REDEYE

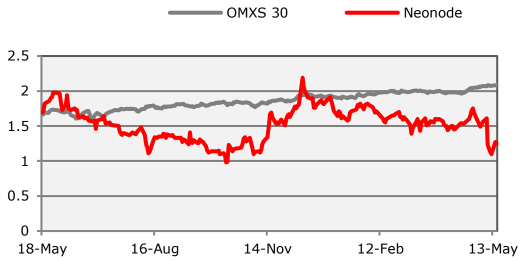
Summary

Neonode (NEON.OQ)

Not yet Chez Stockholm due to losses

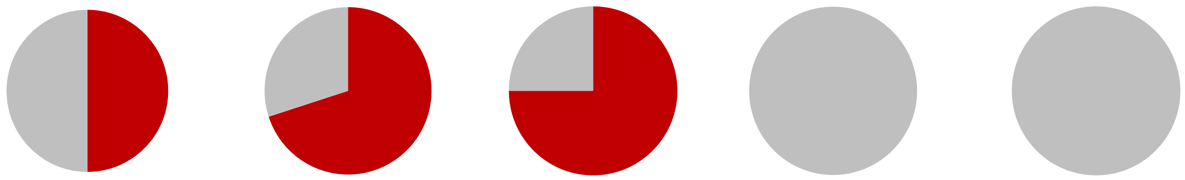
- The operating loss of USD -0.9 million was an unpleasant surprise in relation to our estimates of USD -0.1 million and likely delays an eventual dual listing. The majority of our error was once again on the AirBar side while automotive and printers both had a decent growth adjusted for non-recurring items. Following a visit to the production site we are convinced that the AirBar production delays are no longer an issue.
- The major problem is instead cash that currently only amounts to USD 1.7 million. Half of our new base case of USD 3.0 (3.7) is related to a higher required rate of return due to a lower financial strength rating. The upside potential of some 140 percent is actually larger now than our last update due to the share's steep decline. However, upside potential is secondary at the moment as the share price likely will be driven by fear of dilutive capital raising for a while now.

List:	NASDAQ
Market Cap:	59 MUSD
Industry:	Human Interaction
CEO:	Thomas Eriksson
Chairman:	Per Bystedt



Redeye Rating (0 – 10 points)

Management	Ownership	Profit outlook	Profitability	Financial strength



5.0 points	7.0 points	7.5 points	0.0 points	0.0 points

Key Financials

	2015	2016	2017E	2018E	2019E
Revenue, MUSD	11	10	14	29	55
Growth	*134%*	*-8%*	*42%*	*97%*	*93%*
EBITDA	-7	-4	-1	4	14
EBITDA margin	*-66%*	*-43%*	*-8%*	*13%*	*25%*
EBIT	-8	-5	-1	3	13
EBIT margin	*-69%*	*-50%*	*-10%*	*11%*	*24%*
Pre-tax earnings	-8	-5	-1	3	13
Net earnings	-8	-5	-1	3	12
Net margin	*-69%*	*-48%*	*-10%*	*11%*	*21%*
Dividend/Share	0.00	0.00	0.00	0.00	0.00
EPS adj.	-0.19	-0.11	-0.03	0.07	0.24
P/E adj.	0.0	-12.0	-44.5	19.3	5.3
EV/S	-0.3	5.0	3.4	1.8	0.8
EV/EBITDA	0.4	-11.5	-43.7	13.5	3.0

Share information	
Share price (USD)	1.3
Number of shares (m)	48.8
Market Cap (MUSD)	59
Net debt 17E (MUSD)	-3
Free float (%)	87 %
Daily turnover ('000)	29

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Redeye Rating: Background and definitions

The aim of a Redeye Rating is to help investors identify high-quality companies with attractive valuation.

Company Qualities

The aim of Company Qualities is to provide a well-structured and clear profile of a company's qualities (or operating risk) – its chances of surviving and its potential for achieving long-term stable profit growth.

We categorize a company's qualities on a ten-point scale based on five valuation keys; 1 – Management, 2 – Ownership, 3 – Profit Outlook, 4 – Profitability and 5 – Financial Strength.

Each valuation key is assessed based a number of quantitative and qualitative key factors that are weighted differently according to how important they are deemed to be. Each key factor is allocated a number of points based on its rating. The assessment of each valuation key is based on the total number of points for these individual factors. The rating scale ranges from 0 to +10 points.

The overall rating for each valuation key is indicated by the size of the bar shown in the chart. The relative size of the bars therefore reflects the rating distribution between the different valuation keys.

Management

Our Management rating represents an assessment of the ability of the board of directors and management to manage the company in the best interests of the shareholders. A good board and management can make a mediocre business concept profitable, while a poor board and management can even lead a strong company into crisis. The factors used to assess a company's management are: 1 – Execution, 2 – Capital allocation, 3 – Communication, 4 – Experience, 5 – Leadership and 6 – Integrity.

Ownership

Our Ownership rating represents an assessment of the ownership exercised for longer-term value creation. Owner commitment and expertise are key to a company's stability and the board's ability to take action. Companies with a dispersed ownership structure without a clear controlling shareholder have historically performed worse than the market index over time. The factors used to assess Ownership are: 1 – Ownership structure, 2 – Owner commitment, 3 – Institutional ownership, 4 – Abuse of power, 5 – Reputation, and 6 – Financial sustainability.

Profit Outlook

Our Profit Outlook rating represents an assessment of a company's potential to achieve long-term stable profit growth. Over the long-term, the share price roughly mirrors the company's earnings trend. A company that does not grow may be a good short-term investment, but is usually unwise in the long term. The factors used to assess Profit Outlook are: 1 – Business model, 2 – Sale potential, 3 – Market growth, 4 – Market position, and 5 – Competitiveness.

