NEOMEDIA TECHNOLOGIES INC
Form 10-Q
August 09, 2006

U. S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10 - Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended June 30, 2006

OR

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

Commission File Number 0-21743

NEOMEDIA TECHNOLOGIES, INC.
(Exact Name of Issuer as Specified In Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**36-3680347** (I.R.S. Employer Identification No.)
2201 Second Street, Suite 600, Fort Myers, Florida (Address of Principal Executive Offices)	**33901** (Zip Code)

239-337-3434 Issuer's Telephone Number (Including Area Code)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x Noo

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of “accelerated filer and large accelerated filer” in Rule 12b-2 of the Exchange Act. (Check one): Large Accelerated Filer o Accelerated Filer x Non-accelerated Filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yeso Nox

As of July 21, 2006, there were 638,307,278 outstanding shares of the issuer's Common Stock, and 22,000 outstanding shares of the issuer’s Series C convertible preferred stock.

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PART I -- FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

NeoMedia Technologies, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(In Thousands, Except Share Data)

ASSETS		**June 30 2006** (unaudited)		**December 31 2005** *
Current assets:				
Cash and cash equivalents	$	2,550	$	2,291
Trade accounts receivable, net of allowance for doubtful accounts of $96 and $203, respectively		6,376		341
Inventories, net of allowance for obsolete & slow-moving inventory of $0		345		423
Investment in marketable securities		567		104
Prepaid expenses and other current assets		1,576		151
Total current assets		11,414		3,310
Leasehold improvements & property and equipment, net		781		236
Goodwill		50,943		1,099
Intangible assets, net		23,550		4,830
Cash surrender value of life insurance policy		778		769
Loan to Mobot (2005) and HipCricket (2006)		500		1,500
Other long-term assets		1,125		667
Total assets	$	89,091	$	12,411
LIABILITIES AND SHAREHOLDERS' EQUITY				
Current liabilities:				
Accounts payable	$	5,695	$	1,574
Amounts payable under settlement agreements		97		97
Liabilities of discontinued business unit		676		676
Taxes payable		1,187		80
Accrued expenses		3,918		1,844
Deferred revenues and other		3,894		898
Notes payable		2,417		3,015
Derivative financial instruments		12,407		---
Total current liabilities		30,291		8,184
Preferred stock, $0.01 par value, 25,000,000 shares authorized, 22,000 issued and outstanding, liquidation value of $22,000 and accreted dividends of $616.		2,327		---
Shareholders' equity:				
Common stock, $0.01 par value, 5,000,000,000 shares authorized, 637,708,704 and 475,387,910 shares issued and 636,107,278 and 467,601,717 outstanding, respectively		6,361		4,676
Additional paid-in capital		153,410		106,456

Deferred stock-based compensation	(98)	(169)
Deferred equity financing costs	(13,256)	(13,256)
Accumulated deficit	(88,709)	(92,524)
Accumulated other comprehensive loss	(456)	(177)
Treasury stock, at cost, 201,230 shares of common stock	(779)	(779)
Total shareholders’ equity	56,473	4,227
Total liabilities and shareholders’ equity	$ 89,091	$ 12,411

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

* - Derived from NeoMedia’s audited financial statements for the year ended December 31, 2005.

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NeoMedia Technologies, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
and Comprehensive Income (Loss) (Unaudited)
(In Thousands, Except Share and per Share Data)

	Three Months Ended June 30	
	2006	**2005**
NET SALES:		
Technology license, service and products	$ 6,205	$ 277
Micro paint repair products and services	401	261
Total net sales	6,606	538
COST OF SALES:		
Technology license, service and products	3,948	213
Micro paint repair products and services	569	237
Total cost of sales	4,517	450
GROSS PROFIT	2,089	88
Sales and marketing expenses	3,337	1,230
General and administrative expenses	2,697	444
Research and development costs	896	160
Stock based compensation expense	1,072	418
Loss from operations	(5,913)	(2,164)
Gain (loss) on extinguishment of debt	106	33
Interest (expense), net	(85)	(169)
Gain on derivative financial instruments	11,025	---
NET INCOME (LOSS)	**5,133**	**(2,300)**
Accretion of dividends on convertible preferred stock	**(479)**	---
NET INCOME (LOSS) ATTRIBUTABLE TO COMMON SHAREHOLDERS	**4,653**	**(2,300)**
Comprehensive Income (Loss)		
Net income (loss)	5,133	(2,300)
Other comprehensive income (loss):		
Unrealized gain (loss) on marketable securities	114	(87)
Foreign currency translation adjustment	(320)	(2)
COMPREHENSIVE INCOME (LOSS)	**$ 4,927**	**$ (2,389)**
INCOME (LOSS) PER SHARE ATTRIBUTABLE TO COMMON SHAREHOLDERS - BASIC	**$ 0.01**	**$ (0.01)**
INCOME (LOSS) PER SHARE ATTRIBUTABLE TO COMMON SHAREHOLDERS - DILUTED	**$ 0.01**	**$ (0.01)**

Weighted average number of common shares--basic	**632,402,254**	**448,777,048**
Weighted average number of common shares--diluted	**799,536,925**	**448,777,048**

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

NeoMedia Technologies, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations
and Comprehensive Income (Loss) (Unaudited)
(In Thousands, Except Share and per Share Data)

	Six Months Ended June 30 2006	2005
NET SALES:		
Technology license, service and products	$ 7,880	$ 569
Micro paint repair products and services	778	716
Total net sales	8,658	1,285
COST OF SALES:		
Technology license, service and products	4,775	389
Micro paint repair products and services	988	510
Total cost of sales	5,763	899
GROSS PROFIT	2,895	386
Sales and marketing expenses	4,879	2,025
General and administrative expenses	4,023	1,047
Research and development costs	1,446	344
Stock based compensation expense	2,589	514
Loss from operations	(10,042)	(3,544)
Gain (loss) on extinguishment of debt	(1,858)	171
Interest (expense), net	(79)	(146)
Gain on derivative financial instruments	15,794	---
NET INCOME (LOSS)	**3,815**	**(3,519)**
Accretion of dividends on convertible preferred stock	**(616)**	**0**
NET INCOME (LOSS) ATTRIBUTABLE TO COMMON SHAREHOLDERS	**3,199**	**(3,519)**
Comprehensive Income (Loss)		
Net income (loss)	3,815	(3,519)
Other comprehensive income (loss):		
Unrealized gain (loss) on marketable securities	263	(129)
Foreign currency translation adjustment	(542)	9
COMPREHENSIVE INCOME (LOSS)	**$ 3,536**	**$ (3,639)**
INCOME (LOSS) PER SHARE ATTRIBUTABLE TO COMMON SHAREHOLDERS - BASIC	**$ 0.01**	**$ (0.01)**
INCOME (LOSS) PER SHARE ATTRIBUTABLE TO COMMON SHAREHOLDERS - DILUTED	**$ 0.01**	**$ (0.01)**

Weighted average number of common shares--basic	**580,485,463**	**443,301,430**
Weighted average number of common shares--diluted	**757,912,587**	**443,301,430**

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

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

	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 3,815	($3,519)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Depreciation and amortization	1,431	354
Loss on early extinguishment of debt	1,858	—
Gain on derivative financial instruments	(15,794)	—
Stock-based compensation expense	2,724	514
(Increase) decrease in value of life insurance policies	(9)	9
Changes in operating assets and liabilities		
Trade accounts receivable, net	(727)	(504)
Inventory	184	(21)
Other current assets	(1,013)	65
Accounts payable, amounts due under settlement agreements, liabilities in excess of assets of discontinued business unit, and accrued expenses	(226)	(292)
Deferred revenue other current liabilities	1,328	(61)
Net cash used in operating activities	(6,429)	(3,455)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid to acquire Mobot, Inc., Sponge Ltd., Gavitec AG, and 12Snap AG, net of cash acquired	(11,891)	—
Amounts issued under notes receivable	(500)	—
Investments	—	(500)
Acquisition related costs	(164)	—
Capitalization of software development and purchased intangible assets	(11)	(1,549)
Acquisition of property and equipment	(383)	(162)
Net cash used in investing activities	(12,949)	(2,211)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from issuance of Series C convertible preferred stock, net of issuance costs of $2,725 in 2006	14,066	—
Net proceeds from issuance of common stock, net of issuance costs of $24 in 2006 and $105 in 2005	210	4,302
Net proceeds from exercise of stock options and warrants	8,316	701
Borrowings under notes payable and long-term debt	—	9,932
Repayments on notes payable and long-term debt	(2,428)	(3,837)
Cash commitment fee for $100 million Standby Equity Distribution Agreement	—	(1,000)
Net cash provided by financing activities	20,164	10,098
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(527)	9

NET INCREASE IN CASH AND CASH EQUIVALENTS		**259**		**4,441**
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD		2,291		2,634
CASH AND CASH EQUIVALENTS, END OF PERIOD	**$**	**2,550**	**$**	**7,075**
SUPPLEMENTAL CASH FLOW INFORMATION:				
Interest paid (received) during the period	$	48	$	47
Income taxes paid		—		—
Non-cash investing and financing activities:				
Unrealized gain (loss) on marketable securities		263		—
Prepaid acquisition costs applied to purchase price		168		—
Fair value of shares and notes receivable from Pickups Plus, Inc. acquired in exchange for Series C convertible preferred stock		594		—
Carrying value of promissory note and accrued interest paid in exchange for Series C convertible preferred stock		(3,208)		—
Fair value of shares issued to acquire Mobot, Inc., Sponge Ltd., Gavitec AG, 12Snap AG, and BSD Software, Inc.		46,964		—
Change in net assets resulting from acquisitions of Mobot, Inc., Sponge Ltd., Gavitec AG, 12Snap AG, and BSD Software, Inc.		62,656		—
Accretion of dividends on Series C convertible preferred stock		616		—
Fair value of outstanding warrants converted to liabilities		13,884		—
Portion of change in fair value of outstanding warrants converted to liabilities recorded to paid-in capital		3,790		—
Fair value of Series C convertible preferred stock (host instrument only)		4,908		—
Deferred stock-based financing costs associaed with Series C convertible preferred stock		3,198		—
Difference between net proceeds and recorded fair value of Series C convertible preferred stock		4,041		—
Advance receivable from Mobot, Inc. forgiven upon acquisition		1,500		—
Gain (loss) on extinguishment of debt paid in common stock		(106)		138
Fair value of stock issued for services and deferred to future periods		—		239
Direct costs associated with Standby Equity Distribution Agreement and Equity Line of Credit		—		1,204
Fair value of warrants issued as fees related to the $100 million Standby Equity Distribution Agreement		—		12,256

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

NEOMEDIA TECHNOLOGIES, INC. AND SUBSIDIARIES
UNAUDITED NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND NATURE OF BUSINESS OPERATIONS

Basis of Presentation

The condensed consolidated financial statements include the financial statements of NeoMedia Technologies, Inc. and its wholly-owned subsidiaries ("NeoMedia" or the "Company"). The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete consolidated financial statements. These condensed consolidated financial statements and related notes should be read in conjunction with the Company's Form 10-KSB for the fiscal year ended December 31, 2005. In the opinion of management, these condensed consolidated financial statements reflect all adjustments which are of a normal recurring nature and which are necessary to present fairly the consolidated financial position of NeoMedia as of June 30, 2006, the results of operations for the three and six month periods ended June 30, 2006 and 2005, and cash flows for the six month periods ended June 30, 2006 and 2005. The results of operations for the three and six month periods ended June 30, 2006 are not necessarily indicative of the results which may be expected for the entire fiscal year. All significant intercompany accounts and transactions have been eliminated in preparation of the condensed consolidated financial statements.

Going Concern

The accompanying condensed 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. Net income for the six months ended June 30, 2006 was $3,815,000 which includes a gain on Derivative Financial Instruments of $15,794,000. NeoMedia also reported net losses of $9,147,000 and $7,230,000 for the years ended December 31, 2005 and 2004, respectively, and has an accumulated deficit of $88,709,000 and a working capital deficit of $18,377,000 as of June 30, 2006.

In addition, NeoMedia has material liquidity events that could adversely affect its ability to continue as a going concern, primarily:

- in the event that NeoMedia's stock price at the time the consideration shares issued in connection with the acquisitions of Mobot, Sponge, Gavitec, and 12Snap become saleable is less than the contractual price (between $0.3839 and $0.3956), NeoMedia is obligated to compensate the sellers in cash for the difference between the price at the time the shares become saleable and the relevant contractual price. Assuming a stock price at the time the shares become saleable of $0.165, which was the last sale price on July 21, 2006, NeoMedia would have a cash liability of $25.5 million relating to the guarantees.

- during the six months ended June 30, 2006, NeoMedia made cash payments totaling $2.1 million to silent partners of 12Snap, as partial payment under silent partner agreements put in place prior to the acquisition of 12Snap by NeoMedia. The agreements call for additional cash payments of $2.1million on or before December 31, 2006.

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

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 the profitability from the NeoMedia Mobile, NeoMedia Micro Paint Repair, and NeoMedia Telecom Services businesses.

Nature of Business Operations

During 2005, NeoMedia was structured and evaluated by its Board of Directors and management as three distinct business units: NeoMedia Internet Switching Software (NISS), NeoMedia Micro Paint Repair (NMPR), and NeoMedia Consulting and Integration Services (NCIS).

NCIS is the original business line upon which the Company was founded. This unit resells client-server equipment and related software, and general and specialized consulting services. Because of decreased demand for systems integration products, and increased consolidation and competition in the industry in general, during 2005 resources allocated to the NCIS business unit were increasingly used in sales and business development efforts associated with the NISS business unit. During February 2006, NeoMedia's Board of Directors elected to formally wind down the NCIS business unit. As a result, during February 2006, NeoMedia closed its Lisle, Illinois facility out of which the NCIS business unit was based. NeoMedia does, however, plan to continue servicing existing contracts and customers.

During the first quarter of 2006, following the completion of the acquisitions of 12Snap AG ("12Snap"), Sponge Ltd. ("Sponge"), Gavitec AG ("Gavitec"), Mobot, Inc. ("Mobot"), and BSD Software, Inc. ("BSD"), as well as the winding down of the NCIS business unit, NeoMedia restructured into the following three business units:

- NeoMedia Mobile (NMM) - encompassing NeoMedia's physical-world-to-internet and mobile marketing technologies branded under Qode®, 12Snap, Sponge, Gavitec and Mobot. During the second quarter of 2006, NeoMedia rebranded its PaperClick suite of products under the brand name Qode®.

- NeoMedia Micro Paint Repair (NMPR) - encompassing the micro paint and auto aftermarket accessories manufactured and distributed by NeoMedia

- NeoMedia Telecom Services (NTS) - encompassing the billing, clearinghouse and information management services of recently-acquired BSD

Reclassifications

Certain amounts in the 2005 condensed consolidated financial statements have been reclassified to conform to the 2006 presentation, most notably, "License revenue" and "Resales of software and technology equipment and service fees", which were formerly reported as separate line items on NeoMedia's consolidated statement of operations, are now condensed into the category entitled, "Technology license, service & products." This is primarily due to the winding down of the former NCIS business unit and consolidation of revenues relating to the NCIS unit into the NMM unit, as well as the addition of new revenue streams from Mobot, Sponge, Gavitec, 12Snap, and BSD that fall into the same general category.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

As a result of the addition of the operations of Mobot, Sponge, Gavitec, 12Snap and BSD, and the issuance of the Series C convertible preferred stock during the six months ended June 30, 2006, NeoMedia is presenting certain significant accounting policies that were not applicable as of the filing of its last annual report for the year ended December 31, 2005.

Stock-based Compensation

Beginning January 1, 2006, NeoMedia began to account for stock-based compensation in accordance with SFAS No. 123(R), *Share-Based Payment*. Under the fair value recognition provisions of this statement, share-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of share-based awards at the grant date requires judgment, including estimating expected dividends. In addition, judgment is also required in estimating the amount of share-based awards that are expected to be forfeited. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could be materially impacted. Stock-based compensation expense is calculated using the Black-Scholes-Merton option pricing model on 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.

Fair Value of Derivatives

The Company generally does not use derivative financial instruments to hedge exposures to cash-flow risks or market-risks that may affect the fair values of its financial instruments. However, certain other financial instruments, such as warrants and embedded conversion features that are indexed to the Company's common stock, are classified as liabilities when either (a) the holder possesses rights to net-cash settlement or (b) physical or net-share settlement is not within the control of the Company. In such instances, net-cash settlement is assumed for financial accounting and reporting, even when the terms of the underlying contracts do not provide for net-cash settlement. Such financial instruments are initially recorded at fair value and subsequently adjusted to fair value at the close of each reporting period.

The caption "Derivative Financial Instruments" consists of (i) the fair values associated with derivative features embedded in the Series C convertible preferred stock, (ii) the fair values of the detachable warrants that were issued in connection with the preferred stock financing arrangement, and (iii) the fair value of detachable warrants that were outstanding prior to the issuance of the Series C Preferred Shares.

Sales Taxes Payable

Sales taxes payable represents amounts collected on behalf of specific regulatory agencies that require remittance on a specified date. These amounts are collected at the time of sales and are detailed on invoices provided to customers. At June 30, 2006 sales taxes payable were $1,187,000, of which $838,000 were delinquent sales taxes assumed by NeoMedia in connection with its acquisitions, certain of which are subject to payment plans. In compliance with the Emerging Issues Task Force consensus on issue number 06-03, NeoMedia accounts for sales taxes on a net basis.

Revenue Recognition

NeoMedia derives revenues from the following sources: (1) license revenues relating to patents and internally-developed software, (2) hardware, software, and service revenues related to mobile marketing campaign design and implementation, and (3) sale of its proprietary Micro Paint Repair solution.

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(1) Technology license fees, including Intellectual Property licenses, 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. 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, and Statement of Position 98-9, Modification of SOP 97-2, "Software Revenue Recognition, With Respect to Certain Transactions.". License revenue is recognized if persuasive evidence of an agreement exists, delivery has occurred, pricing is fixed and determinable, and collectibility is probable.

(2) Technology service & product revenue, which includes sales of software and technology equipment, service fee and telecom revenue attributed primarily fees for processing Canadian and U.S. terminated call records for telecommunication companies. These revenue generating items are recognized based on guidance provided in SEC Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition in Financial Statements," as amended (SAB 104). Software and technology equipment resale revenue is recognized when persuasive evidence of an arrangement exists, the price to the customer is fixed and determinable, delivery of the service has occurred and collectibility is reasonably assured. Service revenues including maintenance fees for providing system updates for software products, user documentation and technical support 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. Telecom revenues are recognized at the time that calls are accepted by the clearing house for billing to customers. The Company's recently acquired subsidiaries BSD, Mobot and Gavitec follow this policy.

(3) Technology service also includes mobile marketing services to its customers which mobile marketing projects are recognized after the completion of the project and accepted by the customer. All response and messaging based revenues are recognized at the time such responses are received and processed and the Company recognizes its premium messaging revenues on a gross basis based on guidance provided in Emerging Issues Task Force Issues No. 99-19 (EITF 99-19), "Reporting Revenue Gross as Principal or Net as an Agent" and No. 01-19 (EITF 01-09) "Accounting for Consideration Given by Vendor to a Customer." However, pursuant to EITF 01-09, the Company offsets any consideration given to its customers against revenue. Consulting and management revenues and revenues for periodic services are recognized as services are performed. NeoMedia 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. The Company's recently acquired subsidiaries 12Snap and Sponge follow this policy.

(4) Revenue for training and certification on NeoMedia's Micro Paint Repair systems is recognized equally over the term of the contract, which is currently one year. A portion of the initial fee paid by the customer is allocated to training costs and initial products sold with the system, and is recognized upon completion of training and shipment of the products, provided there is VSOE in a multiple element arrangement. Ongoing product and service revenue is recognized as products are shipped and services performed.

In December 2003, the SEC issued SAB 104, "Revenue Recognition." SAB 104 supersedes SAB 101, "Revenue Recognition in Financial Statements." SAB 104's primary purpose is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superseded as a result of the issuance of EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." Additionally, SAB 104 rescinds the SEC's Revenue Recognition in Financial Statements Frequently Asked Questions and Answers (the "FAQ") issued with SAB 101 that had been codified in SEC Topic 13, Revenue Recognition. Selected portions of the FAQ have been incorporated into SAB 104. While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104, which was effective upon issuance. The adoption of SAB 104 did not impact NeoMedia's consolidated financial statements.

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3. ACQUISITIONS

During the six months ended June 30, 2006, NeoMedia completed acquisitions of Mobot, Sponge, Gavitec, 12Snap, and BSD.

