000. The Company recognized a discount expense in general and administrative expenses of approximately $50,000 relating to this transaction with Mr. Fritz. On August 6, 2003, Mr. Fritz exercised his warrants and purchased 25,000,000 additional shares of common stock at a price of $0.01 per share. III-10 During April 2003, the Company entered into a consulting agreement with William Fritz, an outside director, for consulting and advisement services relating to the merger with Loch Energy, Inc., and to the subsequent implementation of various management programs surrounding the business. The agreement called for total payments of $250,000 over a period of one year. During August 2003, the Company paid the consulting contract in full. During September 2003, the consulting contract was rescinded and the full $250,000 was returned to NeoMedia. During July 2003, the Company borrowed $25,000 from William E. Fritz, one of its outside directors. This amount was added to the principal of a $10,000 note payable to Mr. Fritz that matures in April 2004, with all other terms of the note remaining the same. As consideration for the loan, the Company granted Mr. Fritz 2,500,000 warrants to purchase shares of the Company's common stock at an exercise price of $0.01 per share. The warrants had a fair value of approximately $74,000. In accordance with EITF 00-27, the Company recorded the relative fair value of the warrants as a discount against the note, and amortized the discount over the life of the note. On August 29, 2003, the Company borrowed $50,000 from William E. Fritz, one of its outside directors, under an unsecured note payable. The note was paid in full during September 2003. III-11 ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K (a) Exhibits (1) The following exhibits required by Item 601 of Regulation S-B to be filed herewith are hereby incorporated by reference: Exhibit No. Description Location ----------- ----------- -------- 3.1 Articles of Incorporation of Dev-Tech Associates, Incorporated by reference to Exhibit 3.1 Inc. and amendment thereto to Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 3.2 Bylaws of DevSys, Inc. Incorporated by reference to Exhibit 3.2 to Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 3.3 Restated Certificate of Incorporation of DevSys, Incorporated by reference to Exhibit 3.3 Inc. to Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 3.4 By-laws of DevSys, Inc. Incorporated by reference to Exhibit 3.4 to Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 3.5 Articles of Merger and Agreement and Plan of Incorporated by reference to Exhibit 3.5 Merger of DevSys, Inc and Dev-Tech Associates, Inc. to Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 3.6 Certificate of Merger of Dev-Tech Associates, Inc. Incorporated by reference to Exhibit 3.6 into DevSys, Inc. to Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 3.7 Articles of Incorporation of Dev-Tech Migration, Incorporated by reference to Exhibit 3.7 Inc. and amendment thereto to Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 3.8 By-laws of Dev-Tech Migration, Inc. Incorporated by reference to Exhibit 3.8 to Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 III-12 Exhibit No. Description Location ----------- ----------- -------- 3.9 Restated Certificate of Incorporation of DevSys Incorporated by reference to Exhibit 3.9 Migration, Inc. to Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 3.10 Form of By-laws of DevSys Migration, Inc. Incorporated by reference to Exhibit 3.10 to Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 3.11 Form of Agreement and Plan of Merger of Incorporated by reference to Exhibit 3.11 Dev-Tech Migration, Inc. into DevSys Migration, to Registrant's Registration Statement Inc. No. 333-5534 as filed with the SEC on November 25, 1996 3.12 Form of Certificate of Merger of Dev-Tech Incorporated by reference to Exhibit 3.12 Migration, Inc. into DevSys Migration, Inc. to Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 3.13 Certificate of Amendment to Certificate of Incorporated by reference to Exhibit 3.13 Incorporation of DevSys, Inc. changing its name to Registrant's Registration Statement to NeoMedia Technologies, Inc. No. 333-5534 as filed with the SEC on November 25, 1996 3.14 Form of Certificate of Amendment to Certificate Incorporated by reference to Exhibit 3.14 of Incorporation of NeoMedia Technologies, Inc. to