Profitability

Our Profitability rating represents an assessment of how effective a company has historically utilised its capital to generate profit. Companies cannot survive if they are not profitable. The assessment of how profitable a company has been is based on a number of key ratios and criteria over a period of up to the past five years: 1 – Return on total assets (ROA), 2 – Return on equity (ROE), 3 – Net profit margin, 4 – Free cash flow, and 5 – Operating profit margin or EBIT.

Financial Strength

Our Financial Strength rating represents an assessment of a company's ability to pay in the short and long term. The core of a company's financial strength is its balance sheet and cash flow. Even the greatest potential is of no benefit unless the balance sheet can cope with funding growth. The assessment of a company's financial strength is based on a number of key ratios and criteria: 1 – Times-interest-coverage ratio, 2 – Debt-to-equity ratio, 3 – Quick ratio, 4 – Current ratio, 5 – Sales turnover, 6 – Capital needs, 7 – Cyclicality, and 8 – Forthcoming binary events.

Neonode not yet Chez NASDAQ Stockholm due to losses

The Neonode Q1 report was certainly not what we were expecting. As operating losses continue an eventual dual listing in Stockholm will likely be postponed. The important questions for this update though are rather how we were wrong and if our long-term case has changed. Printers and automotive both had a decent growth adjusted for non-recurring items and business therefore seems to be ok, outside of the least to say slow AirBar ramp-up. However, the balance sheet looks troublesome with cash currently only at USD 1.7 million. We deem risk for dilutive capital raising will be the main focus for the stock market during the next quarter or so.

In our previous update[1] we wrote about the progress in the module strategy[2] and that Neonode only enters module contracts from now on, i.e. as of the end of 2016 it no longer pursues licensing deals. During Q1'17 Neonode actually closed three new OEM supply agreements for embedded sensor modules with delivery starting already in 2017, although these news drowned in the noise on the disastrous conference call regarding (ultimately) cash and burn rate (we return to this matter below). In addition to these three contracts Neonode signed an interesting OEM deal regarding development of an embedded sensor module for flexible OLED displays.[3]

We also note that Neonode to date has manufactured over 45 000 modules in total, not only for AirBar applications. We have visited the production line ourselves and bear witness that production is no longer a bottleneck. During our site visit we talked to e.g. the site manager who has 31 years of experience in EMS, especially within automotive as a subcontractor to for instance Volvo. We learned about some of the highly specialized production steps which caused problems in the beginning as the equipment is world unique, meaning Neonode e.g. needed to fly in rare Asian expertise to learn the processes. Our interpretation is that selling in the various channels was a bit cautious in Q1 following the Q4 production problems and insecurity in

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[1] http://beta.redeye.se/company/neonode-inc/532152/neonode-only-module-deals-now

[2] As there has been some confusion regarding what a module is we would like to give a brief explanation in this sense before we continue. Neonode has previously only licensed the technology of the touch sensor to customers, meaning customers have paid a royalty per unit in order to use Neonode's patented touch sensor technology to build their own sensor modules. One could perhaps compare with Fingerprint Cards that sells sensors to module house partners who build the sensor module by adding packaging, coating etc. The finished module can then immediately be mounted in the smartphone by the smartphone OEM. Compared to Fingerprint Cards and its module partners Neonode would be responsible for the sensor manufacturing as well as the module manufacturing. Neonode will sell so called plug-and-play modules to its customers who only need to assemble the finished modules in their cars, printers or whatever other product it may be.

[3] The OLED deal makes a lot of sense and came as no surprise for us given how challenging it is to bend the metal in projected capacitive sensors. We notice that both Apple and Samsung have been working on flexible OLED but likely the flexible OLED modules are a long-term possibility and no short term saviour.

delivery but now the production line is fully up and running.

Operating loss sequentially increases to USDm -0.9

Sales in Q1 amounted to a disappointing USD 2.3 million (expected USDm 3.7). As mentioned in our initial Q1 reflections[4], sales in all segments were below expectations (we return to the different business areas below). AirBar once again accounted for the majority of the 37 percent deviation. However, apart from the AirBar difference of USD 0.7 million, all other segments were actually within an error margin of USD 0.1-0.2 million. Nonetheless, AirBar is important short-term in the reaching of break-even, likely a lot more important than we initially thought. The weak total sales consequently resulted in an operating loss of USD -0.9 million compared to our close-to-break-even expectations of USD -0.1 million (see the table below).

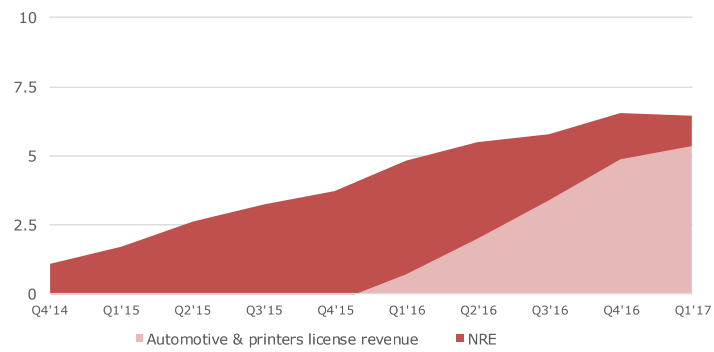
Neonode - Expected vs. Outcome

SEKm	Q1'16	Q1'17E	Outcome	Diff
Sales	3.1	3.7	2.3	-37%
Operating profit	-1.3	-0.1	-0.9	-0.8
PTP	-1.3	-0.1	-0.9	-0.8
EPS, SEK	-0.03	-0.001	-0.016	-0.01
Salesgrowth	138.4%	18.2%	-25.5%	
Grossmargin	81.0%	82.0%	95.5%	
EBIT margin	-41.1%	-1.5%	-37.7%	
EPS growth	n/a	n/a	n/a	

Source: Neonode, Redeye Research

As Neonode did not write about sales or volumes within automotive and printers in the Q1 report the graphs below on automotive and printer sales are based on our guesstimates, although Neonode mentioned that going forward it will continue to break down these important segments.

