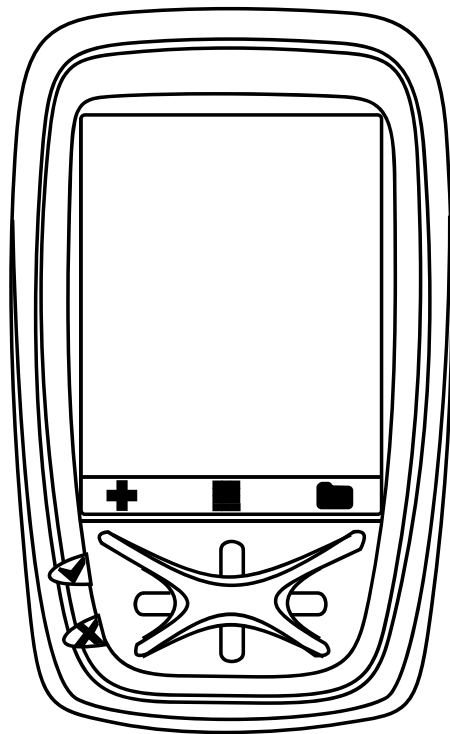


Confidential Investment Memorandum

January 2004



neonode

Neonode AB Investment Memorandum

This document describes the seed investment round proposed by Neonode to a selected number of individual investors. The document is strictly confidential and intended for named recipients only. The document includes forward-looking statements and plans, and readers are advised that any such details may change as the business evolves.

Contact persons: CEO Magnus Goertz mobile +46 733 22 13 51 , fax +46 8 750 60 04
Marketing Manager Alexandra Jansson +46 702 35 11 56
Business Development Manager Jonas Löfgren +46 707 27 39 36

Document received and confidentiality acknowledged:

Date:

Signature

Name in block letters

Neonode's mission

Neonode's mission is to seek a profitable leadership on the mobile market by leading the development and marketing of state-of-the-art mobile handsets that fully harness the power and potential of seamless integration between the mobile handset, the PC and the Internet.

Neonode shall reach a market leadership position within five years by focusing on developing products that offer an unparalleled user experience, by acquiring an exceptional market understanding in a targeted market segment and by integrating "best of breed" technology to meet customer expectations.

Neonode in short

Neonode has since the beginning of June 2003 accomplished to:

- Successfully negotiate and reach agreement on business model with Tele2;
- Reach understanding regarding sales with three large operators;
- Initiated discussions of a sales/marketing campaign with Reebok worldwide;
- Release beta SDK.

The interest from the market has been unexpectedly high. Since the brand release in December 2002 more than 100 companies that has expressed interest in the purchase of N1 have contacted Neonode. The interest has not decreased. Neonode has since the beginning of the commercial phase in June 2003 received offers from, e.g., the following telecommunication operators about orders of units of N1:

- Telcel in Mexico about purchase of 15,000 units
- Proximus in Belgium about purchase of 3,000 units
- TIM in Italy about purchase of 20-30,000 units
- Operator in Egypt about purchase of 500 units per month as test units.

In the beginning of July Neonode also was contacted by an English distributor that expressed the wish to purchase more than 100,000 units of N1. Mobile operators are however preferred customers since they are willing to make advance payments for adjustments of the mobiles.

When Neonode reaches commercial sales of larger amounts of mobiles the revenues will increase rapidly. A net gross margin of 27 % on each sold unit and a calculated price of 420 EURO per unit create substantial profits for the manufacturer and value for the investors.

The sales model of Neonode is based on selling mobiles through partnerships with operators and content providers, through direct sales on the web and user communities. During the brand release in December 2002, the N1 created such a buzz in the industry that Neonode quickly received over 20,000 pre-orders by individual customers and was contacted by hundreds of operators and companies seeking to partner with Neonode. In parallel with the final development of N1 Neonode has continued to develop the relationship with operators and content providers.

Neonode's business model based on assembly on order and distribution to end customer has been widely accepted by operators. They can see the immediate advantage in customization of the device with different settings and brands to different customer groups. The late work with promoting the platform to software companies has resulted in, among others, a 3D gaming engine same as Nokia n-Gage and Fast Mobiles push-2-talk client.