Registrant's Registration Statement authorizing a reverse stock split No. 333-5534 as filed with the SEC on November 25, 1996 3.15 Form of Certificate of Amendment to Restated Incorporated by reference to Exhibit 3.5 Certificate of Incorporation of NeoMedia to Registrant's Annual Report as filed Technologies, Inc. increasing authorized with the SEC on November 2, 2001 capital and creating preferred stock 10.1 Dev-Tech Associates, Inc. 1996 Stock Option Plan Incorporated by reference to Exhibit 10.44 to the Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 10.2 First Amendment and Restatement of Dev-Tech Incorporated by reference to Exhibit Associates, Inc. 1996 Stock Option Plan 10.45 to the Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 10.3 Form of Stock Option Agreement - Dev-Tech Incorporated by reference to Exhibit Associates, Inc. 10.46 to the Registrant's Registration Statement No. 333-5534 as filed with the SEC on November 25, 1996 III-12 Exhibit No. Description Location ------ ----------- -------- 10.4 Dev-Tech Migration, Inc. 1996 Stock Option Incorporated by reference to Exhibit 10.47 to Plan the Registrant's Registration Statement No. 333- 5534 as filed with the SEC on November 25, 1996 10.5 First Amendment and Restatement of Dev-Tech Incorporated by reference to Exhibit 10.48 to Migration, Inc. the Registrant's Registration Statement No. 333- 5534 as filed with the SEC on November 25, 1996 10.6 Form of Stock Option Agreement - Dev-Tech Incorporated by reference to Exhibit 10.49 to Migration, Inc. the Registrant's Registration Statement No. 333- 5534 as filed with the SEC on November 25, 1996 10.7 Dev-Tech Associates, Inc. 401(k) Plan and Incorporated by reference to Exhibit 10.50 to amendments the Registrant's Registration Statement No. 333- 5534 as filed with the SEC on November 25, 1996 10.8 First Amendment and Restatement of NeoMedia Incorporated by reference to Exhibit 10.60 to Technologies, Inc. 1996 Stock Option Plan the Registrant's Registration Statement No. 333- 5534 as filed with the SEC on November 25, 1996 10.9 NeoMedia Technologies, Inc. 1998 Stock Provided Herewith Option Plan 10.10 Amendment to NeoMedia Technologies 1998 Incorporated by reference to Form 14A as filed Stock Option Plan with the SEC on July 2, 1999 10.11 Sale and Purchase Agreement between Incorporated by reference to Exhibit 10.48 to Qode.com, Inc. and NeoMedia Technologies, the Registrant's Current Report on Form 8-K as Inc. filed with the SEC on March 15, 2001 10.12 Warrant repricing letter dated March 19, 2002 Incorporated by reference to Exhibit 1.2 to the Registrant's Current Report on Form 8-K as filed with the SEC on April 2, 2002 10.13 Option repricing letter dated April 3, 2002 Incorporated by reference to Exhibit 1.2 to the Registrant's Current Report on Form 8-K as filed with the SEC on April 15, 2002 10.14 Intellectual Property licensing agreement Incorporated by reference to Exhibit 10.18 to between NeoMedia and A.T. Cross Company the Registrant's

Form S-1/A as filed with the SEC on April 24, 2002 III-14 Exhibit No. Description Location -------- ---------- -------- 10.15 Intellectual Property licensing agreement Registrant's Form S-1/A as filed with the SEC on April between NeoMedia and Symbol 24, 2002 Technologies, Inc. 10.16 Sponsorship and Advertising Agreement Incorporated by reference to Exhibit 10.20 to the between NeoMedia and About.com, Inc. Registrant's Form S-1/A as filed with the SEC on April 24, 2002 10.17 Letter of Intent regarding proposed strategic Incorporated by reference to Exhibit 10.21 to the transaction between NeoMedia and AirClic, Registrant's Form S-1/A as filed with the SEC on April Inc. 24, 2002 10.18 Form of Promissory Note issued to AirClic, Incorporated by reference to Exhibit 10.22 to the Inc. Registrant's Form S-1/A as filed with the SEC on April 24, 2002 10.19 Form of Limited Recourse Promissory Note Incorporated by reference to Exhibit 10.23 to the issued in exchange for 19 Million Shares of Registrant's Form S-1/A as filed with the SEC on April Common Stock 24, 2002 10.20 Nasdaq Staff Determination Letter with Incorporated by reference to Exhibit 10.24 to the respect to de-listing of NeoMedia securities Registrant's Form S-1/A as filed with the SEC on April from the Nasdaq SmallCap market 24, 2002 10.21 Revised warrant repricing letter dated April Incorporated by reference to Exhibit 10.25 to the 3, 2002 Registrant's Form