Acquisition of Mobot

On February 9, 2006, NeoMedia and Mobot. (www.mobot.com) signed a definitive merger agreement, subject to closing conditions, under which NeoMedia acquired all of the outstanding shares of Mobot in exchange for $3,500,000 cash and 16,931,493 shares of NeoMedia common stock (2,604,845 of which are being held in escrow for a period of one year from the closing date for the purpose of securing the indemnification obligations outlined in the purchase agreement). On February 17, 2006, NeoMedia and Mobot completed the closing requirements and the acquisition became effective. Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock to be issued as stock consideration was calculated using a share price of $0.3839, which was the volume-weighted average closing price of NeoMedia common stock for the ten days up to and including February 8, 2006. In the event that NeoMedia’s stock price (at the time the consideration shares are saleable) is less than $0.3839, NeoMedia is obligated to compensate Mobot shareholders in cash for the difference between the price at the time the shares become saleable and $0.3839. Assuming a stock price at the time the shares become saleable of $0.165, which was the last sale price on July 21, 2006, NeoMedia would have a cash liability of $3.7 million resulting from this clause. In addition to cash and stock, at closing NeoMedia forgave notes payable totaling $1,500,000 due from Mobot. This amount is considered other additional consideration in the purchase price allocation.

Mobot is a pioneer in visual search and recognition technology designed to make marketing effective and innovative using mobile devices. Launched in 2004 to help companies cultivate rewarding relationships with mobile phone users, Mobot gives marketers, content providers and carriers the tools to make it easy for any consumer with a camera phone to interact with their offerings. Mobot’s customers include, amongst others, ELLEgirl magazine, for which Mobot “turned on” advertisements throughout the magazine that linked to content and customer loyalty promotions on the mobile Internet; The Light Agency, who distributes Mobot’s visual search and recognition technology to the U.K. grocery sector through its award-winning mobile phone-based loyalty program with the Sainsburys-owned convenience store chain Jackson’s; and Warner Music Group’s U.S. sales and retail marketing company WEA Corp., running a snap-and-enter contest in music stores for music fans to win tailored offers, samples and discounts.

NeoMedia completed the acquisitions of Mobot, Sponge, Gavitec, and 12Snap in an effort to gain entry into the rapidly evolving global mobile marketing industry.

The actual purchase price was based on cash paid, the fair value of NeoMedia stock around the date of the acquisition, and direct costs associated with the combination. The purchase price has been allocated as follows:

		(Dollars in Thousands)
Value of 16,931,493 shares issued at $0.395 per share (1)	$	6,688
Cash paid		3,500
Direct costs of acquisition		8
Advances to Mobot forgiven at acquisition		1,500
Total Fair Value of Purchase Price		11,696
Assets Purchased:		
Cash and cash equivalents	$	328
Accounts receivable		68
Other current assets		49
Property, plant & equipment		30
Intangible assets		13
Customer contracts and relationships		440
Capitalized software platform		4,200
Copyrighted materials		90
Goodwill		6,778
Total Assets Purchased		11,996
Less Liabilities Assumed:		
Accounts payable		51
Accrued liabilities		132
Deferred revenue		117
Total Liabilities Assumed		300

(1) - Shares were valued using the average stock price for two days before and two days after the measurement date, as defined in SFAS 141 and EITF 99-12

The combination is being accounted for as a purchase business combination as defined by Statement of Financial Accounting Standards No. 141, Business Combinations. The allocation of the purchase price to the assets acquired and liabilities assumed is based on an independent valuation report obtained by the Company. The allocation is subject to change resulting from the purchase price guarantee contingency described above.

The values assigned to intangible assets, aside from goodwill, are subject to amortization. The intangible assets were assigned the following lives for amortization purposes:

Intangible asset	Estimated Useful Life (in years)
Customer contracts and relationships	5
Copyrighted materials	5
Capitalized software platform	7

Goodwill was not assigned a life and will be tested for impairment as defined by Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

The accompanying consolidated statement of operations presented herein for the six months ended June 30, 2006, contains the results of operations for Mobot for the period from February 18, 2006, through June 30, 2006. The accompanying consolidated statement of operations presented herein for the three months ended June 30, 2006, contains the results of operations for Mobot for the entire three month period. Pro-forma results of operations for the three and six months ended June 30, 2006 and 2005 are presented at the end of this Note 3.

Acquisition of Sponge

On February 20, 2006, NeoMedia and Sponge signed a definitive share purchase agreement, subject to closing conditions, under which NeoMedia acquired all of the outstanding shares of Sponge in exchange for $6,141,000 cash and 33,097,135 shares of NeoMedia common stock (3,400,490 of which are being held in escrow for a period of one year from the closing date for the purpose of securing the indemnification obligations outlined in the purchase agreement). The agreement also calls for Sponge to earn an additional £2,500,000 (approximately $4.4 million) in the form of NeoMedia common stock if, during the two-year period beginning at closing, the Sponge business earns in excess of £1,300,000 (approximately $2.3 million) in net profits. On February 23, 2006, NeoMedia and Sponge completed the closing requirements and the acquisition became effective. Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock to be issued as consideration was calculated using a share price of $0.384, which was the volume-weighted average closing price of NeoMedia common stock for the ten days up to and including February 8, 2006. In the event that NeoMedia's stock price (at the time the consideration shares are saleable) is less than $0.384, NeoMedia is obligated to compensate Sponge shareholders in cash for the difference between the price at the time the shares become saleable and $0.384. Assuming a stock price at the time the shares become saleable of $0.165, which was the last sale price on July 21, 2006, NeoMedia would have a cash liability of $7.2 million resulting from this clause.

Founded in 2001, Sponge has grown to become a U.K. market leader in providing mobile applications to agencies and media groups, and gain recognition as one of Europe's top independent developers of mobile applications and content. Today, Sponge counts more than 40 agencies, including WPP, Aegis and BBH, as clients, and supplies services for over 100 world-class brands, including Coca Cola®, Heineken® and Diageo. Sponge also supplies a range of mobile services to media groups, including News International, Trinity Mirror, Endemol and IPC. For Walker's (Frito-Lay) potato chips, Sponge enabled a promotion that offered consumers of Walker's -- the U.K.'s largest snack brand -- to win an iPod every 5 minutes for 4 weeks, by texting a unique code found on-pack into the Sponge platform. More than 5% of the total U.K. population participated in the campaign, which has been expanded to Belgium and the Netherlands on the basis of its success in the U.K. A total of 23% of the U.K. population interacted with Sponge applications in 2005.

NeoMedia completed the acquisitions of Mobot, Sponge, Gavitec, and 12Snap in an effort to gain entry into the rapidly evolving global mobile marketing industry.

The actual purchase price was based on cash paid, the fair value of NeoMedia stock around the date of the acquisition, and direct costs associated with the combination. The purchase price has been allocated as follows:

		(Dollars in Thousands)
Value of 33,097,135 shares issued at $0.395 per share (1)	$	13,073
Cash paid		6,141
Direct costs of acquisition		194
Total Fair Value of Purchase Price		19,408
Assets Purchased:		
Cash and cash equivalents	$	177
Accounts receivable		617
Other current assets		35
Property, plant & equipment		53
Customer contracts and relationships		400
Capitalized software platform		1,300
Brand name		800
Copyrighted materials		50
Goodwill		16,692
Total Assets Purchased		20,124
Less Liabilities Assumed:		
Accounts payable		190
Accrued liabilities		322
Other current liabilities		204
Total Liabilities Assumed		716

(1) - Shares were valued using the average stock price for two days before and two days after the measurement date, as defined in SFAS 141 and EITF 99-12

The combination is being accounted for as a purchase business combination as defined by Statement of Financial Accounting Standards No. 141, Business Combinations. The allocation of the purchase price to the assets acquired and liabilities assumed is based on an independent valuation report obtained by the Company. The allocation is subject to change resulting from the purchase price guarantee contingency described above.

The values assigned to intangible assets, aside from goodwill, are subject to amortization. The intangible assets were assigned the following lives for amortization purposes:

Intangible asset	Estimated Useful Life (in years)
Customer contracts and relationships	5
Copyrighted materials	5
Capitalized software platform	7
Brand name	10

Goodwill was not assigned a life and will be tested for impairment as defined by Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

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The purchase agreement calls for the management of Sponge to earn an additional £2,500,000 (approximately $4.4 million) in the form of NeoMedia common stock if, during the two-year period beginning on February 23, 2006, the Sponge business earns in excess of £1,300,000 (approximately $2.3 million) in net profits, plus £1 of NeoMedia common stock for each £1 that earnings exceed £1,300,000 during the two-year period. No shares are to be issued pro rata if the earnings target is not met.

At the end of the two-year measurement period (February 22, 2008), if the earnings target is met, the financial impact on NeoMedia of the issuance of additional shares would be a proportionate increase of approximately $4.4 million in the long-term assets acquired from Sponge, with a corresponding increase in depreciation expense from the point of issuance forward. If the earnings target is not met, no additional shares would be issued and there would be no financial impact to NeoMedia. Pursuant to SFAS 141, NeoMedia has not allocated a value to the contingent consideration in the initial purchase price. Accordingly the final purchase price will not be determined until the conclusion of this contingency.

The accompanying consolidated statement of operations presented herein for the six months ended June 30, 2006, contains the results of operations for Sponge for the period from February 24, 2006, through June 30, 2006. The accompanying consolidated statement of operations presented herein for the three months ended June 30, 2006, contains the results of operations for Sponge for the entire three month period. Pro-forma results of operations for the three and six months ended June 30, 2006 and 2005 are presented at the end of this Note 3.

Acquisition of Gavitec

On February 17, 2006, NeoMedia and Gavitec signed a definitive sale and purchase agreement, subject to closing conditions, under which NeoMedia acquired all of the outstanding shares of Gavitec in exchange for $1,800,000 cash and 13,660,511 shares of NeoMedia common stock (1,366,051 of which are being held in escrow until December 31, 2006 for the purpose of securing the indemnification obligations outlined in the purchase agreement). Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock to be issued as consideration was calculated using a share price of $0.389, which was the volume-weighted average closing price of NeoMedia common stock for the ten days up to and including February 16, 2006. On February 23, 2006, NeoMedia and Gavitec completed the closing requirements and the acquisition became effective. In the event that NeoMedia’s stock price (at the time the consideration shares are saleable) is less than $0.389, NeoMedia is obligated to compensate Gavitec shareholders in cash for the difference between the price at the time the shares become saleable and $0.389. Assuming a stock price at the time the shares become saleable of $0.165, which was the last sale price on July 21, 2006, NeoMedia would have a cash liability of $3.1 million resulting from this clause.

Gavitec was founded in 1997 as a specialized provider and manufacturer of products and solutions for mobile marketing and mobile information technology. As a technology leader in code-reading systems and software for mobile applications, Gavitec offers its clients standardized or individual solutions in the areas of mobile marketing, mobile ticketing, mobile couponing, and mobile payment systems. Gavitec has run an in-market pilot program in Switzerland for its mobile macro-payment system with the leading Swiss retail bank PostFinance, Unisys, seven selected retailers including Migros, CoOp and McDonald’s and approximately a thousand consumers. Participants receive a personal Data Matrix code via text message to their mobile phone. Then to complete a purchase, participants hold their cell phone over Gavitec’s EXIO code reader and enter their PIN code to debit their PostFinance account. Gavitec has also run trials with “Coast Mobile” in conjunction with the British Broadcasting Corporation (BBC) and News International’s The Times newspaper, along with a number of other interactive mobile campaigns.

NeoMedia completed the acquisitions of Mobot, Sponge, Gavitec, and 12Snap in an effort to gain entry into the rapidly evolving global mobile marketing industry.

The actual purchase price was based on cash paid, the fair value of NeoMedia stock around the date of the acquisition, and direct costs associated with the combination. The purchase price has been allocated as follows:

	(Dollars in Thousands)	
Value of 13,660,511 shares issued at $0.386 per share (1)	$	5,273
Cash paid		1,800
Direct costs of acquisition		114
Total Fair Value of Purchase Price		7,187
Assets Purchased:		
Cash and cash equivalents	$	74
Accounts receivable		173
Inventory		106
Other current assets		53
Property, plant & equipment		15
Intangible assets		3
Capitalized software platform		4,600
Copyrighted materials		50
Goodwill		2,611
Total Assets Purchased		7,685
Less Liabilities Assumed:		
Accounts payable		113
Accrued liabilities		24
Deferred revenue		117
Other current liabilities		244
Total Liabilities Assumed		498

(1) - Shares were valued using the average stock price for two days before and two days after the measurement date, as defined in SFAS 141 and EITF 99-12

The combination is being accounted for as a purchase business combination as defined by Statement of Financial Accounting Standards No. 141, Business Combinations. The allocation of the purchase price to the assets acquired and liabilities assumed is based on an independent report obtained by the Company. The allocation is subject to change resulting from the purchase price guarantee contingency described above.

The values assigned to intangible assets, aside from goodwill, are subject to amortization. The intangible assets were assigned the following lives for amortization purposes:

Intangible asset	Estimated Useful Life (in years)
Copyrighted materials	5
Capitalized software platform	7
Brand name	10

Goodwill was not assigned a life and will be tested for impairment as defined by Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

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The accompanying consolidated statement of operations presented herein for the six months ended June 30, 2006, contains the results of operations for Gavitec for the period from February 24, 2006, through June 30, 2006. The accompanying consolidated statement of operations presented herein for the three months ended June 30, 2006, contains the results of operations for Gavitec for the entire three month period. Pro-forma results of operations for the three and six months ended June 30, 2006 and 2005 are presented at the end of this Note 3.

Acquisition of 12Snap

On February 10, 2006, NeoMedia and 12Snap signed a definitive sale and purchase agreement, subject to closing conditions, under which NeoMedia acquired all of the outstanding shares of 12Snap in exchange for $2,500,000 cash and 49,294,581 shares of NeoMedia common stock (6,319,818 of which are being held in escrow until June 30, 2006 for the purpose of securing the indemnification obligations outlined in the purchase agreement). On February 28, 2006, NeoMedia and 12Snap completed the closing requirements and the acquisition became effective. Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock to be issued as consideration was calculated using a share price of $0.3956, which was the volume-weighted average closing price of NeoMedia common stock for the ten days up to and including February 9, 2006. In the event that NeoMedia's stock price (at the time the consideration shares are saleable) is less than $0. 3956, NeoMedia is obligated to compensate 12Snap shareholders in cash for the difference between the price at the time the shares become saleable and $0.3956. Assuming a stock price at the time the shares become saleable of $0.165, which was the last sale price on July 21, 2006, NeoMedia would have a cash liability of $11.4 million resulting from this clause.

12snap AG is headquartered in Munich with branches in Düsseldorf, New York, London, Milan, Stockholm and Vienna. As an expert in innovative marketing and entertainment for mobile phones, 12snap combines know-how in mobile applications, mobile loyalty and mobile marketing. In the mobile marketing space, 12snap creates and implements national and pan-European mobile marketing campaigns for international brands; its mobile loyalty business unit offers customer loyalty programs for companies and brands, and its mobile applications business unit is the center for development and software. 12snap sells and licenses a wide spectrum of mobile solutions to satisfy the demands of the current growing market and the new uses of the third mobile phone generation from dynamic video services and multiplayer games to personalized messaging applications. 12snap has 75 employees, and services to companies including McDonald's, MTV®, Coca-Cola, Ferrero, Wella, adidas, Unilever and Gillette®.

NeoMedia completed the acquisitions of Mobot, Sponge, Gavitec, and 12Snap in an effort to gain entry into the rapidly evolving global mobile marketing industry.

The actual purchase price was based on cash paid, the fair value of NeoMedia stock around the date of the acquisition, and direct costs associated with the combination. The purchase price has initially allocated as follows:

		(Dollars in Thousands)
Value of 49,294,581 shares issued at $0.394 per share (1)	$	19,422
Cash paid		2,500
Direct costs of acquisition		114
Total Fair Value of Purchase Price		22,036
Assets Purchased:		
Cash and cash equivalents	$	465
Investment in marketable securities		951
Accounts receivable		2,683
Other current assets		554
Property, plant & equipment		224
Intangible assets		93
Customer contracts and relationships		400
Capitalized software platform		4,400
Brand name		1,600
Copyrighted materials		50
Goodwill		19,391
Total Assets Purchased		30,811
Less Liabilities Assumed:		
Accounts payable		977
Accrued liabilities		1,990
Deferred revenue		1,434
Other current liabilities		225
Notes payable		4,149
Total Liabilities Assumed		8,775

(1) - Shares were valued using the average stock price for two days before and two days after the measurement date, as defined in SFAS 141 and EITF 99-12

The combination is being accounted for as a purchase business combination as defined by Statement of Financial Accounting Standards No. 141, Business Combinations. The allocation of the purchase price to the assets acquired and liabilities assumed is based on an independent valuation report obtained by the Company. The allocation is subject to change resulting from the purchase price guarantee contingency described above.

The values assigned to intangible assets, aside from goodwill, are subject to amortization. The intangible assets were assigned the following lives for amortization purposes:

Intangible asset	Estimated Useful Life (in years)
Customer contracts and relationships	5
Copyrighted materials	5
Capitalized software platform	7
Brand name	10

Goodwill was not assigned a life and will be tested for impairment as defined by Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

The accompanying consolidated statement of operations presented herein for the six months ended June 30, 2006, contains the results of operations for 12Snap for the period from March 1, 2006, through June 30, 2006. The accompanying consolidated statement of operations presented herein for the three months ended June 30, 2006, contains the results of operations for 12Snap for the entire three month period. Pro-forma results of operations for the three and six months ended June 30, 2006 and 2005 are presented at the end of this Note 3.

Acquisition of BSD

On March 21, 2006, NeoMedia completed its acquisition of BSD Software, Inc. of Calgary, Alberta, Canada for 7,123,698 shares of NeoMedia common stock. Pursuant to the terms of the merger agreement, the number of shares of NeoMedia common stock to be issued as consideration was calculated using a share price of $0.3467, which was the volume-weighted average closing price of NeoMedia common stock for the five days preceding March 21, 2006. BSD owns 90% of the outstanding shares of Triton Global Business Services, Inc., a provider of live and automated operator calling services and e-business support, including billing, clearinghouse and information management services, to companies in the telecommunications industry.

NeoMedia completed the acquisitions of BSD for the purpose of increasing its revenue and profit through establishment of a Telecom Services business unit, as well as gaining access to the Canadian telecom industry in order to penetrate that market with the products of the NeoMedia Mobile division.

The actual purchase price was based on cash paid, the fair value of NeoMedia stock around the date of the acquisition, and direct costs associated with the combination. The purchase price has been allocated as follows:

		(Dollars in Thousands)
Value of 7,123,698 shares issued at $0.352 per share (1)	$	2,508
Direct costs of acquisition		7
Total Fair Value of Purchase Price		2,515
Assets Purchased:		
Cash and cash equivalents	$	55
Accounts receivable		1,733
Other current assets		13
Property, plant & equipment		61
Customer contracts and relationships		1,300
Copyrighted materials		130
Goodwill		4,402
Total Assets Purchased		7,694
Less Liabilities Assumed:		
Accounts payable		2,424
Accrued liabilities		1,224
Notes payable		1,531
Total Liabilities Assumed		5,179

(1) - Shares were valued using the average stock price for two days before and two days after the measurement date, as defined in SFAS 141 and EITF 99-12

The combination is being accounted for as a purchase business combination as defined by Statement of Financial Accounting Standards No. 141, Business Combinations. The allocation of the purchase price to the assets acquired and liabilities assumed is based on an independent valuation report obtained by the Company.

The values assigned to intangible assets, aside from goodwill, are subject to amortization. The intangible assets were assigned the following lives for amortization purposes:

Intangible asset	Estimated Useful Life (in years)
Customer contracts and relationships	5
Copyrighted materials	5

Goodwill was not assigned a life and will be tested for impairment as defined by Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets.

The accompanying consolidated statement of operations presented herein for the six months ended June 30, 2006, contains the results of operations for BSD for the period from March 22, 2006, through June 30, 2006. The accompanying consolidated statement of operations presented herein for the three months ended June 30, 2006, contains the results of operations for BSD for the entire three month period. Pro-forma results of operations for the three and six months ended June 30, 2006 and 2005 are presented at the end of this Note 3.

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Pro Forma Financial Information

Pro-forma results of operations as if NeoMedia was combined with Mobot, Sponge, Gavitec, 12Snap and BSD as of January 1, 2006 are as follows:

Three Months Ended June 30, 2006

	NeoMedia	Mobot	Sponge	Gavitec	12Snap	BSD	Pro-forma Adjust-ments		Pro-forma Combined
Total net sales	$ 6,606	$ 134	$ 420	$ 364	$ 2,225	$ 2,422	($5,565)	(A)	$ 6,606
Net income (loss)	$ 5,133	($236)	($156)	($138)	($428)	$ 231	$ 727	(A)	$ 5,133
Net income (loss) per share									
Basic	$ 0.01						$ ---		$ 0.01
Fully diluted	$ 0.01						$ ---		$ 0.01
Weighted average common shares outstanding									
Basic	632,402,254						---		632,402,254
Diluted	799,536,925						---		799,536,925

Six Months Ended June 30, 2006

	NeoMedia	Mobot	Sponge	Gavitec	12Snap	BSD	Pro-forma Adjust-ments		Pro-forma Combined
Total net sales	$ 8,658	$ 219	$ 1,224	$ 486	$ 6,231	$ 5,274	($7,589)	(B)	$ 14,503
Net income (loss)	$ 3,815	($619)	($38)	($290)	$ 115	$ 247	$ 420	(B)	$ 3,650
Net income (loss) per share									
Basic	$ 0.01						$ ---	(C)	$ 0.01
Diluted	$ 0.01						$ (0.01)	(C)	$ 0.00
Weighted average common shares outstanding									
Basic	580,485,463						71,521,146	(C)	652,006,609
Diluted	757,912,587						71,521,146	(C)	829,433,733

(A) Operations of each subsidiary were included in NeoMedia's consolidated operations for the entire three month period ended June 30, 2006.
(B) - Adjustments are to reflect operations of each acquisition from the closing date through June 30, 2006 and amortization of intangible assets for the period January 1, 2006 through the respective closing dates. Results of operations for each acquisition from its respective closing date through June 30, 2006 are included in NeoMedia's operations for the six months ended June 30, 2006. Closing dates for each acquisition were: Mobot (February 17, 2006); Sponge and Gavitec (February 23, 2006); 12Snap (February 28, 2006); and BSD (March 21, 2006).