Microsoft has recently altered their business model for mobile handsets in a way that will favor Neonode. Microsoft has started a special department that shall promote and serve independent mobile manufacturers and support new user interfaces.

Target Market

Neonode will primarily focus on serving the needs of one specific user segment – teenagers and young adults between the age of 13 and 25, also known as the *Generation Y*.

The term *Generation Y* is used to describe a generation of teenagers and young adults, born between 1979 and 1994. The number of children born during these 15 years has been estimated to 60 million in the U.S alone, which is three times the size of the Generation X and the biggest new generation of consumers since the baby boomers.

Neonode has chosen to serve this market segment for the following reasons;

- They are willing and able to spend up to 13,6% of their disposable income on mobile products and services¹
- They consider their mobile phone to be a fashion item and frequently upgrade or replace their mobile phones to gain access to the latest and most advanced technology and features
- They have an interest in learning new technologies
- They are using computers and access the World Wide Web on a close to-daily basis;
- 65% of consumers aged 16 to 24 are used to buy CDs, books, hardware, software and tickets over the web²
- They drive market demand for new mobile products and services

¹ Mobile Youth 2003 W2 Forum

² MTV Survey Planet Youth 2000

Organization

Neonode currently employs 10 full time employees in four key areas - System Development, Product Management, Customer service, IT & Logistics, Marketing and Sales and Business Development. In addition Neonode has two contract business developers in Sweden, one in France and one in UK.

Management

Neonode's current management team comprises of talented and dedicated professionals with extensive experience in their respective fields and the complementary skills needed to manage and build a highly successful company. Neonode is also in the process of hiring additional key personal such as CFO and a professional board.

Magnus Goertz, 34 **CEO, co-founder**

Magnus has extensive technical and entrepreneurial experience and is the founder of two other Swedish high-tech companies, *Rector AB* and *Brace AB*. Rector AB was a consultancy firm specialized in the design and development of Man-Machine Interface systems. Brace AB was a successful manufacturer of Thin-Client Network Computers. Following the sale of Brace AB in 2000 to Swedish telecommunication company *RadioDesign AB*, Magnus worked as a Strategic Advisor at Radio Design's Business Innovation Department, prior to founding Neonode AB with Thomas Eriksson in October 2000.

Thomas Eriksson, 33 **Chief Technical Designer, co-founder**

Thomas holds a Master's Degree in Electrical Engineering from the Royal Institute of Technology (KTH) in Stockholm, Sweden. Thomas has over 15 years of experience in Product Design and Engineering. Prior to founding Neonode AB with Magnus, Thomas worked at Wireless Toys AB as a Founder/CTO, developing innovative products sold worldwide. At Neonode, Thomas currently supervises a team of engineers in the development of the N1.

Jonas Löfgren, 29 **Business & Partner Development Manager**

Jonas holds a Master of Science Degree and is currently completing his Executive MBA at the University of Gävle in Gävle, Sweden. Jonas has done extensive research in the area of Health Sciences prior to starting his own independent consultant company, specialized in Software Development and User Interface Design for the Health Sciences industry. At Neonode, Jonas supervises a team in the development of partnerships worldwide.

Alexandra Jansson, 28 **Marketing & Sales Manager**

Alexandra holds a Bachelor Degree in Business Administration from the University Federal of Uberlândia, Brazil and has completed additional courses in Marketing at the UCLA in Berkeley, USA. Alexandra has several years of experience as a Strategic Marketing consultant and has gained wireless industry knowledge while working for Ericsson as a

Marketing Communications Manager. At Neonode, Alexandra supervises a team in the development of the areas of marketing and sales.

Neonode's Subcontractors

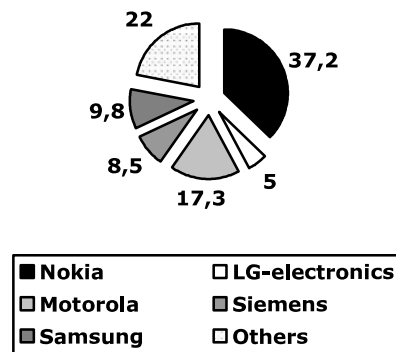
Neonode does not intend to build large production facilities. Elektromekan, Flextronics and Alps will produce the N1. Financial, IT and legal services are provided by external partners. Handset service and telephone support are also handled with external suppliers.