S-1/A as filed with the SEC on April 24, 2002 10.22 Equity Line of Credit Agreement, dated May Incorporated by reference to Exhibit 10.17 to the 6, 2002, between NeoMedia Technologies Registrant's Quarterly Report on Form 10-Q as filed and Cornell Capital Partners, LP with the SEC on August 14, 2002 10.23 Nasdaq Staff delisting notification letter Incorporated by reference to Exhibit 10.18 to the dated May 16, 2002 Registrant's Quarterly Report on Form 10-Q as filed with the SEC on August 14, 2002 10.24 Settlement Agreement relating to wrongful Incorporated by reference to Exhibit 10.19 to the termination lawsuit brought by former Registrant's Form 10-Q as filed with the SEC on president and Chief Operating Officer August 14, 2002 10.25 Mutual settlement agreement by and Incorporated by reference to Exhibit 10.20 to the between NeoMedia Technologies and 2150 Registrants Form 10-Q as filed on November 14, 2002 Western Court Company, LLC III-15 Exhibit No. Description Location -------- ---------- -------- 10.26 Mutual settlement agreement by and between Incorporated by reference to Exhibit 10.21 to NeoMedia Technologies and Ripfire, Inc. the Registrants Form 10-Q as filed on November 14, 2002 10.27 Mutual settlement agreement by and between Incorporated by reference to Exhibit 10.22 to NeoMedia Technologies and Wachovia Bank, the Registrants Form 10-Q as filed on N.A. November 14, 2002 10.28 Mutual settlement agreement by and between Incorporated by reference to Exhibit 10.23 to NeoMedia Technologies and Marianne LePera, the Registrants Form 10-Q as filed on NeoMedia Technologies' former General November 14, 2002 Counsel 10.29 Equity Line of Credit Agreement, dated Incorporated by reference to Exhibit 10.80 to February 11, 2003, between NeoMedia the Registrants Form S-1/A as filed on Technologies and Cornell Capital Partners February 14, 2003 10.30 Sponsorship and Advertising Agreement, dated Incorporated by reference to Exhibit 23.7 to May 23, 2001, between About.com and the Registrants Form S-1/A as filed on NeoMedia November 16, 2001 10.31 Promissory Note dated December 2, 2002 Incorporated by reference to Exhibit 99.1 of between Michael Kesselbrenner and NeoMedia the Registrant's Form 8-K as filed with the SEC on December 12, 2002. 10.32 Pledge Agreement dated December 2, 2002, Incorporated by reference to Exhibit 99.2 of between Michael Kesselbrenner and NeoMedia the Registrant's Form 8-K as filed with the SEC on December 12, 2002. 10.33 Form of Placement Agent Agreement, dated Incorporated by reference to Exhibit 10.84 to November 2002, between NeoMedia the Registrant's Form S-1 as filed on Technologies and Westrock Advisors, Inc. February 12, 2003 10.34 Form of Escrow Agreement, dated November Incorporated by reference to Exhibit 10.85 to 2002, between NeoMedia Technologies and the Registrant's Form S-1 as filed on Cornell Capital Partners February 12, 2003 10.35 Form of Registration Rights Agreement, dated Incorporated by reference to Exhibit 10.86 to November 2002, between NeoMedia the Registrant's Form S-1 as filed on Technologies and Cornell Capital Partners February 12, 2003 10.36 Promissory Note, dated February 23, 2001, Incorporated by reference to Exhibit 10.87 to between Digital Convergence Corporation and the Registrant's Form S-1 as filed on NeoMedia February 12, 2003 10.37 Termination Agreement, dated August 21, 2001, Incorporated by reference to Exhibit 10.88 to between About.com and NeoMedia the Registrant's Form S-1 as filed on February 12, 2003 III-16 Exhibit No. Description Location -------- ---------- -------- 10.38 Memorandum of Terms to merge, dated March 7, Incorporated by reference to Exhibit 3.1 to the 2003, between NeoMedia and Loch Energy, Inc. Registrant's Form 8-K as filed on March 19, 2003 10.39 Binding Letter of Intent to merge, dated July 25, Incorporated by reference to Exhibit 99.5 to 2003, between NeoMedia and Secure Source the Registrant's Form 10-QSB as filed on Technologies, Inc. August 14, 2003 10.4 Definitive Merger Agreement, dated October 3, 2003, Incorporated by reference to Exhibit 99.1 to between NeoMedia and Secure Source Technologies, the Registrant's Form 8-K as filed on Inc October 8, 2003 10.41 Standby Equity Distribution