R12M printers & automotive license revenue - less NRE (USD million)



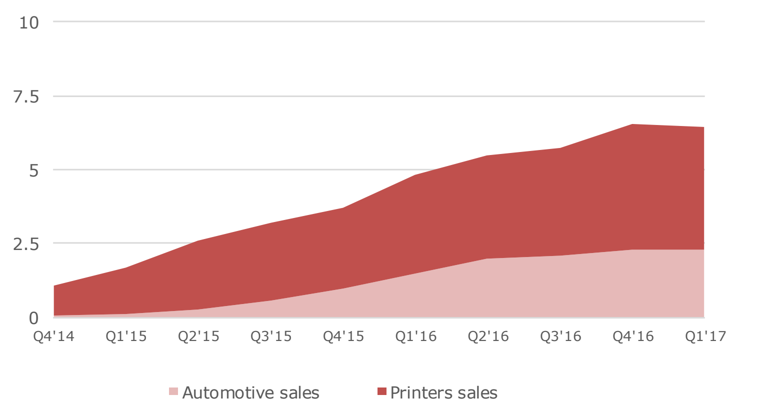
Source: Redeye Research, Neonode

* = With the simplified assumption that all NRE is related to printers and automotive

4 http://beta.redeye.se/company/neonode-inc/541181/neonode-q1-comment-sales-every-segment-below-expectations

The printer revenue of USD 1.1 million implied a negative year on year growth as hinted in the graph below. However, excluding the catch-up revenue in the strong Q1'16 the printer license sales growth would have been 17 percent.

R12M total Printers & Automotive revenue (USD million)



Source: Redeye Research, Neonode

Flat Automotive growth in Q1

Automotive revenue was flat around USD 0.6 million, although if it was not for one delayed royalty report it should have grown about 20 percent to USD 0.7 million. Still, we find it peculiar that 36 launched models ramping did not translate to more underlying growth and as we understand it the Q1 figures was somewhat lower than Neonode's internal expectations as well. To some extent infotainment systems with touchscreens are optional and only standard in premium models but we believe this can only partly explain the discrepancy in Neonode licenses in relation to cars sold by customers. In addition, we see a trend of more standard infotainment versus optional ones in the newer car models. Our best guess is that audits of the customers are necessary but this is a long process ranging up to several quarters. However, we do need to point out the risk from the lack of clarity necessary regarding the discrepancy mentioned. What we earlier wrote on Neonode's successful platforms is still relevant though.[5]

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[5] Automotive OEMs face ferocious competition and the perhaps only countermove has since way back been cost efficiency. Most notably, all car manufacturers are using larger and larger (and hence fewer) platforms to share design, engineering and production efforts over a range of different car models. The objective for all car OEMs is to produce several different vehicles with a common set of components in the most efficient way. Consequently, Neonode's customers are cutting the number of their platforms in half or even more.

We are therefore pleased to see that Neonode's won platforms also are the customers chosen platforms for the future, given the recent model launches. One example is General Motors's D2XX platform which targets a capacity of 2.5 million cars in 2018 and is one of the 4 only mega platforms that GM puts its trust in (down from 20+ platforms in total). Maruti Suzuki aims to grow its 1.4 million shipped cars in 2016 to 2 million cars while reducing the number of platforms from 8 to 3. Maruti Suzuki now holds over 50 percent of the fast growing Indian market, meaning (if we exclude the negligible volumes on Maruti Suzuki's third platform and assume a similar touchscreen penetration among all players in India) that Neonode is posed to control half the Indian market. We believe that the stock market does not understand the crucial fact that Neonode is in the right platforms, i.e. the larger platforms of tomorrow and that it has strong bridgeheads in the right (i.e. growing) regions of the world, such as India and China.

The Volvo XC60 will start to approach its target of 200 000 vehicles annually but it will happen at the earliest in 2018.

Weak AirBar Q1 but the line fully up and running

The 5 500 AirBars sold contributed USD 210 000, which surprisingly was even less than the deferred revenue in Q4 of USD 254 000. We as well as the market had expected significantly more than that, especially considering that 9 000 AirBars, despite production constraints, were shipped to Ingram in the end of Q4, whereof the majority had not been sold then and instead was in the backlog going into Q1. However, as mentioned above, we have visited the production line for AirBar (and the other modules) which seems to be working fine and there are no constraints anymore. Yields are currently at 97-98 percent. Obviously we have overestimated the AirBar ramp quite a bit, possibly from market inertia given that the product area is brand new and unique. Besides the 15.6 inch AirBars 13 and 14 inch models are now being manufactured as well since these sizes are more common among the US early adopters and therefore are important initially in order to get through to the majority with 15.6 inch laptops.

Looking past the financial results, solely zooming in on the operation actions, Neonode seems to be doing a lot of good things in the AirBar area. An Ingram agreement is now in place regarding the important Indian market where the majority of the pre-orders came from. China is also underway. Reviews remain positive. We notice that Amazon and Walmart are price battling though. Both have lowered their prices but the discounts are taken from their own margins.