Neonode's Advisors

- Neonode has engaged the TICE Partner, Arne Engvall of Öhrlings PricewaterhouseCoopers as Auditor of the company. Arne Engvall is a chartered accountant with a recognized reputation for his work with emerging companies.
- Klara Papper AB keeps the business books.
- Neonode has engaged Peter Helle as lawyer of the company. Peter Helle has a long experience in Swedish and international business law and has been mentioned as one of the leading IT and Technology lawyers in Sweden.
- Wawecom France acts as agent and advisor regarding sales to mobile operators.

Competitors

Today's leading manufacturers of mobile handsets consist of a small group of large players. They have all developed their own proprietary software. None of these players focus on one exclusive market segment – they have developed product lines that cover a wide range, from low-end to high-end, targeting both younger and older customers. Among the newcomers we can find Danger from USA focusing on the youth market. Alpha cell working with custom orders from operators. Microcell ODM supplying to operators and consumer brands. A trend in Asia is that traditional PC manufacturers have moved on to mobile phones. Common with Asian manufacturers is the low rate of innovations, branding and openness. Microsoft has also made the first attempts to reach the mobile arena. This is done in alliance with HTC in Taiwan going directly to operators.



Neonode's Strategic Positioning

Neonode will position itself as a company that is capable of developing feature-rich, state-of-the-art mobiles at price/functionality-ratio previously unmatched by existing competitors. This is accomplished by adopting new models of development combined with existing mail order models used by companies like Dell computers. Neonode has also created a unique position enmeshing sales to operators by letting the menus and graphics stay open for adjustments and by not being a supplier of infrastructure and applications. This creates an exclusive and sought for way for the operators to creating their own communities.

Revenue Model

Neonode's principal revenues come from sales of mobile handsets directly to the end-user through cooperation with mobile operators and web shops.

Neonode will have three additional types of revenue streams:

1. SERVICES: Tailored functions and menus. Adjustments for networks and language (consultant fee)
2. RIGHTS: Fees and licences from partners and resellers for using the Neonode trademark and for Neonode certification
3. SPONSORS: Sponsorship fees for content on mobiles and web

Neonode plans to extend the product range diverting the price but still based on that same platform. Unit prices are not going to change dramatically during the lifecycle in order to strengthen the Neonode brand.

There are three main sales channels:

1. Sales via partners (for faster expansion and for more complete offering), operators, distributors
2. Web-based sales on Neonode site
3. Web-based sales on partner sites, operators.

Risks

- Since the market interest is so large Neonode may have a risk of not being able to produce enough units of N1
- Difficulties in recruiting key personnel
- Delays in closing key partnership agreements
- Finance
- Delays in product development, which results in, deferred Market Entry

Financial Summary

The company plans to launch its first product, the N1, in 1Q 2004. There are ongoing discussions also with operators in South America and North Africa.

N1 sales forecast

Region	2004	
Sweden	40 000	
Europe	80 000	
Total:	120 000	

The forecast is done based on a controlled volume increase. This is intentionally made to hold down costs while building fully functional support system in the organisation.

Pricing

Price per N1: 420€ creating a net gross margin: 112 € or 27%

Variable cost per N1 unit

Production costs	50 €
Cost of material	180 €
Licenses	15 €
Other	20 €
Warranty	20%

Adjustments of the Neonode software are categorized in three levels

- **Basic Operator Tuning:** Graphics, settings
- **Campaigns:** Limited volumes, branding, graphics, settings, and project management.
- **Custom:** Complete changes of software with custom applications, services and menus

An hourly fee is charged for the Custom level, on Basic Operator Tuning and Campaigns an initial fixed fee is charged between SEK 200 thousand and 2 million.

Monthly Expenses

Expenses	1000 SEK
Salary	300
Office, (communication)	50
Other, (travel, suppliers, licences, economy)	150
Total	500

Investments in material, production equipment and assembly for the first 1000 units are already made and are not going to affect our future costs.

Stage of Development and Background

When Neonode started 2000 three specific key factors were identified for the future mobile market.