(C) - Adjustment for shares that would have been issued in connection with acquisitions if they had occurred on January 1, 2006. Using the stock price around January 1, 2006, the pro forma number of shares that would have been issued was:

	Mobot	Sponge	Gavitec	12Snap	BSD	Total
Total stock consideration	$ 6,500,000	$ 11,400,000	$ 5,400,000	$ 19,500,000	$ 2,279,263	$ 45,079,263
NeoMedia stock price around January 1, 2006 (measurement date)	$ 0.290	$ 0.290	$ 0.290	$ 0.290	$ 0.290	
Pro forma number of shares of NeoMedia to be issued as purchase price consideration	22,413,793	39,310,345	18,620,690	67,241,379	7,859,527	155,445,734

The adjustment between the reported and the pro forma number of weighted average shares outstanding is caused by (1) the weighting of the pro forma shares for the entire six month period ended June 30, 2006, whereas in the reported number the shares were only outstanding from the closing date through June 30, 2006, and (2) the number of pro forma shares being higher than the actual shares issued due to a lower stock price on the pro forma date of issuance.

Pro-forma results of operations as if NeoMedia was combined with Mobot, Sponge, Gavitec, 12Snap and BSD as of January 1, 2005 are as follows:

	Three Months Ended June 30, 2005								
	NeoMedia	Mobot	Sponge	Gavitec	12Snap	(B) BSD	Pro-forma Adjust-ments		Pro-forma Combined
Total net sales	$ 538	$ 66	$ 451	$ 140	$ 2,050	$ 4,114	---		$ 7,359
Net income (loss)	($2,300)	($189)	($18)	($207)	($94)	$ 261	($724)	(A)	($3,271)
Net income (loss) per share-basic and diluted	($0.01)						$ ---	(B)	($0.01)
Weighted average common shares outstanding	448,777,048						172,717,482	(B)	621,494,530

	Six Months Ended June 30, 2005								
	NeoMedia	Mobot	Sponge	Gavitec	12Snap	(B) BSD	Pro-forma Adjust-ments		Pro-forma Combined
Total net sales	$ 1,285	$ 165	$ 935	$ 392	$ 3,486	$ 4,114	---		$ 10,377
Net income (loss)	($3,519)	($382)	$ 119	($255)	($676)	$ 261	($1,447)		($5,899)
Net income (loss) per share-basic and diluted	($0.01)						$ ---	(B)	($0.01)
Weighted average common shares outstanding	443,301,430						172,717,482	(B)	616,018,912

(A) - Adjustment for amortization of intangible assets for the periods presented.
(B) - Adjustment for shares that would have been issued in connection with acquisitions if they had occurred on January 1, 2006. Using the stock price around January 1, 2006, the pro forma number of shares that would have been issued was:

	Mobot	Sponge	Gavitec	12Snap	BSD	Total
Total stock consideration	$ 6,500,000	$ 11,400,000	$ 5,400,000	$ 19,500,000	$ 2,279,263	$ 45,079,263
NeoMedia stock price around January 1, 2005 (measurement date)	$ 0.261	$ 0.261	$ 0.261	$ 0.261	$ 0.261	
Pro forma number of shares of NeoMedia to be issued as purchase price	24,904,215	43,678,161	20,689,655	74,712,644	8,732,808	172,717,482

consideration

Tax Implications of Acquisitions

For income tax purposes, amounts assigned to particular assets acquired and liabilities assumed in the business combinations are different than amounts used for financial reporting. The differences in assigned values for financial reporting and tax purposes result in temporary differences. In applying SFAS 109, “Accounting for Income Taxes”, the Company is required to recognize the tax effect of these temporary differences and, accordingly, a deferred tax liability has been recognized. The Company determined that its pre-existing and acquired deferred tax assets, and those acquired, including those subject to limitations, were more likely than not to be realized to the extent of the deferred tax liability. The reduction in the valuation allowance resulting in an asset was used to offset the deferred tax liability arising from the business combinations, pursuant to SFAS 109.

In addition, the acquisitions of Sponge, Gavitec, 12Snap, and BSD involve a change of control of foreign entities, and as a result any net operating loss carryforward in existence prior to the acquisition may have limited or no use for NeoMedia.

Intangible Assets

As of June 30, 2006, NeoMedia had intangible assets with a cost as follows:

As of June 30, 2006, NeoMedia had intangible assets with a cost as follows:

(in thousands)

	12 Snap	Sponge	Gavitec	Mobot	BSD	Other	Total
Customer Contracts	$ 400	$ 400	$ 0	$ 440	$ 1,300	$ 113	$ 2,653
Proprietary Software	4,400	1,300	4,600	4,200	0	817	15,317
Brand Name	1,600	800	0	5	0	0	2,405
Copyrighted Materials	177	50	50	90	130	49	546
Patents & Formulations	0	0	0	10	0	6,683	6,693
Goodwill	19,391	16,692	2,611	6,778	4,402	1,069	50,943
Total	$ 25,968	$ 19,242	$ 7,261	$ 11,523	$ 5,832	$ 8,731	$ 78,557

Accumulated amortization on NeoMedia's intangible assets as of June 30, 2006, was:

(in thousands)

	12 Snap	Sponge	Gavitec	Mobot	BSD	Other	Total
Customer Contracts	$ 27	$ 28	$ 0	$ 32	$ 87	$ 55	$ 229
Proprietary Software	210	65	232	220	0	640	1,367
Brand Name	53	28	0	2	0	0	83
Copyrighted Materials	3	4	3	7	9	24	50
Patents & Formulations	0	0	0	1	0	2,334	2,335
Goodwill	0	0	0	0	0	0	0
Total	$ 293	$ 125	$ 235	$ 262	$ 96	$ 3,053	$ 4,064

The carrying value of NeoMedia's intangible assets as of June 30, 2006 was:

(in thousands)

	12 Snap	Sponge	Gavitec	Mobot	BSD	Other	Total
Customer Contracts	$ 373	$ 372	$ 0	$ 408	$ 1,213	$ 58	$ 2,424
Proprietary Software	4,190	1,235	4,368	3,980	0	177	13,950
Brand Name	1,547	772	0	3	0	0	2,322
Copyrighted Materials	174	46	47	83	121	25	496
Patents & Formulations	0	0	0	9	0	4,349	4,358
Goodwill	19,391	16,692	2,611	6,778	4,402	1,069	50,943
Total	$ 25,675	$ 19,117	$ 7,026	$ 11,261	$ 5,736	$ 5,678	$ 74,493

Estimated future amortization expense on NeoMedia's intangible assets is expected to be:

(in thousands)

	Customer Contracts	Proprietary Software	Brand Name	Copyrighted Materials	Patents & Formulations	Goodwill	Total
2006	$ 268	$ 1,065	$ 120	$ 43	$ 264	$ 0	$ 1,760
2007	535	2,130	241	86	528	0	3,520
2008	535	2,130	241	86	528	0	3,520
2009	535	2,098	241	86	528	0	3,488
2010	471	2,071	240	86	528	0	3,396
Thereafter	80	4,456	1,239	109	1,982	0	7,866

Total	$	2,424	$	13,950	$	2,322	$	496	$	4,358	$	0	$ 23,550

It is important to note that actual amortization expense could differ materially from the table due to subjective factors such as changes in assumptions of useful lives or impairment charges.

The weighted average remaining life for the intangible assets was approximately 6.9 years as of June 30, 2006.

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Letter of Intent to Acquire Hip Cricket

On February 16, 2006, NeoMedia signed a non-binding letter of intent to acquire HipCricket, Inc. ("HipCricket") of Essex, CT (www.hipcricket.com) in exchange for $500,000 cash and $4,000,000 of NeoMedia common stock. The number of shares to be issued as stock consideration is to be determined using the volume-weighted average closing price of NeoMedia stock for the ten days prior to the signing of a definitive purchase agreement. The letter of intent is subject to due diligence and signing of a mutually agreeable definitive purchase agreement by both parties.

In addition to signing the LOI, NeoMedia loaned HipCricket the principal amount of $500,000 in the form of two unsecured promissory notes. The notes accrue interest at a rate of 8% per annum. The notes will be applied toward the cash portion of the purchase price upon signing of a definitive purchase agreement for the acquisition of all of the outstanding shares of HipCricket by NeoMedia, as contemplated in the LOI. In the event the acquisition is not consummated, the notes will become due 90 days after termination of the LOI. In the event the LOI is terminated and the notes are not repaid within 90 days of such cancellation, the notes will convert into shares of HipCricket common stock.

HipCricket is a leading mobile marketing firm that provides innovative, custom solutions to broadcasters and brand marketers. Today, HipCricket works with radio groups across the U.S. as well as with some 40 major brand marketers. HipCricket combines senior marketing expertise with state-of-the-art mobile and event marketing technologies to offer clients unprecedented interactivity with their consumers, viewers, listeners or customers on a one-to-one personal level.

4. FINANCING

Securities Purchase Agreement - Series C Convertible Preferred Stock

The Company entered into a Securities Purchase Agreement, dated February 17, 2006 (the "Agreement") with Cornell Capital Partners LP, an accredited investor (the "Purchasers"). Pursuant to the Agreement, the Purchasers agreed to purchase 8% cumulative Series C convertible preferred stock to be fully converted three (3) years from the date of issuance in the aggregate amount of $22,000,000. Net consideration from this arrangement amounted to $17,854,000, comprised of cash of $14,066,000, marketable securities with a calculated fair value of $579,000 and a purchase value of $2,000,000, and the extinguishment of $3,209,000 of preexisting indebtedness. In addition, the Purchaser withheld $2,725,000 commitment and structuring fees from the gross proceeds. The Agreement also provides for the issuance to the Purchasers, at no additional cost to the purchasers, warrants to purchase shares of the Company's common stock. The Agreement also calls for the purchasers to acquire an additional $5,000,000 of Series C convertible preferred stock on the date a registration statement filed by the Company is declared effective by the U.S. Securities and Exchange Commission. In connection with the Agreement, the Company also entered into a registration rights agreement with the Purchasers that requires the Company to (i) file a registration statement with the SEC registering the resale of the shares of common stock issuable upon conversion of the preferred stock and the exercise of the warrants, (ii) achieve effectiveness within a stated period and (iii) maintain effectiveness of the registration statement. Failure to meet these requirements will require the Company to incur liquidating damages amounting to 1% of the principal per month, but in no event shall consideration paid as liquidating damages exceed $1,200,000.

On February 17, 2006, the Company issued the Purchasers $22,000,000 in aggregate principal amount of such 8% cumulative Series C convertible preferred stock. At any time from the closing date until February 17, 2009, the Purchasers have the right to convert the preferred stock, in whole or in part, into common stock of the Company at the then effective conversion price, which varies relative to the Company's trading stock price, as follows: $0.50 per share, or 97% of the lowest closing bid prices (as reported by Bloomberg) of the common stock for the 30 trading days immediately preceding the conversion date. The conversions are limited such that the holder cannot exceed 4.99% ownership, unless the holders waive their right to such limitation. The limitation will terminate under any event of default.

The series 8% cumulative Series C convertible preferred stock also afford the Purchasers anti-dilution protection should, at any time while the Series C preferred stock instruments are outstanding, the Company offer, sell or grant any option to purchase or offer, sell or grant any right to re-price its securities, or otherwise dispose of or issue any common stock or common stock equivalents, entitle any person to acquire shares of common stock at an effective price per share less than the then effective conversion price (excluding employee stock options), as calculated by the formula described above; then, in such instance, the conversion price for the convertible preferred stock shares shall be reduced to the lower price. In case of any such adjustment in the effective conversion price for the convertible preferred shares, this could significantly dilute existing investors.

Under the Agreement, the Purchasers also received "A" warrants, "B" warrants and "C" warrants to purchase an aggregate of up to 75,000,000 shares of common stock. The warrants are exercisable in three separate traunches at a price of $0.50, $0.40 and $0.35 respectively per share, subject to adjustment, included under anti-dilution protection similar to that described above. The warrants have a five-year contractual life. NeoMedia can force exercise of the warrants if the closing bid price of NeoMedia stock is more than $0.10 greater than the exercise price of any of the warrants for 15 consecutive days.

The 8% cumulative Series C convertible preferred stock contains consequences in case of default. Events of default which could subject the Company to penalties and liabilities as specified in the Agreement include:

- Any case or action of bankruptcy or insolvency commenced by the Company or any subsidiary, against the Company or adjudicated by a court against the Company for the benefit of creditors;
- Any default in its obligations under a mortgage or debt in excess of $100,000;
- Any cessation in the eligibility of the Company’s stock to be quoted on a trading market;
- Any lapse in the effectiveness of the registration statement covering the shares related to the conversion option, the warrants as described and transacted in the securities purchase agreement and accompanying documents;
- Any failure to deliver certificates within the specified time; and
- Any failure, by the Company, to pay in full the amount of cash due pursuant to a buy-in or failure to pay any amounts owed on account on account of an event of default within 10 days of the date due.

Other provisions included in the Agreement include the following:

- The 8% cumulative Series C convertible preferred stock is convertible into common stock, at the option of the Purchaser, at any time after the effective date.
- Conversions can be made in increments and from time to time.
- The 8% cumulative Series C convertible preferred stock has voting rights on an “as converted” basis, meaning the Purchaser is entitled to vote the number of shares of common stock into which the 8% cumulative Series C convertible preferred stock was convertible as of the record date for a meeting of shareholders
- As promptly as practicable after any conversion date, the Company shall cause its transfer agent to deliver a certificate representing the converted shares, free of any legends and trading restrictions for the number of shares converted;
- The Company will reserve and keep available authorized and unissued registered shares available to be issued upon conversion;
- Purchaser will not be responsible for any transfer taxes relative to issuance of shares;
- If the Company offers, sells or grants stock at an effective per share price less than the then Conversion Price, then the Conversion Price shall be reduced to equal the effective conversion, exchange or purchase price for such common stock or common stock equivalents;

At February 17, 2006, a summary of the transaction is as follows:

Instrument:		
Convertible Preferred Stock (1)	$	1,711,000
Common stock warrants (2)		16,172,000
Embedded conversion feature		1,935,000
Debt extinguishment loss (3)		(1,964,000)
Total gross proceeds	$	17,854,000

(1) The discount to the face value of the 8% cumulative Series C convertible preferred stock that resulted from the allocation along with deferred costs is being accreted through periodic charges to additional paid-in capital using the effective interest method. Accretion of the deferred costs amounted to $480,000 and $0 during the three months ended June 30, 2006 and 2005, respectively, and $617,000 and $0 during the six months ended June 30, 2006 and 2005, respectively.

(2) The Company issued additional warrants to purchase aggregate 75,000,000 shares of common stock in connection with the 8% cumulative Series C convertible preferred stock. The Company also issued 2,000,000 warrants (valued at $447,000) as financing fees.

(3) The financing arrangement settled face value $3,209,000 of preexisting indebtedness. The debt extinguishment loss was calculated as the amount that the fair value of securities issued (using a relative fair value basis) exceeded the Company's carrying value.

The carrying value of the 8% cumulative Series C convertible preferred stock amounted to $2,327,000, net of unaccreted deferred cost of $24,953,000, at June 30, 2006. Face value of Series C convertible preferred stock at June 30, 2006 is $22,000,000. Derivative financial instruments arising from the issuance of Series C convertible preferred stock are initially recorded and continuously carried at fair values. Upon conversion of any derivative financial instrument, the change in fair value from the previous reporting date to the date of conversion is recorded to income (loss), and then the carrying value is recorded to paid-in capital, provided all other criteria for equity classification are met. The following tabular presentation reflects the components of derivative financial instruments on the Company's balance sheet at June 30, 2006:

(Assets) Liabilities:		June 30, 2006
Cornell warrants	$	6,480,000
Embedded conversion feature		1,031,000
Other warrants (1)		4,896,000
	$	12,407,000

(1) The fair values of certain other derivative financial instruments (warrants) that existed at the time of the issuance of Series C convertible preferred stock were reclassified from stockholders' equity to liabilities when, in connection with the issuance of Series C convertible preferred stock, the Company no longer controlled its ability to share-settle these instruments. These derivative financial instruments had fair values of $13,883,000 and $4,702,000 on February 17, 2006 and June 30, 2006, respectively. The decrease in fair value of these other derivative financial instruments resulted from a decrease in NeoMedia's share price between February 17, 2006 and June 30, 2006. The change in fair value is reported as "Gain on Derivative Financial Instruments" in the accompanying condensed consolidated statement of operations. These warrants will be reclassified to stockholders' equity when the Company reacquires the ability to share-settle the instruments.

The following tabular presentation reflects the number of common shares into which the aforementioned derivative financial instruments are indexed at June 30, 2006:

	Shares of common stock
Cornell warrants	75,000,000
Embedded conversion feature (1)	116,804,124
Other warrants	33,325,000
	225,129,124

(1) The terms of the embedded conversion features (ECF) in the Series C convertible preferred stock provide for variable conversion rates that are indexed to the Company’s trading common stock price. As a result, the number of indexed shares is subject to continuous fluctuation. For presentation purposes, the number of shares of common stock into which the ECF was convertible as of June 30, 2006 was calculated as the face value of $22,000,000 plus assumed dividends of $660,000 if declared, divided by 97% of the lowest closing bid price for the 30 trading days preceding June 30, 2006.

Derivative income for the six months ended June 30, 2006 and 2005 associated with adjustments recorded to reflect the aforementioned derivatives at fair value amounted to $15,794,000 and $0, respectively, and is reported as "Gain on Derivative Financial Instruments" in the accompanying condensed consolidated statement of operations.

Fair value considerations for derivative financial instruments:

Freestanding derivative instruments, consisting of warrants that arose from the Cornell financing and those reclassified as described above are valued using the Black-Scholes-Merton valuation methodology because that model embodies all of the relevant assumptions that address the features underlying these instruments. Significant assumptions included in this model as of June 30, 2006 are as follows:

Holder	Cornell Capital Partners	Other
Instrument	Warrants	Warrants
Exercise price	$0.35 - $0.50	$0.01 - $3.45
Term (years)	5.0	1.0 - 5.0
Volatility	70.80%	52.56% -70.80%
Risk-free rate	3.65%	3.65%

Embedded derivative financial instruments, arising from the Series C convertible preferred stock, consist of multiple individual features that were embedded in the instrument. The Company evaluated all significant features of the hybrid instruments and, where required under current accounting standards, bifurcated features for separate report classification. These features were aggregated into one compound derivative financial instrument for financial reporting purposes. The compound embedded derivative instruments are valued using the Flexible Monte Carlo methodology because that model embodies certain relevant assumptions (including, but not limited to, interest rate risk, credit risk, and conversion/redemption privileges) that are necessary to value these complex derivatives.

Assumptions included exercise estimates/behaviors and the following other significant estimates:

Instrument	**Features**
Conversion prices	$0.95 - $1.29
Remaining terms (years)	1 - 5
Equivalent volatility	52.56% - 56.47%
Equivalent interest-risk adjusted rate	8.17% - 8.58%
Equivalent credit-risk adjusted yield rate	14.50%

Equivalent amounts reflect the net results of multiple modeling simulations that the Monte Carlo Simulation methodology applies to underlying assumptions. The assumptions included in the Monte Carlo Simulation calculation are highly subjective and subject to interpretation.

Standby Equity Distribution Agreements with Cornell

On October 27, 2003, NeoMedia and Cornell entered into a $20 million Standby Equity Distribution Agreement (the "2003 SEDA"). The agreement provided for a maximum "draw" of $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. The SEDA became effective during January 2004, and expired after a two-year term in January 2006. During the six months ended June 30, 2006 and 2005, NeoMedia sold 751,880 and 14,257,025 shares of its common stock to Cornell pursuant to the 2003 SEDA. The following table summarizes funding received from Cornell during the six months ended June 30, 2006 and 2005:

	2006			2005		
	First Quarter	Second Quarter	Six Months Ended June 30	First Quarter	Second Quarter	Six Months Ended June 30
Number of shares sold to Cornell	751,880	---	751,880	6,998,931	7,258,094	14,257,025
Gross Proceeds from sale of shares	$ 234,000	$ ---	$ 234,000	$ 1,709,000	$ 3,219,000	$ 4,928,000
Less: discounts and fees*	(24,000)	---	(24,000)	(204,000)	(489,000)	(693,000)
Net Proceeds from sale of shares	$ 210,000	$ ---	$ 210,000	$ 1,505,000	$ 2,730,000	$ 4,235,000

* Pursuant to the terms of the 2003 SEDA , stock is valued at 98% of the lowest closing bid price during the week it was sold.