No cutting to the chase regarding need for cash

Operating cash flow amounted to USD -1.6 million, whereof about half came from Neonode continuing building inventory. There is now according to Neonode enough components in stock to make e.g. over 50 000 AirBar modules, which strengthens our view that the module demand is strong and the AirBar finally seems to pick up the pace. On the flipside, however, it is important to stress that cash decreased to only USD 1.7 million - significantly lower than our expectations. Consequently, we see a large risk for dilutive capital raising ahead.

The cash flow and burn rate was the elephant in the room on the disastrous conference call where one shareholder kept asking about a break-even date and current burn rate etc. In our opinion these (legitimate) questions could have been handled a lot better by Neonode, for instance by a simple “no comments” instead of evasion. If we see no signs of improvement of the communication we will have no alternative but to lower the parameters of the communication score in our Management Redeye Rating. Communication is important but it should be noted that this is merely one of several key aspects in our rating.

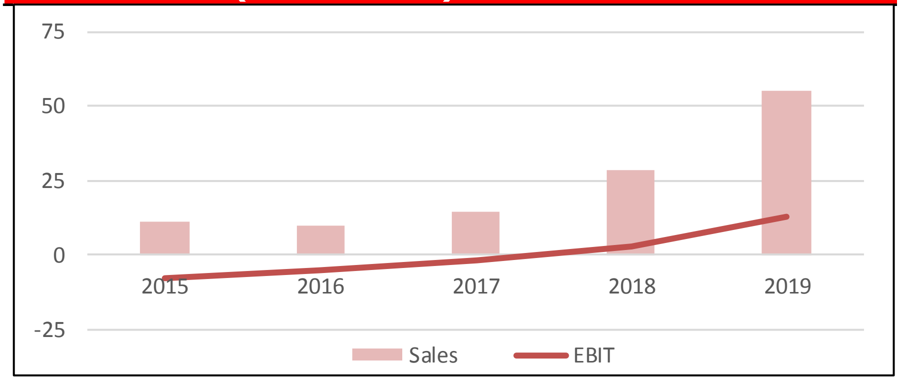
Not yet Chez NASDAQ Stockholm

We get a lot of questions on the eventual dual listing in Stockholm. We assume that a dual listing is still on the table although we do not expect it to occur prior to break-even as we believe Neonode wants to enter NASDAQ Stockholm with a strong, profitable growth.

Financial estimates

Here we present our financial projections and revenue breakdown. The point of inflection is illustrated by the graph showing EBIT and sales below.

Sales & EBIT (USD million)



Source: Redeye Research, Neonode

Changes in our estimates

AirBar accounts for the lion part of our estimates revisions (see the table below). We have lowered our AirBar estimates significantly for the third time in a row as we keep on underestimating the AirBar ramp-up. With the production line now running, channels in place, good reviews, a lot of pre-orders etcetera it would be surprising if AirBar eventually turned out to be a total failure.

Forecast adjustments

(SEKm)		2017E	2018E
Sales	Old	21	41
	New	14	29
% change		-32%	-30%
EBIT	Old	3	10
	New	-1	3
% change		-156%	-66%
Profit before tax	Old	3	10
	New	-1	3
% change		-155%	-66%
Earnings per share	Old	0.05	0.18
	New	-0.03	0.07
% change		-153%	-63%

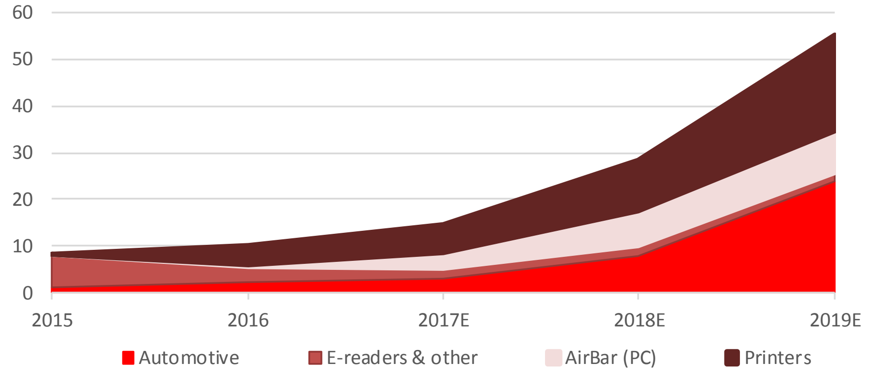
Source: Redeye Research, Neonode

Sales and earnings estimates

Our sales and earnings estimates are summarized in the graph and the table on the next page. The major release in 2018-2019 is mainly due to

Neonode's modules gaining ground, on top of a still growing base of license revenue (100 % margins).

Sales per segment (MUSD)



Source: Redeye Research, Neonode

Short term sales & earnings assumptions

(USD million)	2017E	2018E	2019E
Total sales	**14.5**	**28.5**	**55.1**
Sales growth (%)	*43%*	*97%*	*93%*
Group gross margin	*83%*	*74%*	*65%*
OPEX	-13.5	-18.0	-22.5
EBIT	**-1.5**	**3.3**	**13.1**
EBIT margin	***-10%***	***11%***	***24%***
Pre-tax profit	-1.5	3.3	13.1
Net earnings	-1.5	3.3	13.1
EPS	-0.03	0.07	0.27

Source: Redeye Research, Neonode

Sales assumptions per segment

Below we break down our sales assumptions per segment:

We are not expecting an explosion in automotive modules in 2018 but a result from the 4-5 times higher ASP is that a 17 percent module share in 2018 is enough for a triple digit automotive sales growth.