Agreement, dated Incorporated by reference to Exhibit 10.91 to October 27, 2003, between NeoMedia and Cornell the Registrant's Form SB-2/A as filed on Capital Partners December 19, 2003 10.42 Form of Placement Agent Agreement, dated October Incorporated by reference to Exhibit 10.92 to 27, 2003, between NeoMedia and Newbridge the Registrant's Form SB-2/A as filed on Securities Corporation December 19, 2003 10.43 Form of Registration Rights Agreement, dated Incorporated by reference to Exhibit 10.93 to October 27, 2003, between NeoMedia and Cornell the Registrant's Form SB-2/A as filed on Capital Partners December 19, 2003 10.44 Form of Escrow Agreement, dated October 27, 2003, Incorporated by reference to Exhibit 10.94 to between NeoMedia and Cornell Capital Partners the Registrant's Form SB-2/A as filed on December 19, 2003 10.45 2003 Stock Compensation Plan Incorporated by reference to Exhibit 4.1 to the Registrant's Form S-8 as filed on October 31, 2003 10.46 Letter of Intent to acquire CSI International, Incorporated by reference to Exhibit 3.1 to Inc., dated November 8, 2003 the Registrant's Form 8-K as filed on November 13, 2003 10.47 Letter of Intent to acquire BSD Software, Inc., Incorporated by reference to Exhibit 3.1 to dated December 9, 2003 the Registrant's Form 8-K as filed on December 11, 2003 10.48 Definitive Merger Agreement, dated February 6, Incorporated by reference to Exhibit 3.1 to the 2004, between NeoMedia and CSI International, Inc. Registrant's Form 8-K as filed on February 10, 2004 $4 million Promissory note payable to Cornell 10.49 Capital Partners, dated January 15, 2004 Provided Herewith 23.1 Consent of Stonefield Josephson, Inc. Provided Herewith III-17 (b) Reports on Form 8-K NeoMedia filed a report on Form 8-K on October 3, 2003, reporting that it had terminated its letter of intent to merge with Loch Energy, Inc. NeoMedia filed a report on Form 8-K on October 9, 2003, reporting that it had completed its pending merger with Secure Source Technologies, Inc. NeoMedia filed a report on Form 8-K on November 13, 2003, reporting that it had signed a letter of intent to acquire CSI International, Inc. NeoMedia filed a report on Form 8-K on December 11, 2003, reporting that it had signed a letter of intent to acquire BSD Software, Inc. NeoMedia filed a report on Form 8-K on February 10, 2004, reporting that it had completed its pending merger with CSI International, Inc. ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES Audit Fees The aggregate fees billed by Stonefield Josephson, Inc., NeoMedia's independent auditors, for the audit of NeoMedia's annual consolidated financial statements and reviews of quarterly financial statements for the years ended December 31, 2003 and 2002 were $119,000 and $145,000, respectively. Audit-related Fees The aggregate fees billed by Stonefield Josephson, Inc., NeoMedia's independent auditors, for assurance and related services for the years ended December 31, 2003 and 2002 were $0 and $0, respectively. Tax Fees The aggregate fees billed by Wiltshire, Whitley, Richardson & English, NeoMedia's principal accountants for tax compliance, advice, and planning, for the years ended December 31, 2003 and 2002 were $9,000 and $9,000, respectively. All Other Fees The aggregate fees billed by Stonefield Josephson, Inc., for other products and services during the years ended December 31, 2003 and 2002 were $0 and $0, respectively. Audit Committee Pre-approval The audit committee of NeoMedia's board of directors approves all non-audit services provided by NeoMedia's primary accountants. III-19 SIGNATURES In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized in the City of Fort Myers, State of Florida, on the 27th day of February, 2004. NEOMEDIA TECHNOLOGIES, INC. Registrant By: /s/ Charles T. Jensen, President, Chief Operating Officer, Acting Chief Executive Officer, and Director In accordance with the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on February 27, 2004. Signatures Title Date ---------- ----- ---- --------------------------- President, Acting Chief Executive Officer, /s/ Charles T. Jensen Chief Operating Officer and Director February 27, 2004 ---------------------------- Director and Secretary February 27, 2004 /s/ William E. Fritz ---------------------------- Chairman of the Board /s/ Charles W. Fritz February 27, 2004 ---------------------------- Vice-President, Chief Financial /s/ David A. Dodge Officer and Controller February 27, 2004 ---------------------------- Director February 27, 2004 /s/ Hayes Barclay ---------------------------- Director February 27, 2004 /s/ James J. Keil