On March 30, 2005, NeoMedia and Cornell entered into a Standby Equity Distribution Agreement (the "2005 SEDA") under which Cornell agreed to purchase up to $100 million of NeoMedia common stock over a two-year period, with the timing and amount of the purchase at NeoMedia's discretion. The maximum amount of each purchase would be $2,000,000 with a minimum of five business days between advances. The shares would be valued at 98% of the lowest closing bid price during the five-day period following the delivery of a notice of purchase by NeoMedia, and NeoMedia would pay 5% of the gross proceeds of each purchase to Cornell. Concurrent with the SEDA, NeoMedia entered into an escrow agreement with Cornell and an escrow agent, under which the escrow agent holds in an escrow account shares of NeoMedia common stock, and the cash paid by Cornell for such shares, issued pursuant to an advance under the SEDA. The shares and funds can only be released upon receipt by the escrow agent of a joint disbursement instruction signed by NeoMedia and Cornell. NeoMedia expects to file a registration statement with the SEC to register the shares underlying the 2005 SEDA. The 2005 SEDA would become available at the time the SEC declares effective a registration statement containing such shares.

As a commitment fee for Cornell to enter into the 2005 SEDA, NeoMedia issued 50 million warrants to Cornell with an exercise price of $0.20 per share, and a term of three years, and also paid a cash commitment fee of $1 million. During the six months ended June 30, 2006, Cornell exercised 40 million of the warrants, generating cash proceeds of $8 million to NeoMedia. NeoMedia also issued 4 million warrants with an exercise price of $0.227 to a consultant as a fee in connection with the 2005 SEDA, which have not been exercised. As of June 30, 2005, NeoMedia recorded the $12.3 million fair value of the warrants to "Deferred equity financing costs" and, upon effectiveness of the 2005 SEDA, will amortize this amount to additional paid-in capital straight-line over the two-year life of the 2005 SEDA.

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Promissory Note Payable to Cornell

On March 30, 2005, NeoMedia borrowed from Cornell the principal amount of $10,000,000 before discounts and fees in the form of a secured promissory note. Cornell withheld structuring and escrow fees of $68,000 related to the note. The note was originally scheduled to be repaid at a rate of $1,120,000 per month commencing May 1, 2005, which was subsequently changed to $840,000 per month, continuing until principal and interest were paid in full. The note accrued interest at a rate of 8% per annum on any unpaid principal. In connection with the note, NeoMedia and Cornell entered into a Security Agreement under which the note was secured by all of NeoMedia's assets other than its patents and patent applications. NeoMedia also escrowed 25,000,000 shares of its restricted common stock as security for the note. During the period from March 30, 2005 through January 9, 2006, NeoMedia made payments against the principal totaling $7,210,000. On February 17, 2006, NeoMedia retired the balance of the principal in the amount of $2,790,000, plus accrued interest of $419,000, from the proceeds of the Series C convertible preferred financing arrangement with Cornell. In connection with the payment and issuance of the Series C convertible preferred stock, NeoMedia recognized a loss on extinguishment of debt of $1,964,000 during the six months ended June 30, 2006.

5. INVESTMENT IN MARKETABLE SECURITIES

On February 25, 2005, NeoMedia invested $250,000 in exchange for 8,333,333 shares of PUPS restricted common stock. On February 17, 2006, as a component of net proceeds from the issuance of 8% Series C convertible preferred stock, NeoMedia received marketable securities with a fair value of $579,000, of which, $200,000 represented 20,000,000 shares of PUPS common stock and $379,000 in notes designated as held to maturity. NeoMedia acquired an additional 20,000,000 shares of PUPS common stock for a purchase price equal to $389,000. PUPS is a retail operator and franchiser of retail automotive parts and accessories stores catering to the light truck market, and also provides new vehicle preparation, environmental protection packages, detailing and reconditioning products and services. In accordance with Statements of Financial Accounting Standards No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” the investment in PUPS is being recorded as available-for-sale securities and reported at fair value. Accordingly, unrealized gains and losses on the equity securities are reflected in the condensed consolidated statement of operations and comprehensive income (loss).

The investments in marketable securities are summarized as follows:

	As of June 30, 2006			
	Cost	Unrealized Holding Gain	Unrealized Holding Losses	Fair Value
Available-for-sale	$ 639,000	$ -	($72,000)	$ 566,667
Held to maturity	$ 379,000	$ -	$ -	$ 379,000

Held to maturity securities consist of four notes receivable from PUPS with a face value of $1,365,000 and a fair value of $379,000. The fair value of $379,000 is recorded in other long-term assets on the consolidated balance sheet as of June 30, 2006. The notes are delinquent and accrue interest at rates between 12 - 24%. NeoMedia has not recorded any interest since the Company is using the cost recovery method.

6. FINANCIAL INSTRUMENTS

The carrying amount of the Company's cash equivalents, accounts receivable, prepaid expenses, other current assets, cash surrender value of life insurance policy, 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.

It is not practicable to estimate the fair value of the Company's 17% investment in the common stock of i-Point Media Ltd. and its investments of 250,000 shares of preferred stock of Intactis Software, Inc., because of the lack of quoted market prices and the inability to estimate fair value without incurring excessive costs. During the year ended December 31, 2005 NeoMedia took an impairment of the carrying values of its investments in iPoint-media and Intactis of $530,000 and $250,000, respectively. No impairment charge was taken during the six months ended June 30, 2006. The net carrying value of these investments were $470,000 as of June 30, 2006.

For all available-for-sale investment securities, the carrying values represents fair value of the securities and unrealized gain (losses) that are other than temporary are recognized as other comprehensive income (loss). NeoMedia does not hold these securities for speculative or trading purposes. Also see Note 5.

7. COMPUTATION OF NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is computed by dividing net loss attributable to the stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is computed on the basis of the weighted average number of shares of common stock plus the effect of dilutive potential common shares outstanding during the period using the treasury stock method. Dilutive potential common shares include in-the-money stock options and warrants, and convertible preferred stock instruments. The effect on weighted average shares outstanding of dilutive potential shares during the three and six months ended June 30, 2006 is as follows:

	Three Months Ended June 30, 2006	**Six Months Ended June 30, 2006**
In-the-money options and warrants	66,695,100	75,508,850
Convertible Preferred Stock (on an as converted basis - June 30, 2006) (1)	116,579,361	116,579,361
	183,274,461	192,088,211

(1) - The terms of the embedded conversion features (ECF) in the Series C convertible preferred stock provide for variable conversion rates that are indexed to the Company's trading common stock price. As a result, the number of indexed shares is subject to continuous fluctuation. For presentation purposes, the number of shares of common stock into which the ECF was convertible as of June 30, 2006 was calculated as the face value of $22,000,000 plus assumed dividends of $660,000 if declared, divided by 97% of the lowest closing bid price for the 30 trading days preceding June 30, 2006.

During the three and six months ended June 30, 2005, the Company reported net loss per share, and as such basic and diluted loss per share were equivalent. The number of outstanding options and warrants excluded from the computation of loss per share, because of the anti-dilutive effect is as follows:

	June 30, 2005
Outstanding Stock Options	78,847,971
Outstanding Warrants	72,775,000

8. STOCK BASED COMPENSATION

At June 30, 2006, NeoMedia has four employee stock option plans (the 1996 Stock Option Plan, the 1998 Stock Option Plan, the 2003 Stock Option Plan, and the 2005 Stock Option Plan) and one employee stock compensation plan (the 2003 Stock Incentive Plan) (collectively, the "Plans"). Prior to January 1, 2006, NeoMedia accounted for those plans under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations, as permitted by FASB Statement No. 123, Accounting for Stock-Based Compensation ("Statement 123(R)"). No stock-based employee compensation cost was recognized in the statement of operations for the fiscal years or interim periods ended prior to December 31, 2005, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 1, 2006, NeoMedia adopted the fair value recognition provisions of Statement 123(R), using the modified-prospective-transition method. Under that transition method, compensation cost recognized in the first quarter of 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of Statement 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of Statement 123(R). Results for prior periods have not been restated.

As a result of adopting Statement 123(R) on January 1, 2006, NeoMedia's net income for the three and six months ended June 30, 2006 is $1,111,000 and $2,589,000 lower respectively, than if it had continued to account for share-based compensation under Opinion 25. Basic and diluted earnings per share for the three and six months ended June 30, 2006 is lower by less than $0.01 per share period than it would have been if NeoMedia had not adopted Statement 123(R). Earnings per share attributable to common shareholders for the three and six months ended June 30, 2006 is lower by less than $0.01 per share in each period than it would have been if NeoMedia had not adopted Statement 123(R). Estimated income tax benefits recognized during the three and six months ended June 30, 2006 were offset by a valuation allowance since realization was not reasonably assured.

Prior to the adoption of Statement 123(R), it was NeoMedia's policy to present all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in its statement of cash flows, however, due to NeoMedia's tax loss carryforward, any such benefits were always fully offset by a valuation allowance. Statement 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. NeoMedia will use this presentation if and when it has exhausted its tax loss carryforward.

The following table illustrates the effect on net loss and loss per share if NeoMedia had applied the fair value recognition provisions of Statement 123(R) to options granted under NeoMedia's stock option plans in 2005. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes option-pricing formula and amortized to expense over the options' vesting periods.

	Three Months Ended June 30, 2005	**Six Months Ended June 30, 2005**
Net Loss, as reported	($2,300)	($3,519)
Add: stock-based employee compensation expense included in reported net income, net of related tax effects	---	---
Deduct: Total stock-based employee compensation expense determined under fair value method for all awards, net of related tax effects	(1,051)	(1,404)
Pro-forma net loss	($3,351)	($4,923)
Net Loss per share:		
Basic and diluted - as reported	($0.01)	($0.01)
Basic and diluted - pro-forma	($0.01)	($0.01)

Note that the above pro forma disclosures are provided for the three and six months ended June 30, 2005 because employee stock options were not accounted for using the fair-value method during those periods.

The Plans permit the grant of share options and shares to NeoMedia's employees, board of directors, and outside consultants. NeoMedia believes that such awards better align the interests of its employees with those of its shareholders. Option awards are generally granted with an exercise price equal to the market price of NeoMedia's stock at the date of grant; those option awards generally vest over a period of 3 years and have 10-year contractual terms. Shares granted upon the exercise of stock options are newly issued shares. The fair value of each option award is estimated on the date of grant using the Black-Scholes valuation model that uses the assumptions noted in the following table. Because Black-Scholes valuation model incorporates ranges of assumptions for inputs, those ranges are disclosed. Expected volatilities are based on the expected impact on future stock price of expected future revenue and earnings, historical volatility of NeoMedia's stock, and other factors. NeoMedia uses historical data to estimate option exercise and employee termination within the valuation model. The expected term of options granted represents the period of time that options granted are expected to be outstanding.

	Three and Six months ended June 30,	
	2006	**2005**
Volatility	56%	431% - 446%
Expected dividends	---	---
Expected term (in years)	3	3
Risk-free rate	4.35%	4.50%

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As of January 1, 2006, NeoMedia reevaluated its volatility calculation to take into consideration the guidance outlined in Statement 123(R). Prior to January 1, 2006, NeoMedia calculated volatility using only historical share price data. Under the provisions of Statement 123(R), from January 1, 2006 onward NeoMedia has considered historical volatility, as well expected future volatility. As a result, NeoMedia's volatility decreased significantly for stock based compensation granted during the six months ended June 30, 2006 as compared with stock based compensation granted prior to January 1, 2006. NeoMedia will evaluate its volatility on an ongoing basis using the most current information available. NeoMedia expects that, under the guidelines of Statement 123(R), future volatility will more closely resemble 2006 levels than previous years.

A summary of option activity under the Plans as of June 30, 2006, and changes during the six months then ended is presented below:

	Shares (In thousands)	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Term** (in years)	**Aggregate Intrinsic Value** (In thousands)
Outstanding at January 1, 2006	100,041	$ 0.18		
Granted	25,300	$ 0.37		
Exercised	(2,231)	$ 0.14		
Forfeited	(4,113)	$ 0.21		
Outstanding at June 30, 2006	118,997	$ 0.22	8.6	$ 7,793
Vested or expected to vest at June 30, 2006	73,362	$ 0.16	8.2	$ 7,329

The weighted-average grant-date fair value of options granted during the six months ended June 30, 2006 was $0.11. The total intrinsic value of options exercised during the six months ended June 30, 2006 was $411,000. Total cash received from options exercised was $316,000 and $695,000 for the six months ended June 30, 2006 and 2005, respectively.

A summary of the status of NeoMedia's nonvested shares as of June 30, 2006, and changes during the six months ended June 30, 2006, is presented below:

Nonvested Shares	**Shares** (in thousands)	**Weighted Average Grant Date Fair Value**
Nonvested at January 1, 2006	44,215	$0.18
Granted	15,600	$0.12
Vested	(11,606)	$0.19
Forfeited	(2,574)	$0.21
Nonvested at June 30, 2006	45,635	$0.24

As of June 30, 2006, there was $9,065,000 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized over a weighted-average period of 1.4 years.

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9. SEGMENT REPORTING

As of June 30, 2006, NeoMedia was structured and evaluated by its Board of Directors and Management as three distinct business units:

- NeoMedia Mobile (NMM) - encompassing NeoMedia's physical-world-to-internet and mobile marketing technologies branded under Qode, 12Snap, Sponge, Gavitec and Mobot

- NeoMedia Micro Paint Repair (NMPR) - encompassing the micro paint and auto aftermarket accessories manufactured and distributed by NeoMedia

- NeoMedia Telecom Services (NTS) - encompassing the billing, clearinghouse and information management services of recently-acquired BSD

NeoMedia's reportable segments are strategic business units that offer different technology and marketing strategies. NMM is headquartered in Ft. Myers, Florida, and operates principally in the United States and in Europe through the recent acquisitions of Sponge (United Kingdom), 12Snap (Germany) and Gavitec (Germany). NMPR is headquartered in Ft. Myers, Florida, and currently sells into Canada, the United States, Australia, New Zealand, Scandinavia, Mexico and China. NTS is headquartered in Calgary, Alberta, Canada and presently primarily operates within Canada.

Consolidated net sales and net income (loss) for the three and six month periods ended June 30, 2006 and 2005, and identifiable assets as of June 30, 2005 and 2006 by geographic area were as follows:

	(in thousands) **Three Months Ended June 30,**		(in thousands) **Six Months Ended June 30,**	
	2006	**2005**	**2006**	**2005**
Net Sales:				
United States	$ 501	$ 358	$ 943	$ 968
Germany	4,572	---	4,789	---
United Kingdom	1,038	---	1,338	---
Canada	190	180	583	317
Italy	118	---	805	---
Other	187	---	200	---
	$ 6,606	$ 538	$ 8,658	$ 1,285
Net Income (Loss):				
United States	$ 5,731	($2,133)	$ 4,760	($3,133)
Germany	(48)	---	(538)	---
United Kingdom	(239)	---	(170)	---
Canada	(151)	(167)	(555)	(386)
Italy	(39)	---	499	---
Other	(121)	---	(181)	---
	$ 5,133	$ (2,300)	$ 3,815	$ (3,519)
Identifiable Assets				
United States (1)	$ 80,212			
Germany	2,671			
United Kingdom	516			
Canada	5,692			
	$ 89,091			

(1) - For segment reporting purposes, goodwill and intangible assets of acquired subsidiaries are assumed to be located at NeoMedia headquarters in the United States.

Consolidated net sales, net operating losses for the three and six month periods ended June 30, 2006 and 2005, and identifiable assets as of June 30, 2006, by business unit were as follows:

	(in thousands) **Three Months Ended June 30,**		(in thousands) **Six Months Ended June 30,**	
	2006	**2005**	**2006**	**2005**
Net Sales:				
NeoMedia Mobile (1)	$ 3,268	$ 153	$ 4,711	$ 173
NeoMedia Telecom Services (2)	2,937	---	3,169	---
NeoMedia Micro Paint Repair	401	261	778	716
NeoMedia Consulting & Integration Services (3)	---	124	---	396
	$ 6,606	$ 538	$ 8,658	$ 1,285
Net Income (Loss:)				
NeoMedia Mobile (1)	($3,083)	($543)	($4,847)	($865)
NeoMedia Telecom Services (2)	217	---	(183)	---
NeoMedia Micro Paint Repair	(755)	(275)	(1,206)	(347)
NeoMedia Consulting & Integration Services (3)	---	(583)	-	(925)
Corporate overhead	(2,271)	(899)	(5,743)	(1,382)
Charges related to convertible preferred stock sale	11,025	---	15,794	---
	$ 5,133	($2,300)	$ 3,815	($3,519)
Identifiable Assets				
NeoMedia Mobile (1)	$ 77,653			
NeoMedia Telecom Services (2)	2,847			
NeoMedia Micro Paint Repair	4,690			
NeoMedia Consulting & Integration Services (3)	---			
Corporate	$ 3,901			
	$ 89,091			

(1) - NeoMedia Mobile consists of NeoMedia's qode® and patent business, Mobot, Sponge, Gavitec, and 12Snap. Mobot operations are included in NeoMedia's consolidated financial results for the period February 18, 2006 through June 30, 2006. Gavitec and Sponge operations are included in NeoMedia's consolidated financial results for the period February 24, 2006 through June 30, 2006. 12Snap operations are included in NeoMedia's consolidated financial results for the period March 1, 2006 through June 30, 2006.

(2) - NeoMedia Telecom Services consists of the operations of BSD Software, Inc., acquired March 21, 2006, and included in NeoMedia's consolidated financial results for the period March 22, 2006 through June 30, 2006.

(3) - NeoMedia Consulting & Integration Services business unit was wound down during the first quarter of 2006 and combined with the NeoMedia Mobile business unit. Results from operations previously included in this business unit are now included in the NeoMedia Mobile business unit

Operating costs included in one segment may benefit other segments, and therefore these segments are not designed to measure operating income or loss directly related to the products included in each segment.

11. INVENTORY

Inventories, consisting of material, material overhead, labor and processing costs, are stated at the lower of cost (first-in, first-out) or market and consist of the following at June 30, 2006:

	(dollars in thousands) June 30, 2006	
Raw materials	$	97
Work-in-process		9
Finished goods		239
Total	$	345

12. ACCRUED LIABILITIES

Accrued liabilities consist of the following as of June 30, 2006:

	(dollars in thousands)	
Accruals related to silent partner agreements	$	1,436
Accrued legal and accounting costs		311
Accruals for disputed services		794
Accrued operating expenses		945
Payroll related accruals		432
Total	$	3,918

13. COMMITMENTS AND CONTINGENCIES

NeoMedia and its subsidiaries lease office facilities and certain office and computer equipment under various operating leases. 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. Additionally, NeoMedia issued Series C convertible preferred shares with face value of $22,000,000 (and a commitment for an additional $5,000,000 purchase by the purchasers under the same terms) that are subject to conversion no later than February 17, 2009. NeoMedia holds notes payable to certain vendors and silent partners of an acquired subsidiary that mature at various dates in the future.

The following table sets forth NeoMedia’s future minimum payments due under operating leases, vendor and consulting agreements, convertible stock agreements, and debt agreements:

(dollars in thousands)

	Operating Leases	Vendor & Consulting Agreements	Notes Payable	Series C Convertible Preferred Stock	Total
2006 (remaining six months)	$ 473	$ 271	$ 2,386	$ ---	$ 3,130
2007	783	340	31	---	1,154
2008	501	156	---	---	657
2009	190	39	---	27,000	27,229
2010	58	---	---	---	58
Thereafter	42	---	---	---	42
Total	$ 2,047	$ 806	$ 2,417	$ 27,000	$ 32,270

It is not possible to predict the maximum potential amount of future payments under these or similar agreements due to the conditional nature of the Company’s obligations and the facts and circumstances involved in each particular agreement. The Company does not record a liability for claims related to indemnification unless the Company concludes that the likelihood of a material claim is probable and estimable. Historically, payments pursuant to these indemnifications have been immaterial. See Item 1 of Part II of this Form 10-Q for discussion of legal proceedings.

In the event that NeoMedia’s stock price at the time the consideration shares issued in connection with the acquisitions of Mobot, Sponge, Gavitec, and 12Snap become saleable is less than the contractual price (between $0.3839 and $0.3956), NeoMedia is obligated to compensate the sellers in cash for the difference between the price at the time the shares become saleable and the relevant contractual price. Assuming a stock price at the time the shares become saleable of $0.165, which was the last sale price on July 21, 2006, NeoMedia would have a cash liability of $25.5 million relating to the guarantees. On June 21, 2006, NeoMedia filed a registration statement on Form S-3 which included the consideration shares issued to acquire Mobot, Sponge, Gavitec, and 12Snap, among others, which was subsequently withdrawn. NeoMedia intends to file a new registration statement on form S-3 to cover these areas. At current stock prices, NeoMedia does not believe that it will be able to generate enough cash to satisfy the purchase price guarantees if and when they become due, which is expected to occur upon effectiveness of the registration statement. As a result, NeoMedia is attempting to negotiate for payment of the purchase price guarantees in another form, including additional shares of common stock. There is no guarantee that NeoMedia will be successful in negotiating such an agreement with any or all of the parties involved.