Sales assumptions: Automotive

(MUSD)	2017E	2018E	2019
Total sales	**3.2**	**7.9**	**23.8**
whereof infotainment (%)	*100%*	*57%*	*36%*
whereof Autoliv steering wheels (%)	*0%*	*0%*	*26%*
whereof tailgate (%)	*0%*	*23%*	*18%*
whereof door handles (%)	*0%*	*20%*	*20%*
Sales growth (%)	*41%*	*147%*	*202%*
Total Neonode units shipped (mil)	**1.3**	**2.2**	**4.1**
whereof modules (%)	0%	17%	39%
whereof licensing (%)	100%	83%	61%
Volume growth (%)	*7%*	*70%*	*88%*
Blended ASP (USD)	**2.5**	**3.6**	**5.8**

Source: Redeye Research, Neonode

AirBar is still an important short term growth driver even though we try to be more cautious and now do not expect more than 150 000 AirBars in 2018 and 73 000 for 2017 (see below):

Sales assumptions: AirBar (PC)			
(MUSD)	**2017E**	**2018E**	**2019**
Total sales	**3.6**	**7.5**	**9.0**
whereof own sales (%)	*0%*	*0%*	*0%*
whereof Ingram (%)	*100%*	*100%*	*97%*
whereof OEM bundled (%)	*0%*	*0%*	*3%*
Sales growth (%)	*2306%*	*109%*	*20%*
Total Neonode units shipped (')	**73**	**150**	**200**
Volume growth (%)		*105%*	*33%*
Blended ASP (USD)	**49**	**50**	**45**

Source: Redeye Research, Neonode

Printer modules is expected to start their ramping in H2'18. We estimate a higher license ASP on the new printer models due to better pricing but also because these are more high end printers with lower volumes.

Sales assumptions: Printers			
(MUSD)	**2017E**	**2018E**	**2019**
Total sales	**5.7**	**11.0**	**20.3**
whereof HP (%)	*88%*	*64%*	*51%*
whereof others (%)	*17%*	*36%*	*49%*
Sales growth (%)	*33%*	*93%*	*84%*
Total Neonode units shipped (mil)	**10.0**	**13.8**	**15.7**
whereof modules (%)	0%	5%	20%
whereof licensing (%)	100%	95%	80%
Volume growth (%)	*14%*	*38%*	*14%*
Blended ASP (USD)	**0.6**	**0.8**	**1.3**

Source: Redeye Research, Neonode

E-readers is a nice cash cow but we do not expect any growth in this area. NRE will decrease as it is not needed anymore when Neonode has fully transitioned to module projects.

Sales assumptions: E-readers & other			
(MUSD)	**2017E**	**2018E**	**2018E**
Total sales	**2.0**	**2.1**	**2.0**
whereof E-readers	*100%*	*62%*	*75%*
whereof NRE	*45%*	*38%*	*25%*
Sales growth (%)	*-21%*	*57%*	*-6%*
Total Neonode units shipped (mil)	**2.3**	**2.2**	**2.5**
Volume growth (%)	*13%*	*-2%*	*14%*
ASP excl. NRE (USD)	**0.6**	**0.6**	**0.6**

Source: Redeye Research, Neonode

Quarterly estimates

The lower sales estimates seen above means that we now expect continuing losses in Q2 and Q3 before a USD 0.3 million profit in Q4 (see the table below).

Quarterly estimates (million USD)

SEKm	2015	Q1'16	Q2'16	Q3'16	Q4'16	2016	Q1'17	Q2'17	Q3'17	Q4'17	2017
Sales	**11.1**	**3.1**	**2.6**	**1.6**	**2.9**	**10.2**	**2.3**	**2.7**	**4.0**	**5.4**	**14.5**
Sales growth (%)	*134%*	*38%*	*-7%*	*-47%*	*-3%*	*-8%*	*-26%*	*7%*	*147%*	*87%*	*42%*
EBIT	**-7.7**	**-1.3**	**-1.3**	**-2.1**	**-0.4**	**-5.1**	**-0.9**	**-0.7**	**-0.2**	**0.3**	**-1.5**
PTP	-7.7	-1.3	-1.3	-2.2	-0.5	-5.2	-0.9	-0.7	-0.2	0.4	-1.5
EPS (USD)	-0.19	-0.03	-0.03	-0.05	-0.01	-0.12	-0.02	-0.01	0.00	0.01	-0.03
EBIT margin (%)	-299%	-41%	-50%	-131%	-15%	-69%	-38%	-26%	-6%	6%	-10%
Gross margin (%)	66%	81%	85%	98%	89%	87%	95%	92%	79%	75%	83%
EPS growth (%)	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a

Source: Redeye Research, Neonode

Investment case

No stock market trust regarding the new module based business model

Neonode is transitioning its business model from selling licenses to hardware modules, which will increase the addressable market more than fivefold and double the gross profit per unit. Our belief is therefore that Neonode is facing a strong growth and that the associated change in investor perception will have major effects on the share. The stock market does not agree with us. We interpret this as a general mistrust towards Neonode's management who is seen as infamous target missers that only talk and do not execute. We believe this public image will change along with reports showing growth and profitability.

Short term focus and neglection of the strong position in automotive

In addition to the distrust against Management we believe that the stock market compared to us has a shorter horizon, focusing on AirBar and neglecting the strong position in automotive. Neonode's patented technology has key competitive advantages against today's dominating technologies (projected capacitive & resistive) when it comes to performance features as low cost, power consumption, best image quality and extreme adaptability. It works on all surfaces and in all temperatures and environments. Neonode's technology is therefore a perfect match for automotive – its key growth area. In automotive, there are substantial barriers to entry as car manufacturers don't accept even a 3 ppm defective rate. A supplier therefore has to pass up to 5 years of demanding tests to qualify as a part of a platform. Neonode has passed these tests for customers deploying new automotive platforms and therefore its modules should be installed in every new model on those platforms for the next decade. The stock market, however, does not fully grasp the implications of Neonode's success in achieving qualified vendor status of the global automotive OEMs, the new technology acceptance or the ramp-up process of Neonode's customers. Approximately half of the 36 car models where Neonode's technology is installed are currently shipping. This will increase significantly in the coming years as new customer car models incorporate Neonode's technology and the existing customers' Neonode based touch platforms expand across their entire model line-ups. All in all, Neonode and its strong automotive position together with the new hardware module-based business model is positioned to hit the point of inflection, i.e. a noticeable, positive turning point in the investment case and the stock market's appreciation.