- The need for personalizing and customizing mobiles for the user and the operator.
- The 24h usage of the mobile.
- The traditional Software and Datacom industries focus on entering the mobile arena

This resulted in the creation of a credit card sized mobile platform, N1P, open for any application and open for redesign of menus loaded with a standard Microsoft OS, a device that is full with features that are known from the Datacom industry. By adopting this technology in an early stage Neonode has been able to create a base of patents surrounding this platform. By putting a lot of effort on the user interface Neonode has created a unique superior and future proof technology for user interaction, text editing and browsing. This platform was also designed for a small organization of customer service and designed for easy maintenance and returns resulting from the mail order model.

To keep a small organization and leverage from the massive amount of programmers around the world (6 million Microsoft developers) Neonode created a 3rd party Software Development Kit. Beginning of 2003 Neonode decided to move one-step further and adopt the latest technology from Microsoft, Windows CE.NET. This decision was taken to ensure the external developers to work in a stable and future proof environment. In this context Neonode also adopted a new software development process from Microsoft.

The fact that the Neonode platform is based on Microsoft's Windows CE.NET and makes games and applications easily portable from Pocket PC. This has got great response from software providers resulting in cooperation with among others the company supplying the 3D gaming engine to Nokia n-Gage, a "push 2 talk" Instant Messaging client, and DICE's (Digital Illusion) game developers.

Neonode has now entered the commercial phase and has since the beginning of June 2003 accomplished to:

- ❑ Successfully negotiate and reach agreement on business model with Tele2;
- ❑ Reach understanding regarding sales with three large operators;
- ❑ Initiated discussions of a sales/marketing campaign with Reebok worldwide;
- ❑ Release beta SDK.

The interest from the market and the telecom operators is massive.

Neonode Roadmap and Exit Opportunities for the Investor

Neonode intention is to create a fast and profitable way for its investors to either exit within a short time from the investment or participate in the growth of Neonode. Contacts have been taken that can result in a backdoor entry on the Swedish stock exchange during 2004.

- ❑ Signing of first LOI with operator (July 2003)
- ❑ Shipment of test units for operators (August 2003)
- ❑ Implement WEB and database systems (August 2003)
- ❑ Final adjustments on the N1 mobile functions (February 2004)
- ❑ Sales of first 500 units to the pre order list (March 2004)
- ❑ Merge with a stock market company and new issuance of shares.

Terms & Conditions of Seed Investment Round

The initial plan of the owners was to take Neonode to the commercialisation phase without external funding. The change of plans to make this phone a complete and open platform for software developers has however created the need for a final bridge investment. Neonode is therefore making this initial investment offer in order to secure the final adjustments of the N1 mobile. The investment will bridge the gap between final adjustments and commercial sales of larger quantities and to solidify the business and the management team.

This is a round with a pre-money valuation of the company to SEK 40,000,000. Neonode will make no prediction of the future value of the company, but we expect that the market interest in Sweden will be high for a company that markets and develops mobiles based on the Microsoft .NET standard.

Participating investors will therefore receive:

- ❑ Substantial ownership in the new Swedish mobile company with patented technology
- ❑ Ownership in a company that has received an exceptional market interest and recognition internationally

- ❑ Shares with large potential for growth
- ❑ Ownership in a company that works within a field of interest to all Swedes
- ❑ A clear and straight forward exit strategy given the stock notation
- ❑ Participation in a sought after consumer project that is likely to be insensitive to (or even positively dependant on) downturns in the market

Neonode intends to engage maximum 5-10 investors.

The investment will be done by investors participation in the initial share subscription for a newly formed Swedish AB. Investors shall subscribe for shares and undertake to make an unconditional shareholders contribution for amounts exceeding the par value of the subscribed shares. The investors will receive common stock in proportion to the investment.

The other owners along with the investors of Neonode will be the founders and the staff (approximately 10 persons) and additional stakeholders (12).

The newly formed company will purchase the company that now holds the right to the Neonode project. The purchase price will be 1 SEK. The project holding company has a loan to ALMI Företagspartner amounting to SEK 1,000,000 and other outstanding liabilities amounting to approximately SEK 500,000.

Other Information

www.neonode.com

www.google.com/search?q=neonode

neonode.r8.org