14. OTHER

Liabilities related to silent partnership arrangements

12Snap, a wholly-owned subsidiary of NeoMedia, entered into three silent partnership arrangements in 2000 with principal borrowing amounts, totaling EUR 3,500,000 (approximately $4.2 million). Silent partnerships are a common form of investment in Germany. The purpose of a silent partnership is to financially support the Company in its efforts to research, design and develop its product and services, while allowing the lenders not to become a legal owner of the company and thus not become liable for the obligation of the company. The lenders are not involved in the management of 12Snap, but significant business decisions such as changes in the articles of incorporation, mergers and acquisitions or significant contractual matters are subject to their approval.

The partnership agreements regularly terminate on December 31, 2008 and 2009. However, due to the acquisition of all shares of 12Snap by NeoMedia, an early termination has been agreed on for all silent partnership agreements. Those silent partnerships have thus terminated as of February 28, 2006. According to the termination agreements EUR 1,750,000 (approximately $2.1 million) were repaid to the silent partners in March 2006. Another installment amounting to EUR 1,750,000 (approximately $2.1 million) plus interest will be due as of December 31, 2006.

Debt of NeoMedia Telecom Services

The NeoMedia Telecom Services business unit was formed in March 2006 with the acquisition of BSD Software, Inc. BSD was party to certain debt agreements prior to the acquisition which became obligations of NeoMedia upon completion of the acquisition, as follows:

Wayside Solutions, Inc., a corporation affiliated with BSD, provided financing services to BSD prior to the acquisition. Prior to the acquisition, NeoMedia reached an agreement with Wayside to pay the outstanding debt due to Wayside subsequent to completion of the acquisition. During June 2006, NeoMedia issued 3,721,698 shares of its common stock in satisfaction of the debt and accrued interest. NeoMedia valued the stock at $0.227 per share, which was the last sale price on the date of issuance.

During June 2006, NeoMedia issued 1,512,093 shares of its common stock in satisfaction of the debt and accrued interest due to Guy Fietz, CEO, President and a shareholder of BSD, and now Vice President and General Manager of NeoMedia Telecom Services. NeoMedia valued the stock at $0.24 per share, which was the last sale price on the date of issuance.

NeoMedia also assumed amounts due to former BSD shareholders which bear interest at rates varying from 0%-10% per annum, are unsecured and due on demand and are subject to cash payment plans. Amounts due under such arrangements were $60,000 as of June 30, 2006.

Micro Paint Developments in China

On February 28, 2006, NeoMedia signed a 10-year exclusive supplier agreement with Automart, a Beijing-based joint venture operating under the laws of the People's Republic of China specializing in automobile sales, financing, insurance and repair. Automart is the brand name of Jinche Yingang Auto Technological Services Limited, with which NeoMedia signed a distribution agreement in August 2005. The new agreement expands on the previous agreement, giving Automart the exclusive rights to distribute NeoMedia’s micro paint repair products to their own stores and others throughout China, Hong Kong, Macao, and Taiwan, and also guaranteeing that Automart will purchase at least 70% of its non-micro paint products through NeoMedia as its distributor. NeoMedia has signed distribution agreements with DuPont and PPG, and intends to become a distributor of other automotive aftermarket products to Automart.

During the fourth quarter of 2005 and first quarter of 2006, NeoMedia shipped and invoiced $757,000 of Micro Paint Repair products to Automart that has not yet been recognized in revenue as of June 30, 2006. If and when collectibility is reasonably assured, NeoMedia expects to recognize revenue for these shipments. The amount of $571,000 is included in deferred costs as of June 30, 2006.

Pick Ups Plus and Automotive Preservation

On February 25, 2005, NeoMedia invested $250,000 in exchange for 8,333,333 shares of Pickups Plus, Inc. (“PUPS”)(OTCBB:PUPS) restricted common stock. PUPS is a retail operator and franchiser of retail automotive parts and accessories stores catering to the light truck market, and also provides new vehicle preparation, environmental protection packages, detailing and reconditioning products and services. In addition, on February 17, 2006, NeoMedia acquired an additional 20,000,000 shares of PUPS common stock from Cornell Capital Partners acquired from the proceeds of the Series C convertible preferred stock sale. The total of 28,333,333 shares owned represent approximately 19.75% of PUPS outstanding shares (based on 143,482,281 PUPS shares outstanding as of March 15, 2006). Because the investment represents less than 20% of PUPS outstanding shares, and because NeoMedia does not exercise significant influence over PUPS operations or decision making, NeoMedia has recorded the investment as available for sale securities and reported at fair value. As of June 30, 2006, NeoMedia has recorded an unrealized holding loss of $72,000 due to the decrease in the quoted market price of PUPS common stock.

Also on February 25, 2005, NeoMedia signed two non-binding Letters of Intent to acquire up to 100% of Automotive Preservation, Inc. (“AP”), a distributor of automotive paint and accessory products, from AP’s parent company, PUPS. The first Letter of Intent calls for NeoMedia to initially acquire 30% of AP for $1,600,000, to be paid $600,000 in cash, $554,000 in shares of NeoMedia restricted common stock, and $446,000 through the assumption of AP debt by NeoMedia. Under the second Letter of Intent, upon completion of the acquisition of the initial 30% of AP by NeoMedia, NeoMedia would have the option to acquire an additional 30% of AP for $1,650,000, payable in shares of NeoMedia restricted common stock. The second Letter of Intent also gives NeoMedia the option to purchase the final 40% of AP for either: (i) $2,200,000, payable in shares of NeoMedia restricted common stock, if NeoMedia exercises this right within 12 months of acquiring the second 30% of AP, or (ii) a price equivalent to AP’s previous quarter EBITDA multiplied by 8, payable in shares of NeoMedia restricted common stock. Both Letters of Intent are non-binding and subject to due diligence by NeoMedia and AP. On September 21, 2005, the BOD approved to change the deal structure for the acquisition of AP, so that the Company would acquire only 30% of AP for a total purchase price of $1.6 million of which $600,000 would be paid in cash and $446,000 would be paid through the assumption of debt, and $554,000 through the issuance of restricted NeoMedia stock. NeoMedia will not acquire the remaining 70% of AP under the new structure.

During April 2006, NeoMedia announced its intention to issue a stock dividend with the distribution of common shares of Pickups Plus, Inc. as a property dividend. NeoMedia will distribute 8,333,333 shares of Pickups Plus common stock, which it acquired in February 2005, to NeoMedia shareholders of record as of April 28, 2006. The shares will be distributed at such time as Pickups Plus files and makes effective a registration statement registering the shares.

Patent Issuance

During April 2006, the Instituto Mexicano de la Propiedad Industrial, the patent office in Mexico, awarded patent No. 233529 to NeoMedia, which corresponds to patents issued to the company by the U.S. Patent Office and the Canadian Intellectual Property Office, for a "Method and System for Accessing Electronic Resources via Machine-Readable Data on Intelligent Documents." Dr. Kevin Hunter, NeoMedia’s chief scientist, is the inventor of record. NeoMedia has also filed for patents for the process in Europe, Japan and Brazil. The patent deals with improved methods of storing information placed directly on physical objects as PC-readable data utilizing 2-dimensional bar codes and various data compression techniques.

15. SUBSEQUENT EVENTS

On July 26, 2006, NeoMedia signed a an operating agreement with Shang Fang Wei Ye Technology Development Limited Company (“Shang Fang”), a subsidiary of Beijing Sino-U.S. Jinche Yingyang Auto Technological Services Ltd., to introduce and market NeoMedia’s patented qode direct-to-Web technology in key markets in Asia. Under the operating agreement, NeoMedia’s primary role will be as the main interface to mobile operators, with the company primarily responsible for demonstrating environments as well as developing demonstration products for mobile systems, service network environment enablers, and mobile application solutions and services. Shang Fang’s primary role will be to provide an interface with various Asian governments as well as to identify and help negotiate with potential commercial partners of qode® in that part of the world.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

During 2006, NeoMedia has continued its efforts to commercialize its NeoMedia Mobile and NeoMedia Micro Paint Repair business units, both in North America and overseas. As part of the commercialization efforts, NeoMedia began to implement an aggressive growth campaign focusing on expansion through three major avenues: acquisition and globalization.

To this end, during the second half of 2005 and the first half of 2006, NeoMedia made the following strategic maneuvers:

August 2005:	signed agreement to distribute Micro Paint products to China via Jinche Automotive Group
September 2005:	signed agreement to distribute Micro Paint products to Mexico and Latin America via Micropaint de Mexico
October 2005:	signed agreement to distribute Micro Paint products to Scandinavia via WITHO-AS
December 2005:	signed agreements to distribute DuPont and PPG automotive aftermarket products to Jinche in China
February 2006:	completed acquisitions of Mobot (US), 12Snap (Europe), Gavitec (Europe), and Sponge (Europe); signed letter of intent to acquire Hip Cricket; completed $22 million funding to finance acquisitions and future growth
March 2006:	completed acquisition of BSD Software, creating the NeoMedia Telecom Services (NTS) business unit
July 2006:	Signed agreement to work to introduce Qode technology into China through partner agreement

Acquisitions

During 2005 and the first quarter of 2006, NeoMedia has aggressively pursued acquisitions that will confirm its presence in the global mobile marketing space. To this end, during the three months ended March 31, 2006, NeoMedia completed, or agreed to complete, acquisitions of Mobot, Sponge, Gavitec, 12Snap, BSD, and Hip Cricket. It is the intention of NeoMedia’s board of directors and management to continue to pursue strategic acquisitions in both its mobile marketing and the micro paint repair business units.

2006 Developments for New Acquisitions

Mobot

Mobot continued to build on its pioneering leadership of the mobile image recognition industry. Mobot announced an expanded relationship with Hachette Filipacchi Media and delivered a first-of-its-kind nationwide (U.S. & Can.) campaign for Starbucks.

ELLE Magazine, published by Hachette, is launching an interactive shopping program called *EWish*, based on Mobot technology and services. EWish allows readers to add products to their personalized web page by taking pictures of magazine advertisements and product images, and sending these to Mobot. Mobot servers catalog the requests and image recognition is used to link the correct products and content to the user's web page at elle.com. The premiere issue for EWish is October, 2006.

Starbucks Summer Pursuit is a mobile scavenger hunt that combines the use of text messaging and picture messaging to create a uniquely creative consumer experience. Users answer questions by using their camera phone to take and send a picture to Mobot. Mobot image recognition servers are then used to determine if the answer is correct. The solution also supports text based answers for non-camera phone users. The Mobot platform is used to deliver the entire mobile experience and game play. Consumers are playing for the chance to win a trip to Costa Rica, among other incentives and prizes.

Sponge

Sponge has continued to broaden its client base in the second quarter with an increasing range of products aimed at media groups, agencies and carriers. Media successes included increased activity for IPC magazines and News International. On the TV front Sponge ran its first promotions in Sweden and Norway for Big Brother. Sponge has also worked on a number of brand promotions, including: a major specialist motorcycle magazine; on-pack text-to-win mechanics for a major soft drinks brand to coincide with the World Cup as well as other drinks and confectionary brands.

Also launched was a pan-European, eight-country trade promotion for TaylorMade®-adidas® Golf incorporating a customized mobile phone solution to drive sales by incentivizing retail sales personnel. The Sales Incentive Text-to-Win application recognizes in-store staff by their account number and name included in an inbound SMS message, and automatically submits valid entrants into the next of a number of prize draws. In June, Sponge also reached agreement to supply marketing solutions to Vodafone for their customers.

At the recent Promotional Marketing Awards in the U.K., Sponge saw its agency partners win all but two of the awards for campaigns incorporating mobile marketing -- including the Best of Show 'Grand Prix' prize.

Gavitec

Gavitec continues to successfully market its Products in ScanCommerce (Exio / MD-20) and Enterprise Solutions (Lavasphere - the award winning technology turning cellular phones into code-readers) through mobile solutions partners to clients including McDonald's Portugal, Amnesty International, Malaysian Railways, World Soccer Games 2006, EMT (Empresa Malagueña de Transportes), a Spanish public transport company and Ströer, an OOH (Out-Of-Home) Media Company. TopSolutions, a leading software development and systems integration house, is Gavitec's mobile solutions partner for McDonald's Portugal, which is running a large scale mobile-couponing program. EMT continued to run a pilot that gave EMT the distinction of being the first Spanish public transport company effectively and successfully using mobile ticketing. Through the use of Gavitec technology, EMT passengers are now able to pay for and receive bus tickets using their own mobile phones. Omniprime together with the Government of

Malysia implemented Gavitec technology in the public transportation railways. In Kaiserslautern, Germany - one of the 2006 World Cup arenas - consumers could call for Beer (Bieralarm) while using a Gavitec-enabled solution provided by REA and Bitburger Beer. Gavitec optimized Ströer sales-force and services using its Lavasphere product.

On the technological front, Gavitec furthered the development of its code-reading capabilities adding QR-Engine on JAVA to augment its existing DataMatrix technology on JAVA. Now, the engine will be downloadable via Internet or telephone connection to a considerable number of mobile phones, providing the opportunity to distribute the innovative software to a broader audience through business-to-consumer, mass market to incubate new applications.

12Snap

In the second quarter of 2006, *12snap* again reached consumers far beyond its headquarters in Germany and offices in the UK, Italy and Sweden. Through campaigns for such high profile brand names as Adidas, Coca-Cola, Ferrero, and McDonald's, 12snap enabled millions of consumers throughout the EMEA (Europe, Middle East & Africa) region to participate in high-quality and entertaining mobile marketing campaigns. This scale and geographic reach also allowed 12snap to strengthen its technology to be compatible with the different carriers and handsets available in the EMEA. Additionally, new client wins such as Lufthansa helped to further strengthen 12snap's strong position among marketers who want to use the mobile phone as an effective and interactive marketing tool.

NeoMedia Telecom

NeoMedia Telecom is currently in the final stages of completing the successful transition of some of its key customers to a new Canadian Interchange (IXC) carrier network, which provides both 1010 dial-around and 900 service nationally. The company is already experiencing a positive impact from this transition in two ways: (1) several customers who were regional are expanding to a national billing strategy, and (2) NeoMedia Telecom has been able to reduce costs by moving from local exchange carriers (LEC's) to the new IXC, which is a non-tariffed (regulated rates) national network.

Consulting & Integration Services Business Unit

As part of the acceleration of global expansion in the Mobile and Micro Paint business units, as well as the creation of the NeoMedia Telecom Services (NTS) business unit through the BSD acquisition, NeoMedia also decided in February 2006 to wind down its legacy NeoMedia Consulting & Integration Services (NCIS) business unit. The NCIS unit consisted of client-server equipment and related software resales. The resale market has been commoditized over the past several years, and NeoMedia believes its resources are better spent on the development and commercialization of its NMM, NMPR and NTS business units. Certain of the proprietary products associated with the NCIS business, such as PDF-417 and Maxicode print encoder software and WISP migration tools, will be retained by NeoMedia and consolidated with the NMM unit. NeoMedia does not intend to pursue additional resales of hardware and software or integration services not directly related to its other business units.

Accounting Treatment of Series C Convertible Preferred Stock

In connection with the accounting treatment of the Series C convertible preferred stock sale, NeoMedia recognized a gain on derivative financial instruments of $11,025,000 and $15,794,000 during the three and six month periods ended June 30, 2006, respectively. The gain is due to the change in fair value of derivative financial instruments resulting from a decrease in NeoMedia's stock price from $0.389 per share on the date of the Series C convertible preferred stock sale (February 17, 2006) to $0.231 per share on June 30, 2006. The fair value of the derivative financial instruments at each measurement date correlates to NeoMedia's stock price at the same date. As a result, NeoMedia's net income varies significantly from its cash flow from operations during the three and isx months ended June 30, 2006. In future periods, NeoMedia's earnings could fluctuate dramatically from quarter to quarter if its stock price is significantly different from the stock price at the end of the previous measurement period. Because NeoMedia cannot guarantee that it has enough authorized shares to net share settle the Series C convertible preferred stock, the change in fair value of derivative instruments will be recorded to NeoMedia's statement of operations each reporting period until the Series C convertible preferred stock is fully converted.

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Critical Accounting Policies

The United States Securities and Exchange Commission (the "SEC") 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: intangible asset valuation, which affects amortization and impairment of goodwill and other intangibles; financial instruments and concentrations of credit risk, which affects gains and losses from derivative financial instruments; allowance for doubtful accounts; inventory valuation, which affects cost of sales and gross margin; stock based compensation; estimate of litigation-based liability; and revenue recognition . 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, allowance for doubtful accounts, and stock-based compensation. The methods, estimates and judgments NeoMedia uses in applying these most critical accounting policies have a significant impact on the results it 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.

According to SFAS 144, a long-lived asset should be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The following are examples of such events or changes in circumstances:

–- A significant decrease in the market price of the asset
–- A significant adverse change in the extent or manner in which the asset is being used, or in its physical condition
–- A significant adverse change in legal factors or in the business climate that could affect the value of the asset, including an adverse action or assessment by a regulator
–- An accumulation of costs significantly in excess of the amount originally expected
–- A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of the asset
–- A current expectation that, more likely than not, the asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

NeoMedia follows the two-step process outlined in SFAS 144 for determining if an impairment charge should be taken: (1) the expected undiscounted cashflows from a particular asset or asset group are compared to the carrying value; if the expected undiscounted cashflows are greater than the carrying value, no impairment is taken, but if the expected undiscounted cashflows are less than the carrying value, then (2) an impairment charge is taken for the difference between the carrying value and the expected discounted cashflows. The assumptions used in developing expected cashflow estimates are similar to those used in developing other information used by NeoMedia for budgeting and other forecasting purposes. In instances where a range of potential future cashflows is possible, NeoMedia uses a probability-weighted approach to weigh the likelihood of those possible outcomes. NeoMedia used a rate of 10% for purposes of discounting cashflows in 2006 and 2005.

Financial Instruments and Concentrations of Credit Risk. The Company's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses, notes payable, derivative financial instruments, other current liabilities and convertible preferred stock. Management believes the carrying values of cash and cash equivalents, accounts payable, accounts payable and accrued expenses, notes payable, and other current liabilities approximate their fair values due to their short-term nature. The fair value of convertible preferred stock is estimated on June 30, 2006 to be approximately $17,937,000.

The Company generally does not use derivative financial instruments to hedge exposures to cash-flow risks or market-risks that may affect the fair values of its financial instruments. However, certain other financial instruments, such as warrants and embedded conversion features that are indexed to the Company's common stock, are classified as liabilities when either (a) the holder possesses rights to net-cash settlement or (b) physical or net-share settlement is not within the control of the Company. In such instances, net-cash settlement is assumed for financial accounting and reporting, even when the terms of the underlying contracts do not provide for net-cash settlement. Such financial instruments are initially recorded at fair value and subsequently adjusted to fair value at the close of each reporting period.

The caption "Derivative Financial Instruments" consists of (i) the fair values associated with derivative features embedded in the Series C convertible preferred stock, (ii) the fair values of the detachable warrants that were issued in connection with the preferred stock financing arrangement, and (iii) the fair value of detachable warrants that were outstanding prior to the issuance of the Series C Preferred Shares..

Allowance for Doubtful Accounts. NeoMedia maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. 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 historical experience, NeoMedia's estimates could change and impact its reported results.

Inventory. Inventories are stated at lower of cost (using the first-in, first-out method) or market. NeoMedia continually evaluates the composition of its inventories assessing slow-moving and ongoing products and maintains a reserve for slow-moving and obsolete inventory as well as related disposal costs.

Stock-based Compensation. Beginning January 1, 2006, NeoMedia began to account for stock-based compensation in accordance with SFAS No. 123(R), *Share-Based Payment*. Under the fair value recognition provisions of this statement, share-based compensation cost is measured at the grant date based on the value of the award and is recognized as expense over the vesting period. Determining the fair value of share-based awards at the grant date requires judgment, including estimating expected dividends. In addition, judgment is also required in estimating the amount of share-based awards that are expected to be forfeited. If actual results differ significantly from these estimates, stock-based compensation expense and our results of operations could be materially impacted. Stock-based compensation expense is calculated using the Black Scholes option pricing model on 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. From time to time, NeoMedia is defendant in certain litigation in the ordinary course of business (see the section entitled "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. NeoMedia derives revenues from the following sources: (1) license revenues relating to patents and internally-developed software, (2) hardware, software, and service revenues related to mobile marketing campaign design and implementation, and (3) sale of its proprietary Micro Paint Repair solution.

(1) Technology license fees, including Intellectual Property licenses, 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. 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, and Statement of Position 98-9, Modification of SOP 97-2, "Software Revenue Recognition, With Respect to Certain Transactions.". License revenue is recognized if persuasive evidence of an agreement exists, delivery has occurred, pricing is fixed and determinable, and collectibility is probable. The Company defers revenue related to license fees for which amounts have been collected but for which revenue has not been recognized in accordance with the above, and recognizes the revenue over the appropriate .