Break-even and large module deals to drive the stock price

We expect financial reports with black figures to change the perception of investors and move the stock. In addition, large module contracts similar to the USD 11 million deal in the fall of 2016 are important for the share.

Substantial margin of safety

We do not see Neonode as a high risk, high expectations play as it already has the customers, the traction and the ramp-up in existing and coming models to support a substantial growth. Thus, our base case of USD 3.0 per share in relation to our reasonably pessimistic scenario of USD 1.2 implies a substantial margin of safety.

Valuation

Valuation conclusion and the Neonode share

First things first, where did we fail in our Neonode analysis? We have earlier accused the stock market of focusing too much on AirBar although now it turns out that AirBar was a lot more important short term in the break-even equation than we anticipated. The automotive trajectory have been slightly slower than we expected but the substantial deviations from our estimates have all been related to AirBar. We have been a little too optimistic on the implications and timing etcetera considering positive information on the automotive side, one example being the order of USD 11 million in the fall of 2016[6] where we expected more would have come by now. Last, we have been too lenient on the balance sheet. During the past three quarters investments in total have been about USD 2 million and inventory has been increasing by in total USD 2.5 million during the same period. In other words, we did not leave enough room for any other outcome than AirBar succeeding.

The production line seems fine now, the module strategy shows progress and test batches of modules seems to be on the way to virtually every customer ((small volumes – but an important first step). However, we have one more time lowered our AirBar estimates significantly. We have a **new base case of USD 3.0 per share (3.7) and bear case drops from USD 1.6 to 1.2.** In our reasonably pessimistic scenario we assume AirBar was mostly important as a proof of module manufacturing in general and therefore expect it to eventually be discontinued. In our bull case of USD 6.2 though, we keep our estimates unchanged.

About half of the decrease of our valuation is based on lowered estimates for especially AirBar but the revision is also to a large part related to changes in our Redeye Rating. We have lowered the score for financial strength from 2 to 0 as we see a large risk for dilutive capital raising. Consequently, our required rate of return are now 15.2 percent, up from 15.0 percent (the effect should have been 1 percentage point larger than that had Redeye not lowered the normalized risk free interest rate level from 3.5 % to 2.5 %). However, it is important to remember that the rating change in financial strength is just temporary until the balance sheet is somehow strengthened. In other words, we are discounting a rights issue or a private placement. Should Neonode manage without further use of external capital

[6] The USD 11 million module deal includes a tailgate sensor but has more functions than only opening the trunk although Neonode cannot mention anything regarding this. As the power consumption is low the sensor will work all the time and does not need a running engine. The deal relates to one car model in 2018 with delivery planned to start in Q4'17. We expect total volumes for this embedded model to be around 700 000 and the life cycle of 3-5 years implies on average 140 000 – 230 000 cars shipped annually. There are more module deal projects at other OEMs in the pipeline but these will likely affect 2018 and not 2017. However, Neonode not only has embedded tailgate sensors but also similar aftermarket solutions as well with faster selling cycles, meaning some possible aftermarket revenue in 2017 but we are not including that in our estimates at the moment.

the valuation would jump back from USD 3.0 to 3.4 per share.

Despite cutting our estimates and ultimately our valuation by 19 percent the upside is even larger now than our last update as the share has tanked severely before as well as after the Q1 report. The upside to our base case is now 140 percent compared to about 130 percent in our last update. However, we believe the upside potential likely is secondary at the moment as fear currently trumps greed. We are of course talking about the cash of only USD 1.7 million and the risk we mentioned above regarding dilutive capital raising. Even though the production line is fully running since a while back the sell-through business model will likely mean revenue recognition for Neonode in Q3, meaning investors should be ready for a weak Q2 report.

DCF Valuation

We are using a discounted cash flow valuation (DCF) with a base scenario and a reasonably pessimistic and optimistic case respectively. Using our Redeye Rating, we have applied a discount rate of 15.2 percent, which to some extent is a reflection of the Company's history. We use an average effective tax rate of 30 percent long-term but expect basically no tax before 2020 due to the large deferred tax assets.

In the tables below we present a summary of our estimates and highlight the key differing assumptions in the different scenarios, the main swinging factor being the success of the module strategy.

Valuation scenarios: Differing key assumptions

	2017E			2021E			CAGR yr 17-21E		
(USD million)	**Bear**	**Base**	**Bull**	**Bear**	**Base**	**Bull**	**Bear**	**Base**	**Bull**
Automotive									
Total volumes (mil.)	1	1	1	5	9	12	37%	64%	74%
Blended ASP (USD)	2.5	2.5	2.5	5.7	7.3	13.4	23%	31%	52%
Total sales	16	14	15	49	124	269	32%	71%	105%
Printers									
Total volumes (mil.)	11	10	11	12	17	28	4%	14%	27%
Blended ASP (USD)	0.6	0.6	0.6	1.7	2.6	2.8	28%	46%	48%
Total sales	7	6	6	20	45	76	32%	67%	88%
AirBar									
Total volumes (mil.)	0.1	0.1	0.1	0.0	0.3	1.0	-100%	42%	92%
Blended ASP (USD)	49.1	49.1	49.1	35.0	35.0	35.0	-8%	-8%	-8%
Total sales	4	4	4	0	11	35	-100%	31%	77%
E-readers & other									
Total volumes (mil.)	2	2	2	3	3	3	3%	3%	3%
Blended ASP (e-readers)	0.6	0.6	0.6	0.6	0.6	0.6	0%	0%	0%
Total sales	2	1	2	3	2	3	1%	10%	1%
Gross margins (%)									
Blended gross margin	81%	83%	80%	58%	51%	47%	-8%	-12%	-12%
Operating expenses									
OPEX (% of sales)	85%	93%	88%	42%	23%	11%	-16%	-30%	-40%

Source: Redeye, Neonode

Valuation scenarios: Estimates summary (USD million)						
	(USDm)		CAGR (%), per years		Weighted avr.	Long-term (%)
	2017E	2021E	18-21E	18-24E	17-21E	
Total sales						
Bear	16	49	32%	17%	33	2.0%
Base	14	124	71%	39%	63	2.0%
Bull	15	269	105%	39%	134	2.0%
EBIT						
Bear	-1	8	166%	68%	3	-
Base	-1	35	120%	56%	15	-
Bull	-1	97	96%	42%	48	-
EBIT (%)						
Bear	-9%	16%	-	-	8%	15%
Base	-10%	28%	-	-	24%	20%
Bull	-10%	36%	-	-	35%	25%

Source: Redeye, Neonode

Base Case Scenario

In our base case we expect Neonode to be able to pivot from licenses to modules although it would take a little bit longer than the company itself believes. We expect modules to account for about 39 and 20 percent of automotive and printers volumes respectively, in 2019, which will more than offset the license ASP erosion of on average 3-4 percent a year.

We estimate a 71 percent CAGR automotive volume growth during 2017-2021 where infotainment volumes continue to grow in line with the market and Neonode keeps its market share of about 4 percent. The remaining growth is divided by door handle sensors, tailgate and steering wheels.

As for printers we assume a growing touch penetration from 2015 levels of 50 percent to around 65 percent in 2021, equal to an addressable market of about 65 million printers of which Neonode would capture about 26 percent. We expect around 50 percent of these printers to come from HP. Our assumed growing printer module penetration with 94 percent module revenue in 2021 means blended ASP could be $2.6, implying a 40 percent CAGR from today's levels.

We expect AirBar volumes reaching around 300 000 in 2021 where they remain steady, meaning about 0.2 percent of all PCs and notebooks sold annually. With a mix of 97 percent Ingram and partners and 3 percent OEM sales we estimate a blended ASP of $40 for 2020.

We assume average module gross margins of 48 percent for all applications during 2017-2021, decreasing to 45 percent. Our 23 percent OPEX of sales in 2021 implies scalability as it expects a CAGR growth of only 21 percent during 2017-2021, considerably less than the sales growth.

From the assumptions mentioned above we derive a CAGR sales growth of 71 percent during years 2017-2021 with an average EBIT margin of 24 percent. Following this high margin stage, margins will start to approach the long-term EBIT margin of 20 percent. Together the assumptions result in a **base case of $3.0 per share**.

Bear Case scenario

Our investment case relies to a great extent on the assumption that Neonode will succeed in its business model transition to modules. As Neonode's modules are gaining ground a total failure is no longer likely but we do believe that the conversion in bear case will take a few years longer as the different old models could live longer than expected. By lowering its ambitions and laying off people Neonode could easily maintain high profit margins but would then become a company of minor size with very limited growth possibilities.

We also expect decreasing market shares from dual sourcing of printer customers and a decline in the total printers shipped, which is not offset by higher touch penetration. We believe that the greatest risk in automotive is tier-1 suppliers launching their own optical touch modules and that this materializes in a reasonably pessimistic scenario. As for AirBar we expect it to be discontinued about a year from now.

Without the high profit growth from the module conversion Neonode would also easily be subjected to further patent infringements, causing a vicious circle of lower and lower sales, meaning lower and lower means to defend the IP and even more companies infringing on Neonode's patents.

In our bear case we also apply a higher margin of safety when it comes to the long-term technology risks as the many shortcomings of pro cap provide a massive incentive for development of existing and new technologies to replace pro cap. However, we do believe that pro cap in a bear case would prove to be more viable than expected due to suitable ITO replacements, preventing Neonode from expanding short and mid-term.

With the assumptions above we expect a slower CAGR sales growth of 32 percent during 2018-2021. The average EBIT margin during the same period would due to the high margins on licenses be 8 percent before reaching a long-term EBIT margin of 15 percent. In total, this corresponds to **a bear case valuation of $1.2 per share.**

Bull case scenario

In bull case we assume that everything runs smooth with the transition to modules. We also believe that the cars would include on average around 53 percent more modules than our base case, partly due to tailgate and door handle sensors but especially the steering wheel where Neonode could approach a double digit penetration as Autoliv approaches its target of doubling its market share. As for ASP we expect increased touchscreen sizes to be able to offset a large part of the ASP decline from the customers volume discounts.

For printers we expect the same strong demand for modules as in automotive. Printer volumes may have a zero-growth but we see a rapid surge in touch penetration from todays' 50 percent to 75 percent, whereof Neonode in bull case could capture around 40 percent.

In addition, the AirBar becomes a great success, paving the way for many additional products and modules in high as well as low volume segments.

From the assumptions above we estimate a CAGR sales growth of 105 percent during years 2018-2021 with an average EBIT margin of 35 percent. Hereafter we expect that margins will go down to a sustainable, long-term EBIT margin of solid 25 percent due to scalability and low investment needs. Together all these assumptions result in a **bull case valuation of Neonode of $6.2 per share**.