(2) Technology service & product revenue, which includes sales of software and technology equipment and service fee is recognized based on guidance provided in SEC Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition in Financial Statements," as amended (SAB 104). Software and technology equipment resale revenue is recognized when persuasive evidence of an arrangement exists, the price to the customer is fixed and determinable, delivery of the service has occurred and collectibility is reasonably assured. Service revenues including maintenance fees for providing system updates for software products, user documentation and technical support 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. Telecom revenues are recognized at the time that calls are accepted by the clearing house for billing to customers. The Company's recently acquired subsidiaries BSD, Mobot, and Gavitec follow this policy. The Company defers revenue related to technology service & product revenue for which amounts have been invoiced and or collected but for which the requisite service has not been provided. Revenue is then recognized over the matching service period.

(3) Technology service also includes mobile marketing services to its customers which mobile marketing projects are recognized after the completion of the project and accepted by the customer. All response and messaging based revenues are recognized at the time such responses are received and processed and the Company recognizes its premium messaging revenues on a net basis based on guidance provided in Emerging Issues Task Force Issues No. 99-19 (EITF 99-19), "Reporting Revenue Gross as Principal or Net as an Agent" and No. 01-09 (EITF 01-09), "Accounting for Consideration Given by a Vendor to a Customer." Consulting and management revenues and revenues for periodic services are recognized as services are performed. NeoMedia 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. The Company's recently acquired subsidiaries 12Snap and Sponge follow this policy. The Company defers revenue related to mobile marketing service fees for which amounts have been invoiced and/or collected but for which revenue has not been recognized. Revenue is then recognized over the matching service period.

(4) Revenue for training and certification on NeoMedia's Micro Paint Repair systems is recognized equally over the term of the contract, which is currently one year. A portion of the initial fee paid by the customer is allocated to training costs and initial products sold with the system, and is recognized upon completion of training and shipment of the products, provided there is VSOE in a multiple element arrangement. Ongoing product and service revenue is recognized as products are shipped and services performed. The Company defers revenue related to micro paint repair training and certification for which amounts have been invoiced and/or collected but for which revenue has not been recognized. Revenue is then recognized over the estimated contract period, which is currently one year.

In December 2003, the SEC issued SAB 104, "Revenue Recognition." SAB 104 supersedes SAB 101, "Revenue Recognition in Financial Statements." SAB 104's primary purpose is to rescind accounting guidance contained in SAB 101 related to multiple element revenue arrangements, superseded as a result of the issuance of EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." Additionally, SAB 104 rescinds the SEC's Revenue Recognition in Financial Statements Frequently Asked Questions and Answers (the "FAQ") issued with SAB 101 that had been codified in SEC Topic 13, Revenue Recognition. Selected portions of the FAQ have been incorporated into SAB 104. While the wording of SAB 104 has changed to reflect the issuance of EITF 00-21, the revenue recognition principles of SAB 101 remain largely unchanged by the issuance of SAB 104, which was effective upon issuance. The adoption of SAB 104 did not impact NeoMedia's consolidated financial statements.

Income Tax Valuation Allowance. 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 June 30, 2006 and 2005.

Foreign Currency Translation. The local currency has been primarily used as the functional currency throughout the world. Translation gains and losses of those operations that use local currency as the functional currency are included in the consolidated balance sheets as "Accumulated other comprehensive income (loss)." Where the U.S. dollar is used as the functional currency, foreign currency gains and losses are reflected in income.

Stock-Based Compensation

NeoMedia adopted Statement of Financial Accounting Standards No. 123 ("SFAS 123R") on January 1, 2006, using the prospective method for stock option grants prior to January 1, 2006 and the modified-prospective transition method for stock option grants and restricted stock issued after January 1, 2006. As a result, the unamortized compensation expense from stock options granted prior to January 1, 2006 is not included in the statement of operations. SFAS 123R requires all share-based payments to employees to be recognized in the income statement based on their fair values. Under the modified-prospective transition method, compensation cost recognized for the three and six months ended June 30, 2006 includes: (a) compensation cost for all share-based payments granted, but not yet vested as of January 1, 2006 based on the grant-date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R. Such amounts are reduced by NeoMedia's estimate of forfeitures of all unvested awards.

Prior to January 1, 2006, NeoMedia accounted for its stock-based compensation plans under the intrinsic-value method prescribed in Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees," ("APB 25") and related interpretations as permitted by Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation." ("SFAS 123"). Under APB 25, when the exercise price of options granted to employees equals the market price of the common stock on the date of grant, no compensation expense is recorded. When the exercise price of options granted to employees is less than the market price of the common stock on the date of grant, compensation expense is recognized over the vesting period. Had NeoMedia accounted for stock based compensation under the fair value method during the three and six months ended June 30, 2005, net loss would have been higher by $1.1 million and $1.4 million, respectively, during these periods, causing no change to the reported net loss per share of $0.01 for the three and six month periods ending june 30, 2005.

SFAS 123R requires share-based payments to employees to be measured at fair value. However, the valuation of employee stock options is an inherently subjective process, since market values are generally not available for long-term, non-transferable employee stock options. Accordingly, an option pricing model is utilized to derive an estimated fair value. NeoMedia use the Black-Scholes-Merton pricing model in order to calculate the estimated fair value for its stock options.

Approximately 82% and 74% of the stock-based compensation expense recorded in the three and six months ended June 30, 2006 respectively relates to the continued vesting of stock options that were granted prior to January 1, 2006. In accordance with the transition provisions of SFAS 123R, the grant date estimates for these options have not been changed.

As of June 30, 2006, there was $9.1 million of total stock-based compensation expense not yet recognized relating to non-vested awards granted under NeoMedia's option plans and restricted stock agreements as calculated under SFAS 123R. This expense is net of estimated forfeitures and is expected to be recognized over a weighted-average period of approximately 1.4 years. The amount of stock-based compensation expense to be recorded in any future period cannot be exactly predicted due to the uncertainty of future grant levels and actual forfeitures to be recorded. Additionally, changes to the assumptions used in the Black Scholes model could cause a material change in the amount of compensation expense to be recorded in future reporting periods.

One of the key components used in calculating the fair value of stock options is the volatiliy of the underlying stock. As of January 1, 2006, NeoMedia reevaluated its volatility calculation to take into consideration the guidance outlined in Statement 123(R). Prior to January 1, 2006, NeoMedia calculated volatility using only historical share price data. Under the provisions of Statement 123(R), from January 1, 2006 onward NeoMedia has considered historical volatility, as well expected future volatility. As a result, NeoMedia's volatility decreased significantly for stock based compensation granted during the six months ended June 30, 2006 as compared with stock based compensation granted prior to January 1, 2006. NeoMedia will evaluate its volatility on an ongoing basis using the most current information available. NeoMedia expects that, under the guidelines of Statement 123(R), future volatility will more closely resemble 2006 levels than previous years.

Effect Of Recently Issued Accounting Pronouncements

A discussion of recent accounting pronouncements is included in Note 2 to the consolidated financial statements included in our Annual Report on Form 10-KSB for the year ended December 31, 2005.

Emerging Issues Task Force issue number 06-03 has been adopted early by NeoMedia in the first quarter of 2006. The implementation of EITF 06-03 had no impact on current or historical financial statements.

In June 2006, the FASB issued FASB Interpretation (FIN) No. 48, "Accounting for Uncertainty in Income Taxes," that provides guidance on the accounting for uncertainty in income taxes recognized in financial statements. The interpretation will be adopted by the Company on January 1, 2007. The Company is currently evaluating the impact of adopting FIN 48; however, does not expect the adoption of this provision to have a material effect on the financial position, results of operations or cash flows.

In July 2006, the FASB issued FASB Staff Position (FSP) No. FAS 13-2, "Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction," that provides guidance on how a change or a potential change in the timing of cash flows relating to income taxes generated by a leveraged lease transaction affects the accounting by a lessor for the lease. This staff position will be adopted by the Company on January 1, 2007. The Company is currently evaluating the impact of adopting this FSP; however, the Company does not expect the adoption of this provision to have a material effect on its financial position, results of operations or cash flows.

Results Of Operations For The Three Months Ended June 30, 2006 As Compared To The Three Months Ended June 30, 2005

Net sales. Total net sales for the three months ended June 30, 2006 were $6,606,000, which represented a $6,068,000, or 1,128%, increase from $538,000 for the three months ended June 30, 2005. This increase primarily resulted from revenues of subsidiaries 12Snap, Sponge, Mobot, Gavitec, and BSD, all of which were acquired during the first quarter of 2006. NeoMedia could realize a material increase in revenue over the next 12 months relative to 2005 due to the acquisitions of Mobot, 12Snap, Sponge, Gavitec, and BSD for the entire quarter. NeoMedia could also realize a material increase in revenue over the next 12 months if the Company is successful in implementing its Qode® go-to-market strategy, if pending court cases involving its intellectual property are resolved in NeoMedia's favor, or if it is successful in implementing the expansion of the Micro Paint Repair business unit into China and other geographies.

Technology license, service, product and licenses. Technology service, product and license sales increased $5,928,000, or 2,140% to $6,205,000 for the three months ended June 30, 2006 compared to $277,000 for the three months ended June 30, 2005. The increase was primarily the result of sales from subsidiaries 12Snap, Sponge, Mobot, Gavitec, and BSD, all of which were acquired during the first quarter of 2006. NeoMedia could realize an increase in license fees over the next 12 months due to the recent acquisitions of Mobot, 12Snap, Sponge, Gavitec, and BSD, if the Company is successful in implementing its Qode® go-to-market strategy, or if pending court cases involving its intellectual property are resolved in NeoMedia's favor.

Micro Paint Repair products and services. Sales of Micro Paint Repair products and services were $401,000 for the three months ended June 30, 2006, compared with $261,000 for the three months ended June 30, 2005, an increase of $140,000, or 54%. The increase was primarily due to the growth of the Company's US operations. In addition, during the fourth quarter of 2005 and first quarter of 2006, NeoMedia shipped and invoiced $757,000 of product to Beijing Sino-US Jinche Yingang Auto Technological Services Limited that has not yet been recognized as revenue as of June 30, 2006. Once collectibility is reasonably assured, NeoMedia expects to recognize revenue for these shipments. NeoMedia could realize a material increase in Micro Paint Repair revenue if the Company is successful in continuing the expansion of the business unit into China and other geographies.

Cost of technology license, service, product and licenses. Cost of technology services, products and licenses fees were $3,948,000 for the three months ended June 30, 2006 compared to $213,000 for the three months ended June 30, 2006, an increase of $3,735,000, or 1,754%. The increase was due primarily to the cost of increased sales from subsidiaries 12Snap, Sponge, Mobot, Gavitec, and BSD, all of which were acquired during the first quarter of 2006.

Cost of Micro Paint Repair products and services. Cost of Micro Paint Repair products and services was $569,000 for the three months ended June 30, 2006, compared with $237,000 for the three months ended June 30, 2005, an increase of $332,000, or 140%. This increase is the result of fixed cost of goods sold associated with NeoMedia's corporate Micro Paint facility in Ft. Myers, Florida. The facility operated at a gross margin loss during the first half of 2006 as it gained market traction. Cost of micro paint repair products and services as a percentage of related sales was 142% in 2006, compared to 91% in 2005. NeoMedia expects cost of micro paint repair products and services to decrease as the corporate facility increases its customer base and profitability and product sales expand globally.

Gross Profit. Gross profit was $2,089,000 for the three months ended June 30, 2006, an increase of $2,001,000, or 2,274%, compared with gross profit of $88,000 for the three months ended June 30, 2005. This increase was primarily the result of the gross profit of the subsidiaries 12Snap, Sponge, Mobot, Gavitec, and BSD, all of which were acquired during the first quarter of 2006.

Sales and marketing. Sales and marketing expenses were $3,337,000 for the three months ended June 30, 2006, compared to $1,230,000 for the three months ended June 30, 2005, an increase of $2,107,000 or 171%. This increase resulted primarily from the addition of sales force and cost associated with added sales and marketing resources associated with Mobot, 12Snap, Sponge, Gavitec, and BSD. NeoMedia expects sales and marketing expense to increase over the next 12 months with the continued development and expansion of the NeoMedia Mobile, NeoMedia Micro Paint Repair, and NeoMedia Telecom product groups.

General and administrative. General and administrative expenses increased by $2,253,000, or 5,074%, to $2,697,000 for the three months ended June 30, 2006, compared to $444,000 for the three months ended June 30, 2005. The increase resulted primarily from increased infrastructure expense coupled with the expenses of the subsidiaries 12Snap, Sponge, Mobot, Gavitec, and BSD, all of which were acquired during the first quarter of 2006. NeoMedia expects general and administrative expense to increase over the next 12 months with the continued expansion of the NeoMedia Mobile business.

Stock based compensation expense. Stock based compensation was $1,072,000 for the three months ended June 30, 2006, as compared with $418,000 for the three months ended June 30, 2005, an increase of $654,000, or 156%. The increase was due to the adoption of SFAS 123R (Share Based Payment) on January 1, 2006.

Research and development. During the three months ended June 30, 2006, NeoMedia charged to expense $896,000 of research and development costs, an increase of $736,000 or 460% compared to $160,000 for the three months ended June 30, 2005. The increase is primarily due to the addition of development staff hired and acquired in connection with the ongoing commercialization of the NeoMedia Mobile business unit. NeoMedia expects research and development costs to increase over the next 12 months with the continued development efforts of NeoMedia Mobile business unit products and services worldwide.

Gain (loss) on extinguishment of debt. Gain on extinguishment of debt was $106,000 for the three months ended June 30, 2006, an increase of $73,000, or 221%. The gains resulted from the difference between the cash or market value of stock issued to settle the debt and the carrying value of the debt at the time of settlement.

Interest income (expense). Interest income (expense) consists primarily of interest accrued for creditors as part of financed purchases, past due balances, and notes payable, net of interest earned on cash equivalent investments. Interest income (expense) decreased by $84,000, or 49%, to ($85,000) for the three months ended June 30, 2006 from ($169,000) for the three months ended June 30, 2005, due to the pay down of notes payable.

Gain on derivative financial instruments. Gain on derivative financial instruments was $11,026,000 for the three months ended June 30, 2006. The gain is on the derivatives associated with the preferred stock sale on February 17, 2006. Certain derivatives were created at the time of the offering and those derivatives are recorded at fair value on the accompanying balance sheet. The gain for the three months ended June 30, 2006 is the reduction in value of the derivative from March 31, 2006 to June 30, 2006 and is due almost entirely to a reduction in NeoMedia's stock price from March 31, 2006 to June 30, 2006. There was no such gain or loss on derivative financial instruments for the three months ended June 30, 2005.

Net Income (Loss). The net income (loss) for the three months ended June 30, 2006 was $5,133,000, which represented a $7,433,000, or 323% increase from a ($2,300,000) loss for the three months ended June 30, 2005. The increase in net income is due primarily to the $11,025,000 gain on derivative financial instruments during 2006, partially offset by increased operating expenses from the expanded operations from the acquired subsidiaries.

Results Of Operations For The Six Months Ended June 30, 2006 As Compared To The Six Months Ended June 30, 2005

Net sales. Total net sales for the six months ended June 30, 2006 were $8,658,000, which represented a $7,373,000, or 574%, increase from $1,285,000 for the six months ended June 30, 2005. This increase primarily resulted from revenues from subsidiaries 12Snap, Sponge, Mobot, Gavitec, and BSD, all of which were acquired during the first quarter of 2006. NeoMedia could realize a material increase in revenue over the next 12 months relative to 2005 due to the acquisitions of Mobot, 12Snap, Sponge, Gavitec, and BSD for the entire quarter. NeoMedia could also realize a material increase in revenue over the next 12 months if the Company is successful in implementing its Qode® go-to-market strategy, if pending court cases involving its intellectual property are resolved in NeoMedia's favor, or if it is successful in implementing the expansion of the Micro Paint Repair business unit into China and other geographies.

Technology license, service, product and licenses. Technology service, product and license sales increased $7,311,000, or 1,285% to $7,880,000 for the six months ended June 30, 2006 compared to $569,000 for the six months ended June 30, 2005. The increase was primarily the result of sales of subsidiaries 12Snap, Sponge, Mobot, Gavitec, and BSD, all of which were acquired during the first quarter of 2006. NeoMedia could realize an increase in license fees over the next 12 months due to the recent acquisitions of Mobot, 12Snap, Sponge, Gavitec, and BSD, if the Company is successful in implementing its Qode® go-to-market strategy, or if pending court cases involving its intellectual property are resolved in NeoMedia's favor.

Micro Paint Repair products and services. Sales of Micro Paint Repair products and services were $778,000 for the six months ended June 30, 2006, compared with $716,000 for the six months ended June 30, 2005, an increase of $62,000, or 9%. The increase was primarily due to the growth of the Company's US operations. In addition, during the fourth quarter of 2005 and first quarter of 2006, NeoMedia shipped and invoiced $757,000 of product to Beijing Sino-US Jinche Yingang Auto Technological Services Limited that has not yet been recognized as revenue as of June 30, 2006. Once collectibility is reasonably assured, NeoMedia expects to recognize revenue for these shipments. NeoMedia could realize a material increase in Micro Paint Repair revenue if the Company is successful in continuing the expansion of the business unit into China and other geographies.

Cost of technology license, service, product and licenses. Cost of technology services, products and licenses fees were $4,775,000 for the six months ended June 30, 2006 compared to $389,000 for the six months ended June 30, 2006, an increase of $4,386,000, or 1,128%. The increase was due primarily to the cost of increased sales from subsidiaries 12Snap, Sponge, Mobot, Gavitec, and BSD, all of which were acquired during the first quarter of 2006.

Cost of Micro Paint Repair products and services. Cost of Micro Paint Repair products and services was $988,000 for the six months ended June 30, 2006, compared with $510,000 for the six months ended June 30, 2005, an increase of $478,000, or 94%. This increase is the result of fixed cost of goods sold associated with NeoMedia's corporate Micro Paint facility in Ft. Myers, Florida coupled with volume related increased costs of sales. The facility operated at a gross margin loss during the first half of 2006 as it gained market traction. Cost of micro paint repair products and services as a percentage of related sales was 127% in 2006, compared to 71% in 2005. NeoMedia expects cost of micro paint repair products and services to decrease as the corporate facility increases its customer base and profitability and product sales expand globally.

Gross Profit. Gross profit was $2,895,000 for the six months ended June 30, 2006, an increase of $2,509,000, or 650%, compared with gross profit of $386,000 for the six months ended June 30, 2005. This increase was primarily the result of the gross profit of the subsidiaries 12Snap, Sponge, Mobot, Gavitec, and BSD, all of which were acquired during the first quarter of 2006.

Sales and marketing. Sales and marketing expenses were $4,879,000 for the six months ended June 30, 2006, compared to $2,025,000 for the six months ended June 30, 2005, an increase of $2,854,000 or 141%. This increase resulted primarily from the addition of sales force and cost associated with added sales and marketing resources associated with Mobot, 12Snap, Sponge, Gavitec, and BSD. NeoMedia expects sales and marketing expense to increase over the next 12 months with the continued development and expansion of the NeoMedia Mobile, NeoMedia Micro Paint Repair, and NeoMedia Telecom product groups.

General and administrative. General and administrative expenses increased by $2,976,000, or 284%, to $4,023,000 for the six months ended June 30, 2006, compared to $1,047,000 for the six months ended June 30, 2005. The increase resulted primarily from increased infrastructure expense coupled with the expenses of the subsidiaries 12Snap, Sponge, Mobot, Gavitec, and BSD, all of which were acquired during the first quarter of 2006. NeoMedia expects general and administrative expense to increase over the next 12 months with the continued expansion of the NeoMedia Mobile business.

Stock based compensation expense. Stock based compensation was $2,589,000 for the six months ended June 30, 2006, as compared with $514,000 for the six months ended June 30, 2005, an increase of $2,075,000, or 404%. The increase was due to the adoption of SFAS 123R (Share Based Payment) on January 1, 2006.

Research and development. During the six months ended June 30, 2006, NeoMedia charged to expense $1,446,000 of research and development costs, an increase of $1,102,000 or 320% compared to $344,000 for the six months ended June 30, 2005. The increase is primarily due to the addition of development staff hired and acquired in connection with the ongoing commercialization of the NeoMedia Mobile business unit. NeoMedia expects research and development costs to increase over the next 12 months with the continued development efforts of NeoMedia Mobile business unit products and services worldwide.

Gain (loss) on extinguishment of debt. NeoMedia incurred a loss on extinguishment of debt of $1,858,000 for the six months ended June 30, 2006, primarily resulting from debt retired in connection with the Series C preferred stock issued and sold to Cornell on February 17, 2006. A loss was incurred on the surrender of a certain promissory note to Cornell dated March 30, 2005 in connection with the preferred stock sale. During the six months ended June 30, 2005, NeoMedia recognized a gain on extinguishment of debt of $171,000, resulting from the payment of debt at a discount to its book value.

Interest income (expense). Interest income (expense) consists primarily of interest accrued for creditors as part of financed purchases, past due balances, and notes payable, net of interest earned on cash equivalent investments. Interest income (expense) decreased by $67,000, or 46%, to ($79,000) for the six months ended June 30, 2006 from ($146,000) for the six months ended June 30, 2005, due to the pay down of notes payable.

Gain on derivative financial instruments. Gain on derivative financial instruments was $15,794,000 for the six months ended June 30, 2006. The gain is on the derivatives associated with the preferred stock sale on February 17, 2006. Certain derivatives were created at the time of the offering and those derivatives are recorded at fair value on the accompanying balance sheet. The gain for the six months ended June 30, 2006 is the reduction in value of the derivative from February 17, 2006 to June 30, 2006 and is due almost entirely to a reduction in NeoMedia's stock price from February 17, 2006 to June 30, 2006. There was no such gain or loss on derivative financial instruments for the six months ended June 30, 2005.

Net Income (Loss). The net income (loss) for the six months ended June 30, 2006 was $3,815,000, which represented a $7,334,000, or 208% increase from a ($3,519,000) loss for the six months ended June 30, 2005. The increase in net income is due primarily to the $15,794,000 gain on derivative financial instruments during 2006, partially offset by increased operating expenses from the expanded operations from the acquired subsidiaries.

Liquidity and Capital Resources

Current Period Activity

Net Cash from Operations. Net cash used in operating activities was $6,429,000 for the six months ended June 30, 2006, compared with $3,455,000 for the six months ended June 30, 2006. NeoMedia's net cash used in operating activities increased substantially during the six months ended June 30, 2006. The increase was driven primarily by the following factors (1) additional sales, marketing, research and development resources employed to complete the technical requirements for a 2006 qode® launch in the U.S. and Europe; (2) increased general and administrative costs associated with supporting the new acquisitions and other administrative initiatives such as Sarbanes Oxley; and (3) negative operational cashflow from newly-acquired subsidiaries Mobot, Gavitec, and 12Snap. NeoMedia expects to continue to generate negative operational cashflow over the next 12 months as it continues to invest in the qode® launch.

Net Used in Investing. NeoMedia's net cash flow used in investing activities for the six months ended June 30, 2006 and 2005 was $12,949,000 and $2,211,000, respectively. The increase resulted primarily from the investment of $11.9 million in the acquisitions of Mobot, Sponge, Gavitec and 12Snap. NeoMedia also advanced $500,000 to Hip Cricket in the form of promissory notes, and increased capital expenditures on equipment and software required for the qode® launch.

Net cash provided by financing activities. Net cash provided by financing activities for the six months ended June 30, 2006 and 2005 was $20,179,000 and $10,098,000, respectively. NeoMedia received $14.1 million from the sale of Series C convertible stock during February 2006. NeoMedia also received $8.3 million from the exercise of warrants and employee stock options during the first half of 2006.

Significant Liquidity Events

In the event that NeoMedia's stock price at the time the consideration shares issued in connection with the acquisitions of Mobot, Sponge, Gavitec, and 12Snap become saleable is less than the contractual price (between $0.3839 and $0.3956), NeoMedia is obligated to compensate the sellers in cash for the difference between the price at the time the shares become saleable and the relevant contractual price. Assuming a stock price at the time the shares become saleable of $0.165, which was the last sale price on July 21, 2006, NeoMedia would have a cash liability of $25.5 million relating to the guarantees. On June 21, 2006, NeoMedia filed a registration statement on Form S-3 which included the consideration shares issued to acquire Mobot, Sponge, Gavitec, and 12Snap, among others, which was subsequently withdrawn. NeoMedia intends to file a new registration statement on form S-3 to cover these areas. At current stock prices, NeoMedia does not believe that it will be able to generate enough cash to satisfy the purchase price guarantees if and when they become due, which is expected to occur upon effectiveness of the registration statement. As a result, NeoMedia is attempting to negotiate for payment of the purchase price guarantees in another form, including additional shares of common stock. There is no guarantee that NeoMedia will be successful in negotiating such an agreement with any or all of the parties involved.

During the six months ended June 30, 2006, NeoMedia made cash payments totaling $2.1 million to silent partners of 12Snap, as partial payment under silent partner agreements put in place prior to the acquisition of 12Snap by NeoMedia. The agreements call for additional cash payments of $2.1million on or before December 31, 2006.

During the fourth quarter of 2005 and first quarter of 2006, NeoMedia shipped and invoiced $757,000 of Micro Paint Repair products to Automart for which payment has not been received. Recognition of revenue on this transaction has been deferred since this is a new customer in a new territory. If and when payment is made, NeoMedia expects to recognize revenue for these shipments, and would also receive a material cash infusion. In the absence of payment, NeoMedia would not recognize revenue related to these products and would not recoup its cost of goods sold which have already been paid.

Sources of Cash and Projected Cash Requirements

NeoMedia intends to fund its growth and working capital deficiencies from the following sources during the remainder of 2006 and beyond:

Series C Convertible Preferred Stock Sale. During the first quarter of 2006, NeoMedia received approximately $14.1 million net proceeds from the Series C convertible preferred stock sale. NeoMedia used $13.8 million of the proceeds to pay the cash portion of the purchase price of Mobot, Gavitec, Sponge, and 12Snap. Pursuant to the investment agreement entered into in connection with the Series C convertible preferred stock sale, $5 million of the purchase price was withheld by the investors, and will be funded at the time a registration statement including the common shares underlying the Series C convertible preferred stock is declared effective.

Exercise of Options and Warrants. Attached to the Series C convertible preferred stock were 75 million warrants to purchase shares of NeoMedia common stock at exercises prices ranging from $0.35 - $0.50. NeoMedia can force conversion of the warrants if its stock price is more than $0.10 higher than the exercise price of the warrants once the shares underlying the warrants are registered. If all of these warrants were exercised, NeoMedia would receive $30.5 million proceeds. In addition, NeoMedia can force conversion of certain other warrants if the closing bid price of NeoMedia stock is greater than $0.30 for five consecutive days, at which point NeoMedia would receive an additional $2 million proceeds. At current prices, NeoMedia would not realize any proceeds from these warrants.

In addition, certain outstanding employee stock options are in-the-money and could be exercised at the holders' discretion from time to time.

$100 Million SEDA. On March 30, 2005, NeoMedia and Cornell Capital Partners entered into a Standby Equity Distribution Agreement under which Cornell Capital Partners agreed to purchase up to $100 million of NeoMedia's common stock over a two-year period, with the timing and amount of the purchase at NeoMedia's discretion. The maximum amount of each purchase would be $2,000,000 with a minimum of five business days between advances. NeoMedia expects to file a registration statement with the SEC during 2006 to register the shares underlying the $100 million 2005 SEDA. The 2005 SEDA would become available at the time the SEC declares effective a registration statement containing such shares. NeoMedia expects to file a registration including the shares underlying the SEDA after the Series C convertible preferred shares are converted.

NeoMedia's reliance on Cornell Capital Partners as its primary financing source has certain ramifications that could affect future liquidity and business operations. For example, pursuant to an investment agreement between NeoMedia and Cornell signed in connection with the Series C convertible preferred stock sale, NeoMedia cannot (i) enter into any debt arrangements in which it is the borrower, (ii) grant any security interest in any of its assets, or (iii) grant any security below market price. Additionally, pursuant to a security agreement between NeoMedia and Cornell signed in connection with the $100 million SEDA, Cornell has a security interest in all of NeoMedia's assets, with the exception of patents and patent applications. Such covenants could severely harm NeoMedia's ability to raise additional funds from sources other than Cornell, and would likely result in a higher cost of capital in the event funding were secured.

In addition, NeoMedia has incurred both cash and non-cash costs associated with the financing arrangements with Cornell Capital Partners. In connection with the $27 million Series C convertible preferred stock sale, NeoMedia incurred the following costs: (i) Cornell held back a $2.7 million cash fee from the proceeds of the sale, (ii) NeoMedia issued 75 million warrants to Cornell with exercise prices between $0.35 and $0.50, and (iii) NeoMedia issued 2 million warrants with an exercise price of $0.328 to another party for structuring and consulting fees associated with the sale. In connection with the 2005 SEDA, NeoMedia incurred the following costs: (i) NeoMedia issued 75 million warrants to Cornell with an exercise price of $0.20, and (ii) NeoMedia issued 4 million warrants with an exercise price of $0.227 to another party for structuring and consulting fees associated with the 2005 SEDA.

NeoMedia's cash flow used in operations was approximately $6.4 million for the six months ended June 30, 2006. In the event that NeoMedia's stock price does not increase to levels where NeoMedia can exercise enough of its outstanding warrants to generate material operating capital, or if the market for NeoMedia's stock will not support the sale of shares underlying such warrants or other funding sources, or NeoMedia does not realize a material increase in revenue during the next 12 months, NeoMedia will have to seek additional cash sources. There can be no assurances that such funding sources will be available. 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.

Contractual Obligations

NeoMedia and its subsidiaries lease office facilities and certain office and computer equipment under various operating leases. 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. Additionally, NeoMedia issued Series C convertible preferred shares with face value of $22,000,000 (and a commitment for an additional $5,000,000 purchase by the purchasers under the same terms) that are subject to conversion no later than February 17, 2009.

In addition, NeoMedia is obligated to make debt payments by December 31, 2006 in connection with silent partner agreements totaling approximately $2.1 million plus accrued interest and penalties.

The following table sets forth NeoMedia's future minimum payments due under operating leases, vendor and consulting agreements, convertible stock agreements, and debt agreements:

(dollars in thousands)

	Operating Leases	Vendor & Consulting Agreements	Notes Payable	Series C Convertible Preferred Stock	Total
2006 (remaining six months)	$ 473	$ 271	$ 2,386	$ 0	$ 3,130
2007	783	340	31	0	1,154
2008	501	156	0	0	657
2009	190	39	0	27,000	27,229
2010	58	0	0	0	58
Thereafter	42	0	0	0	42
Total	$ 2,047	$ 806	$ 2,417	$ 27,000	$ 32,270

In addition to contractually obligated amounts above, NeoMedia has also guaranteed the value of stock consideration issued in connection with certain acquisitions, the amount of which will not be determinable until the shares issued for such acquisitions are registered. In the event that NeoMedia's stock price at the time the consideration shares issued in connection with the acquisitions of Mobot, Sponge, Gavitec, and 12Snap become saleable is less than the contractual price (between $0.3839 and $0.3956), NeoMedia is obligated to compensate the sellers in cash for the difference between the price at the time the shares become saleable and the relevant contractual price. Assuming a stock price at the time the shares become saleable of $0.165, which was the last sale price on July 21, 2006, NeoMedia would have a cash liability of $25.5 million relating to the guarantees.

Going Concern

The accompanying condensed 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. . Net income for the six months ended June 30, 2006, was $3,815,000 which includes a gain on derivative financial instruments of $15,794,000. NeoMedia also reported net losses of $9,147,000 and $7,230,000 for the years ended December 31, 2005 and 2004, respectively, and has an accumulated deficit of $88,709,000 and a working capital deficit of $18,877,000 as of June 30, 2006.

In addition, NeoMedia has material liquidity events that could adversely affect its ability to continue as a going concern, primarily:

· in the event that NeoMedia’s stock price at the time the consideration shares issued in connection with the acquisitions of Mobot, Sponge, Gavitec, and 12Snap become saleable is less than the contractual price (between $0.3839 and $0.3956), NeoMedia is obligated to compensate the sellers in cash for the difference between the price at the time the shares become saleable and the relevant contractual price. Assuming a stock price at the time the shares become saleable of $0.165, which was the last sale price on July 21, 2006, NeoMedia would have a cash liability of $25.5 million relating to the guarantees.

· during the six months ended June 30, 2006, NeoMedia made cash payments totaling $2.1 million to silent partners of 12Snap, as partial payment under silent partner agreements put in place prior to the acquisition of 12Snap by NeoMedia. The agreements call for additional cash payments of $2.1million on or before December 31, 2006.

If NeoMedia's financial resources are insufficient NeoMedia may require additional financing in order to execute its operating plan and continue as a going concern. NeoMedia cannot predict whether this additional financing will be in the form of equity, debt, or another form. NeoMedia 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, NeoMedia may be unable to implement its current plans for expansion, repay its debt obligations as they become due, pay any additional costs required under its recently completed acquisition agreements, 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. The financial statements do not include any adjustments relating to the recoverability and reclassification of recorded asset amounts or amounts and reclassification of liabilities that might be necessary, should NeoMedia be unable to continue as a going concern.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

NeoMedia previously filed its periodic reports as a small business issuer through the period ended December 31, 2005. The information required by Item 305 of Regulation S-K was not required under the disclosure requirements for small business issuers. Pursuant to Item 305 of Regulation S-K, disclosure of quantitative and qualitative information about market risk is required in the first annual report. Information relating to interim financial statements is not required until after the first fiscal year end in which Item 305 is applicable. Accordingly, NeoMedia anticipates providing a quantitative and qualitative analysis regarding market risk in our Form 10-K for the year ending December 31, 2006.

ITEM 4. CONTROLS AND PROCEDURES

There were no policy reviews, improvements of documentation or general improvement in the state of internal controls that led to any change during the fiscal quarter, or subsequent to the end of the fiscal quarter through the date of this Form 10-Q, that materially affected or were reasonably likely to materially affect, internal controls over financial reporting

Evaluation of Disclosure Controls and Procedures. As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company’s Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of the Company’s disclosure controls and procedures. The Company’s disclosure controls and procedures are designed to provide a reasonable level of assurance of achieving the Company’s disclosure control objectives. The Company’s Principal Executive Officer and Principal Financial Officer have concluded that the Company’s disclosure controls and procedures are, in fact, effective at this reasonable assurance level as of the end of period covered. In addition, the Company reviewed its internal controls, and there have been no significant changes in its internal controls or in other factors that could significantly affect those controls subsequent to the date of their last evaluation or from the end of the reporting period to the date of this Form 10-Q.

Changes in Internal Controls. In connection with the evaluation of the Company’s internal controls during the Company’s six months ended June 30, 2006, the Company’s Principal Executive Officer and Principal Financial Officer have determined that there were no changes to the Company’s internal controls over financial reporting that have materially affected, or are reasonably likely to materially effect, the Company’s internal controls over financial reporting during the six months ended June 30, 2006, or subsequent to the date of their last evaluation, or from the end of the reporting period to the date of this Form 10-Q, except that the Company has added a European Controller to oversee the ongoing assimilation of its recently acquired European subsidiaries.

PART II -- OTHER INFORMATION

ITEM 1. 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. The following outlined legal proceedings for which the potential outcome could be in excess of $50,000.

Scanbuy, Inc.

On January 23, 2004, NeoMedia filed suit against Scanbuy, Inc. (“Scanbuy”) in the Northern District of Illinois, claiming that Scanbuy 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, thereby infringing NeoMedia’s patents. The complaint stated that on information and belief, Scanbuy had actual and constructive notice of the existence of the patents-in-suit, 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. On April 15, 2004, the court dismissed the suits against Scanbuy for lack of personal jurisdiction.

On April 20, 2004, NeoMedia re-filed its suit against Scanbuy in the Southern District of New York alleging patent infringement. Scanbuy filed its answer on June 2, 2004. NeoMedia filed its answer and affirmative defenses on July 23, 2004. On February 13, 2006, Scanbuy filed an amended answer to the complaint. NeoMedia filed its reply to Scanbuy’s amended answer on March 6, 2006. Discovery is ongoing.

Former Mobot Shareholders

On June 8, 2006, Mark Freitas (“Plaintiff”), a former Mobot shareholder, filed a complaint in Massachusetts state court against NeoMedia alleging that NeoMedia breached the merger agreement between NeoMedia and Mobot by failing to file a registration statement with the SEC that included his shares by May 9, 2006. Plaintiff's complaint requested that the Court issue a preliminary injunction prohibiting NeoMedia from: (1) causing its charter to be amended so as to increase the number of shares of authorized common stock in excess of one billion shares; (2) entering into any contract, agreement, or other undertaking in which NeoMedia shares are used as payment; (3) issuing a warrant or option to acquire NeoMedia common stock with an exercise price of less than $0.3839; and (4) filing a registration statement with the SEC that does not include the Mobot shareholder's shares. Plaintiff also seeks costs and attorney's fees in his complaint.

A hearing on the request for preliminary injunctive relief was held on June 21, 2006. During the hearing, Plaintiff changed his request for relief by asking that the Court enjoin NeoMedia from amending the Registration Statement it filed on June 21, 2006 to add any additional shares or from filing any further registration statements until the one filed on June 21, 2006 becomes effective. On June 26, 2006, the Court issued a Memorandum of Decision and Order on Plaintiff's Request for Preliminary Injunction and denied Plaintiff's request for a preliminary injunction.

NeoMedia plans to file a motion to dismiss the complaint, but the parties have agreed to extend the deadline for the submission of those papers to the Court. NeoMedia may also join Plaintiff's request that the action be transferred to the Business Litigation Session of the Suffolk Superior Court. NeoMedia intends to defend the lawsuit vigorously.

12Snap Silent Partners

On April 18, 2006, 12Snap AG, a wholly-owned subsidiary of NeoMedia acquired on February 28, 2006, received a letter of Technologie Beteiligungsfonds Bayern GmbH & Co. KG, Munich, to initiate arbitration proceedings. Technologie Beteiligungsfonds claims for a final payment in the amount of EUR 353,400 plus interest of 5% per annum since March 1, 2006 arising out of a silent partnership agreement with 12Snap. On July 5, 2006, the Company filed a statement of defense with the arbitration panel. The Company expects the matter will be subject to a German arbitration proceeding during the third or fourth quarter of 2006.

Threatened Litigation

On March 15, 2006, NeoMedia received a letter from an unrelated third party alleging that the party performed independent consulting services leading up to the closing of the merger between NeoMedia and Mobot on February 17, 2006. The letter contends that NeoMedia and Mobot breached a consulting agreement whereby the party was to be paid $300,000, equal to 3% of the merger consideration paid by NeoMedia to Mobot. NeoMedia is investigating the allegations, and based upon its findings will decide whether to defend or attempt to settle the dispute.

ITEM 1A. RISK FACTORS

Risks Related to NeoMedia's Business

NeoMedia has Historically Lost Money and Losses May Continue

NeoMedia has incurred substantial operating losses since inception, and anticipates continuing to incur substantial losses for the foreseeable future. Net income for the six months ended June 30, 2006, was $3,815,000 which includes a gain on derivative financial investments of $15,794,000. NeoMedia also reported net losses of $9,147,000 and $7,230,000 for the years ended December 31, 2005 and 2004 respectively. NeoMedia's accumulated losses were approximately $88,709,000 and $92,524,000 as of June 30, 2006 and December 31, 2005, respectively. As of June 30, 2006 and December 31, 2005 and 2004, NeoMedia had a working capital deficit of approximately $18,877,000, $4,874,000 and $2,597,000, respectively. NeoMedia had stockholders' equity of $56,473,000, $4,227,000 and $4,392,000 as of June 30, 2006 and December 31, 2005 and 2004, respectively. NeoMedia generated revenues of $8,658,000, $1,285,000, $2,156,000 and $1,700,000 for the six months ended June 30, 2006 and 2005 and the years ended December 31, 2005 and 2004, respectively. In addition, during the six months ended June 30, 2006 and 2005 and the years ended December 31, 2005 and 2004, NeoMedia recorded negative cash flows from operations of $6,429,000, $3,455,000, $6,509,000 and $4,650,000, respectively. To succeed, NeoMedia must develop new client and customer relationships and substantially increase its revenue derived from improved products and additional value-added services. NeoMedia has expended, and to the extent it has available financing, NeoMedia 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, NeoMedia may not be able to achieve or sustain profitability.

NeoMedia's Independent Registered Public Accounting Firm Have Added Going Concern Language To Their Report On NeoMedia's Consolidated Financial Statements, Which Means That NeoMedia May Not Be Able To Continue Operations

The report of Stonefield Josephson, Inc., NeoMedia's independent registered public accounting firm, with respect to NeoMedia's consolidated financial statements and the related notes for the years ended December 31, 2005 and 2004, indicates that, at the date of their report, NeoMedia had suffered significant recurring losses from operations and its working capital deficit raised substantial doubt about its ability to continue as a going concern. NeoMedia's consolidated financial statements do not include any adjustments that might result from this uncertainty.

NeoMedia Has Guaranteed The Value of Stock Issued In Connection With Recent Mergers Through The Registration Of The Shares, Which Could Result In A Material Cash Liability

Pursuant to the terms of the merger agreements with Mobot, Sponge, Gavitec, and 12Snap, in the event that NeoMedia's stock price at the time the consideration shares issued in connection with each acquisition are saleable is less than the price at which they were valued for purposes of the merger agreement (between $0.3839 and $0.3956 per share), NeoMedia is obligated to compensate the sellers in cash for the difference between the price at the time the shares become saleable and the price the shares were valued for purposes of the merger agreement. Subsequent to the closing of the acquisitions, NeoMedia's stock has closed as low as $0.153 per share. Assuming a stock price at the time the shares become saleable of $0.165, which was the last sale price on July 21, 2006, NeoMedia would have a cash liability of $25.5 million resulting from these clauses.

NeoMedia Has Contractual Commitments to Pay Silent Partners

Resulting from the acquisition of 12 Snap, NeoMedia has a commitment to pay EUR 1,750,000 (approximately $2.1M US), at the end of 2006 to the Silent Partners of 12 Snap. If NeoMedia's financial resources are insufficient, NeoMedia may require additional financing in order to meet this obligation. There is no guarantee that NeoMedia will be able to obtain the necessary additional capital to meet this obligation on a timely basis, on acceptable terms, or at all. In any of these events, NeoMedia may be unable to repay this obligation when it becomes due.

NeoMedia Could Identify Material Internal Control Weaknesses As Part of Its Sarbanes-Oxley Internal Control Review for Its Fiscal Year Ended December 31, 2006,

The regulations implementing Section 404 of the Sarbanes-Oxley Act of 2002 require an assessment of the effectiveness of the Company's internal controls over financial reporting beginning with our Annual Report on Form 10-K for the fiscal year ending December 31, 2006. The Company's independent auditors will be required to confirm in writing whether management's assessment of the effectiveness of the internal controls over financial reporting is fairly stated in all material respects, and separately report on whether they believe management maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006. As part of the assessment of our internal controls in connection with the process required by Section 404 of the Sarbanes-Oxley Act of 2002, management intends to continue to review, evaluate and strengthen our controls and processes. Management cannot state that material weaknesses in internal controls will not be determined. Management also cannot state that the process of evaluation and the auditor's attestation will be completed on time. If a material weakness is discovered, corrective action may be time consuming, costly and further divert the attention of management. The disclosure of a material weakness, even if quickly remedied, could reduce the market's confidence in the Company's financial statements and harm the Company's stock price, especially if a restatement of financial statements for past periods is required

There is Limited Information Upon Which Investors Can Evaluate NeoMedia's Business Because The Physical-World-to-Internet Market Has Existed For Only A Short Period Of Time

The physical-world-to-Internet market in which NeoMedia operates is a recently developed market. Further, NeoMedia has conducted operations in this market only since March 1996. Consequently, NeoMedia has a relatively limited operating history upon which an investor may base an evaluation of NeoMedia's primary business and determine NeoMedia's prospects for achieving its intended business objectives. To date, NeoMedia has sold its physical-world-to-Internet products to only 12 companies. NeoMedia 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 NeoMedia's future success to be highly speculative in light of its 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 new and rapidly evolving markets, such as the physical-world-to-Internet space. To address these risks, NeoMedia must, among other things:

- maintain and increase its client base;
- implement and successfully execute its business and marketing strategy;
- continue to develop and upgrade its products;
- continually update and improve service offerings and features;
- respond to industry and competitive developments; and
- attract, retain, and motivate qualified personnel.

NeoMedia may not be successful in addressing these risks. If NeoMedia is unable to do so, its business, prospects, financial condition, and results of operations would be materially and adversely affected.

NeoMedia's future success depends on the timely introduction of new products and the acceptance of these new products in the marketplace.

Rapid technological change and frequent new product introductions are typical for the markets NeoMedia serves. NeoMedia's future success will depend in large part on continuous, timely development and introduction of new products that address evolving market requirements. To the extent that NeoMedia fails to introduce new and innovative products, it may lose market share to its competitors, which may be difficult to regain. Any inability, for technological or other reasons, to successfully develop and introduce new products could materially and adversely affect NeoMedia's business.

NeoMedia'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

NeoMedia'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, as amended. These requirements may reduce the potential market for NeoMedia's common stock by reducing the number of potential investors. This may make it more difficult for investors in NeoMedia's common stock to sell shares to third parties or to otherwise dispose of them. This could cause NeoMedia's stock price to decline. Penny stocks are stock:

- with a price of less than $5.00 per share;
- that are not traded on a "recognized" national exchange;

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- 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

- in issuers with net tangible assets less than $2 million (if the issuer has been in continuous operation for at least three years) or $10 million (if in continuous operation for less than three years), or with average revenues of less than $6 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.

Existing Shareholders Will Experience Significant Dilution When Certain Investors Convert Their Preferred Stock to Common Stock or When the Investors Exercise Their Warrants and Receive Common Stock Shares Under the Investment Agreement with the Investors

The issuance of shares of common stock pursuant to the conversion of Series C convertible preferred stock pursuant to our transaction with Cornell Capital Partners will have a dilutive impact on our stockholders. As a result, our net income or loss per share could decrease in future periods, and the market price of our common stock could decline. In addition, the lower our stock price is, the more shares of common stock we will have to issue pursuant to the conversion of our preferred stock. If our stock price is lower, then our existing stockholders would experience greater dilution.

Due To The Accounting Treatment Of Certain Convertible Preferred Stock Instruments Issued By NeoMedia, A Fluctuation In NeoMedia's Stock Price Could Have A Material Impact On NeoMedia's Results Of Operations

During the first and second quarters of 2006, NeoMedia recognized income in the amount of $4,768,000 and $11,026,000, respectively, from adjustments recorded to reflect the change in fair value of derivatives issued in connection with its Series C convertible preferred shares. The income results from a decrease in NeoMedia's share price from $0.389 per share at the time of issuance of the Series C convertible preferred shares (February 17, 2006) to $0.345 at March 31, 2006 to $0.231 at June 30, 2006. An increase to NeoMedia's shares price would result in a charge to income. NeoMedia will adjust the carrying value of the derivative instruments to market at each balance sheet date. As a result, NeoMedia could experience significant fluctuations in its net income (loss) in future periods as a result of such charges.

NeoMedia is Uncertain Of The Success Of Its NeoMedia Mobile Business Unit And The Failure Of This Unit Would Negatively Affect The Price Of NeoMedia's Stock

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

- its NeoMedia Mobile business unit will ever achieve profitability;
- its current product offerings will not be adversely affected by the focusing of its resources on the physical-world-to-Internet space; or
- the products NeoMedia develops will obtain market acceptance.

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

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A Large Percentage Of NeoMedia's Assets Are Intangible Assets, Which Will Have Little Or No Value If NeoMedia's Operations Are Unsuccessful

At June 30, 2006 and December 31, 2005 and 2004, approximately 84%, 48% and 49%, respectively, of NeoMedia's total assets were intangible assets, consisting primarily of rights related to NeoMedia's patents, other intellectual property, and excess of purchase price over fair market value paid for Mobot, Sponge, Gavitec, 12Snap, BSD, and CSI International, Inc. If NeoMedia's operations are unsuccessful, these assets will have little or no value, which would materially adversely affect the value of NeoMedia's stock and the ability of NeoMedia's stockholders to recoup their investments in NeoMedia's capital stock.

NeoMedia reviews its amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. Goodwill is required to be tested for impairment at least annually. NeoMedia may be required to record a significant charge to earnings in its financial statements during the period in which any impairment of our goodwill or amortizable intangible assets is determined, resulting in an impact on results of operations.

Certain Of NeoMedia's Emerging Products and Services Have Limited History And May Not Result In Success

To date, NeoMedia has conducted limited marketing efforts directly relating to its emerging technology products, consisting primarily of the Qode suite of products, and certain products of recent acquisitions Mobot and Gavitec. Many of NeoMedia's marketing efforts with respect to these emerging technologies have been largely untested in the marketplace, and may not result in materially increased sales of these emerging products and services. To penetrate the emerging markets in which it competes, NeoMedia expects that it will have to exert significant efforts to create awareness of, and demand for, its emerging products and services. NeoMedia intends to continue to expand its sales and marketing resources as the market continues to mature. NeoMedia's failure to further develop its sales and marketing capabilities and successfully market its emerging products and services would have a material adverse effect on its business, prospects, financial condition, and results of operations.

NeoMedia's Internally Developed Systems Are Inefficient And May Put NeoMedia At A Competitive Disadvantage

NeoMedia 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 NeoMedia develops 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 NeoMedia at a competitive disadvantage when compared to competitors with more efficient systems.

NeoMedia Could Fail to Attract Or Retain Key Personnel

NeoMedia'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 NeoMedia has. NeoMedia may not be successful in attracting and retaining qualified personnel on a timely basis, on competitive terms, or at all. NeoMedia's failure to attract and retain qualified personnel could have a material adverse effect on its business, prospects, financial condition, and results of operations.

NeoMedia Depends Upon Its Senior Management And Their Loss Or Unavailability Could Put NeoMedia At A Competitive Disadvantage

NeoMedia's success depends largely on the skills of certain key management and technical personnel, including Charles T. Jensen, NeoMedia's President and Chief Executive Officer, Charles W. Fritz, NeoMedia's founder and Chairman of the Board of Directors, Martin N. Copus, NeoMedia's Chief Operating Officer and head of the NMM business unit, and David A. Dodge, NeoMedia's Chief Financial Officer. The loss of the services of Messrs. Jensen, Fritz, Copus, or Dodge could materially harm NeoMedia'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. NeoMedia does not presently maintain a key-man life insurance policy on Messrs. Jensen, Fritz, Copus, or Dodge.

NeoMedia May Be Unsuccessful In Integrating Its Recently Completed and Pending Acquisitions With Its Current Business

The success of the acquisitions of Mobot, 12Snap, Sponge, Gavitec, and BSD could depend on the ability of NeoMedia's executive management to integrate the business plan of each company with NeoMedia's overall business plan. Failure to properly integrate the business could have a material adverse effect on the expected revenue and operations of the acquisitions, as well as the expected return on investment for NeoMedia.

NeoMedia May Be Unable To Protect Its Intellectual Property Rights And May Be Liable For Infringing The Intellectual Property Rights Of Others

NeoMedia's success in the physical-world-to-Internet market is dependent upon its proprietary technology, including patents and other intellectual property, and on the ability to protect proprietary technology and other intellectual property rights. In addition, NeoMedia must conduct its operations without infringing on the proprietary rights of third parties. NeoMedia 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, NeoMedia 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. Although NeoMedia believes that it has taken appropriate steps to protect its unpatented proprietary rights, including requiring that its employees and third parties who are granted access to NeoMedia's proprietary technology enter into confidentiality agreements, NeoMedia 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 NeoMedia's.

NeoMedia licenses from third parties certain software tools that are included in NeoMedia's services and products. If any of these licenses were terminated, NeoMedia could be required to seek licenses for similar software from other third parties or develop these tools internally. NeoMedia 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. NeoMedia 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, NeoMedia. An adverse determination could subject NeoMedia to significant liabilities to third parties, require NeoMedia to seek licenses from, or pay royalties to, third parties, or require NeoMedia to develop appropriate alternative technology. Some or all of these licenses may not be available to NeoMedia on acceptable terms or at all, and NeoMedia 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 NeoMedia's business, prospects, financial condition, and results of operations.

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NeoMedia Is Exposed To Product Liability Claims And An Uninsured Claim Could Have A Material Adverse Effect On NeoMedia's Business, Prospects, Financial Condition, And Results Of Operations, As Well As The Value Of NeoMedia's Stock

Many of NeoMedia'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 NeoMedia, regardless of NeoMedia's responsibility for such failure. NeoMedia could, therefore, be subject to claims in connection with the products and services that it sells. NeoMedia currently maintains product liability insurance. There can be no assurance that:

- NeoMedia has contractually limited its liability for such claims adequately or at all; or
- NeoMedia would have sufficient resources to satisfy any liability resulting from any such claim.

The successful assertion of one or more large claims against NeoMedia could have a material adverse effect on its business, prospects, financial condition, and results of operations.

NeoMedia Will Not Pay Cash Dividends and Investors May Have To Sell Their Shares In Order To Realize Their Investment

NeoMedia has not paid any cash dividends on its common stock and does not intend to pay cash dividends in the foreseeable future. NeoMedia intends to retain future earnings, if any, for reinvestment in the development and marketing of NeoMedia's products and services. As a result, investors may have to sell their shares of common stock to realize their investment.

Some Provisions Of NeoMedia's Certificate of Incorporation And bylaws May Deter Takeover Attempts, Which May Limit The Opportunity Of NeoMedia's Stockholders To Sell Their Shares At A Premium To The Then-Current Market Price

Some of the provisions of NeoMedia's Certificate of Incorporation and bylaws could make it more difficult for a third party to acquire NeoMedia, even if doing so might be beneficial to NeoMedia's stockholders by providing them with the opportunity to sell their shares at a premium to the then-current market price. On December 10, 1999, NeoMedia'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 NeoMedia'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 NeoMedia'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 NeoMedia'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, NeoMedia'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, redemption rights, and sinking fund provisions.

NeoMedia is authorized to issue a total of 25,000,000 shares of Preferred Stock, par value $0.01 per share. The issuance of any preferred stock could have a material adverse effect on the rights of holders of NeoMedia's common stock, and, therefore, could reduce the value of shares of NeoMedia'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 NeoMedia's 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 NeoMedia or a change in NeoMedia's control thereby preserving control by the current stockholders.

Risks Relating To NeoMedia's Industry

The Security of the Internet Poses Risks To The Success Of NeoMedia'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 NeoMedia's physical-world-to-Internet business.

NeoMedia Will Only Be Able To Execute Its Physical-World-To-Internet Business Plan If Internet Usage and Electronic Commerce Continue To Grow

NeoMedia's future revenues and any future profits are substantially dependent upon the widespread acceptance and use of the Internet and camera devices on mobile telephones. If use of the Internet and camera devices on mobile telephones does not continue to grow or grows more slowly than expected, or if the infrastructure for the Internet and camera devices on mobile telephones does not effectively support the growth that may occur, or does not become a viable commercial marketplace, NeoMedia's physical-world-to-Internet business, and therefore NeoMedia's business, prospects, financial condition, and results of operations, could be materially adversely affected. Rapid growth in the use of, and interest in, the Internet and camera devices on mobile telephones is a recent phenomenon, and may not continue on a lasting basis. In addition, customers may not adopt, and continue to use mobile telephones as a medium of information retrieval or commerce. Demand and market acceptance for recently introduced services and products over the mobile Internet are subject to a high level of uncertainty, and few services and products have generated profits. For NeoMedia 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 use of the Internet and camera devices on mobile telephones 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 mobile phone Internet usage continues to experience significant growth in the number of users, their frequency of use, or in their bandwidth requirements, the infrastructure for the mobile Internet may be unable to support the demands placed upon them. In addition, the mobile Internet and mobile interactivity could lose its viability due to delays in the development or adoption of new standards and protocols required to handle increased levels of mobile Internet activity, or due to increased governmental regulation. Significant issues concerning the commercial and informational use of the mobile 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, the Web or other online services also could result in slower response times and adversely affect usage of the Internet, the Web and other online networks generally and NeoMedia's physical-world-to-Internet product and networks in particular.

NeoMedia May Not Be Able To Adapt As The Internet, Physical-World-To-Internet, And Customer Demands Continue To Evolve

NeoMedia may not be able to adapt as the mobile Internet and physical-world-to-Internet markets and consumer demands continue to evolve. NeoMedia'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 mobile Internet and physical-world-to-Internet markets are characterized by:

- rapid technological change;
- changes in user and customer requirements and preferences;
- frequent new product and service introductions embodying new technologies; and
- the emergence of new industry standards and practices that could render proprietary technology and hardware and software infrastructure obsolete.

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

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

NeoMedia's Competitors In The Micro Paint Repair Industry Could Duplicate NeoMedia's Proprietary Processes

NeoMedia's success in the micro paint repair industry depends upon proprietary chemical products and processes. There is no guarantee that NeoMedia's competitors will not duplicate NeoMedia's proprietary processes.

NeoMedia 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 NeoMedia. NeoMedia believes that competition will intensify and increase in the near future. NeoMedia's target market is rapidly evolving and is subject to continuous technological change. As a result, NeoMedia'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 NeoMedia's business, prospects, financial condition, and results of operations.

Some of NeoMedia'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. NeoMedia may not successfully compete in any market in which it conducts or may conduct operations. Many of NeoMedia's competitors in the Micro Paint Repair business have a longer operating history in the industry, as well as access to greater financial resources. NeoMedia may not be able to penetrate markets or market its products as effectively as NeoMedia's better-funded more-established competitors.

In The Future There Could Be Government Regulations And Legal Uncertainties Which Could Harm NeoMedia's Business

Any new legislation or regulation, the application of laws and regulations from jurisdictions whose laws do not currently apply to NeoMedia's business, or the application of existing laws and regulations to the Internet and other online services, could have a material adverse effect on NeoMedia's business, prospects, financial condition, and results of operations. Due to the increasing popularity and use of the Internet, the Web 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, the Web or other online services, which could, in turn, decrease the demand for NeoMedia's services and increase NeoMedia's cost of doing business, or otherwise have a material adverse effect on NeoMedia's business, prospects, financial condition, and results of operations. Moreover, the relevant governmental authorities have not resolved the applicability to the Internet, the Web 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 NeoMedia'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 NeoMedia's ability to collect and use information collected by NeoMedia'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. NeoMedia could incur significant additional expenses if new regulations regarding the use of personal information are introduced or if NeoMedia's privacy practices are investigated.

Certain of NeoMedia's micro paint solutions could be subject to environmental regulations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds (a), (b), (c) and (d)

During the three months ended June 30, 2006, NeoMedia issued 5,233,791 unregistered shares of common stock to satisfy debt assumed in its acquisition of BSD Software, Inc. The carrying value of the debt was $1,314,000, and the fair value of the shares issued was $1,208,000.

Item 3. Default upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

On June 28, 2006, NeoMedia held its annual meeting of shareholders, at which the following matters were ratified: (i) re-election of its current five directors, (ii) ratification of Stonefield Josephson, Inc. as NeoMedia's auditors for the fiscal year ended December 31, 2006, and (iii) an increase to the Company's authorized common shares to 5 billion.

The number of votes cast for each matter were:

Matter	For	Against	Withheld	Total
Matter #1				
Barclay, A. Hayes	606,054,355	---	12,178,469	618,232,824
Fritz, Charles W.	607,518,642	---	10,714,182	618,232,824
Fritz, William E.	608,744,257	---	9,488,567	618,232,824
Jensen, Charles T.	610,206,579	---	8,026,245	618,232,824
Keil, James J.	606,399,055	---	11,833,769	618,232,824
Matter #2				
Ratification of Stonefield Josephson, Inc. as independent auditors	612,558,232	2,589,920	3,084,672	618,232,824
Matter #3				
Increase to authorized shares	567,687,092	48,882,386	1,663,346	618,232,824

Item 5. Other Information

None.

Item 6. Exhibits and reports on form 8-K

(a) Exhibits:

Exhibit No.	**Description**	**Location**
31.1	Certification by Chief Executive Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Provided herewith
31.2	Certification by Chief Financial Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	Provided herewith
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Provided herewith
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	Provided herewith

(b) Reports on Form 8-K:

NeoMedia filed a report on Form 8-K on April 3, 2006, with respect to Item 8.01, reporting that Cornell Capital Partners had exercised warrants to purchase 20,000,000 shares of NeoMedia common stock, par value $0.01 per share. The warrants were issued to Cornell Capital on March 30, 2005 as a commitment fee for Cornell Capital entering into that certain Standby Equity Distribution Agreement, dated March 30, 2006 by and between NeoMedia and Cornell Capital. The warrants had an exercise price equal to $0.20 per share. In connection with the exercise of the 20,000,000 Warrants, NeoMedia received proceeds of $4,000,000.

NeoMedia filed amendment No. 1 to Form 8-K on May 3, 2006, with respect to Items 2.01 and 9.01, for the purposes of providing the required financial statements of Mobot, Inc.

NeoMedia filed amendment No. 1 to Form 8-K on May 8, 2006, with respect to Items 2.01 and 9.01, for the purposes of providing the required financial statements of 12Snap AG.

NeoMedia filed amendment No. 1 to Form 8-K on May 9, 2006, with respect to Items 2.01 and 9.01, for the purposes of providing the required financial statements of Gavitec AG.

NeoMedia filed amendment No. 1 to Form 8-K on May 9, 2006, with respect to Items 2.01 and 9.01, for the purposes of providing the required financial statements of Sponge Ltd.

NeoMedia filed amendment No. 1 to Form 8-K on June 2, 2006, with respect to Items 2.01 and 9.01, for the purposes of providing the required financial statements of BSD Software, Inc.

NeoMedia filed amendment No. 2 to Form 8-K on June 21, 2006, with respect to Items 2.01 and 9.01, for the purposes of providing restated financial statements of Sponge Ltd.

NeoMedia filed a report on Form 8-K on July 27, 2006, with respect to Item 1.01, reporting that it had signed a an operating agreement with Shang Fang Wei Ye Technology Development Limited Company ("Shang Fang"), a subsidiary of Beijing Sino-U.S. Jinche Yingyang Auto Technological Services Ltd., to introduce and market NeoMedia's patented qode direct-to-Web technology in key markets in Asia.

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant has caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NEOMEDIA TECHNOLOGIES, INC.
Registrant

Date: August 7, 2006

By: */s/ Charles T. Jensen*
Charles T. Jensen, President, Chief Executive Officer, and Director

Date: August 7, 2006

By: */s/ David A. Dodge*
David A. Dodge, Vice President, Chief Financial Officer and principal accounting officer