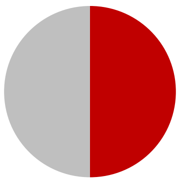
Summary Redeye Rating

The rating consists of five valuation keys, each constituting an overall assessment of several factors that are rated on a scale of 0 to 2 points. The maximum score for a valuation key is 10 points.

Rating changes in the report

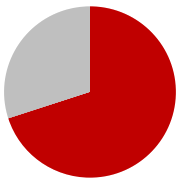
Financial strength lowered from 2 to 0. If communication does not improve we are required to lower the management score (see above).

Management 5.0p



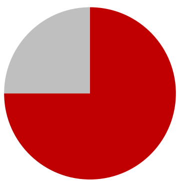
The CEO is the co-founder of Neonode and inventor of the technology. Overall, Management and Board have been long in the organization or have extensive experience from adjacent industries. Compensation levels are moderate but we feel that the exercise prices in the warrant programs are a bit too generous. Management has earlier missed its guidance on several occasions causing stock market mistrust but it has managed to successfully pivot from e-readers to automotive and printing, demonstrating years of consistent hard work and correctly focused efforts in order to be qualified. The large investments is thus now about to pay off. All in all, the factors mentioned are reassuring regarding the tough but sound business model shift from licenses to modules.

Ownership 7.0p



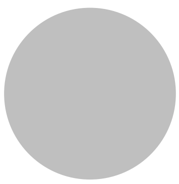
Both Board and Management are aboard, holding substantial amounts of shares; in particular the CEO and COB who are among the five largest owners. Reputable institutions also own significant positions. For a higher ownership score we would like to see a major shareholder with an even larger stake. At the moment no one holds a corner in Neonode.

Profit outlook 7.5p



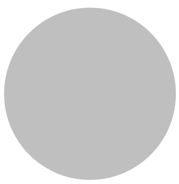
With the many competitive advantages of its unique, patented technology, Neonode is poised to benefit from the growing touch penetration. Following challenging qualification phases of up to 5 years Neonode will now be on the platforms for an impressive list of tier-1 customers for 10+ years, meaning substantial barriers to entry as Neonode will be included in all coming models on those platforms. Only the ramp-up in already launched models, where a majority is not even yet shipping, will together with the shift from licenses to modules support a strong growth for the coming years. In addition, the modules open up a world of new opportunities in segments with lower volumes.

Profitability 0.0p



As Neonode never before has been able to reach profitability our retrospective profitability Redeye Rating can be no more than 0. However, we believe that Neonode at the moment is around the point of inflection. The scalability and the low costs together with the growing existing customer relationships indicate that Neonode seems to have all the ingredients it takes to make significant profits in a not so distant future. At that point the rating would start to gradually increase.

Financial strength 0.0p



Neonode has a lean balance sheet without debt and basically no capitalized assets. The $8.7 million private placement in the fall 2016 has to a large extent disappeared now and we see a large risk for further dilutive capital raising. A rather small product portfolio and the major dependence (for now) on a few customers also pose risks.

Income statement	2015	2016	2017E	2018E	2019E
Net sales	11	10	14	29	55
Total operating costs	-18	-15	-16	-25	-41
EBITDA	**-7**	**-4**	**-1**	**4**	**14**
Depreciation	0	0	0	0	-1
Amortization	0	0	0	0	0
Impairment charges	0	0	0	0	0
EBIT	**-8**	**-5**	**-1**	**3**	**13**
Share in profits	0	0	0	0	0
Net financial items	0	0	0	0	0
Exchange rate dif.	0	0	0	0	0
Pre-tax profit	**-8**	**-5**	**-1**	**3**	**13**
Tax	0	0	0	0	-1
Net earnings	**-8**	**-5**	**-1**	**3**	**12**

Balance	2015	2016	2017E	2018E	2019E
Assets					
Current assets					
Cash in banks	3	3	3	5	15
Receivables	1	2	2	4	7
Inventories	0	1	1	4	8
Other current assets	1	2	3	6	11
Current assets	**5**	**8**	**9**	**19**	**42**
Fixed assets					
Tangible assets	1	2	2	3	4
Associated comp.	0	0	0	0	0
Investments	0	0	0	0	0
Goodwill	0	0	0	0	0
Cap. exp. for dev.	0	0	0	0	0
O intangible rights	0	0	0	1	2
O non-current assets	0	0	0	0	0
Total fixed assets	**1**	**2**	**2**	**4**	**7**
Deferred tax assets	0	0	0	0	0
Total (assets)	**6**	**10**	**12**	**23**	**48**
Liabilities					
Current liabilities					
Short-term debt	0	0	0	0	0
Accounts payable	1	1	1	3	6
O current liabilities	3	3	6	12	20
Current liabilities	**4**	**5**	**7**	**15**	**26**
Long-term debt	0	0	0	0	0
O long-term liabilities	0	1	2	2	5
Convertibles	0	0	0	0	0
Total Liabilities	**4**	**6**	**9**	**17**	**31**
Deferred tax liab	0	0	0	0	0
Provisions	0	0	0	0	0
Shareholders' equity	2	5	3	6	18
Minority interest (BS)	0	0	0	0	0
Minority & equity	**2**	**4**	**3**	**6**	**18**
Total liab & SE	**6**	**10**	**12**	**23**	**48**

Free cash flow	2015	2016	2017E	2018E	2019E
Net sales	11	10	14	29	55
Total operating costs	-18	-15	-16	-25	-41
Depreciations total	0	-1	0	0	-1
EBIT	**-8**	**-5**	**-1**	**3**	**13**
Taxes on EBIT	0	0	0	0	0
NOPLAT	**-8**	**-5**	**-1**	**3**	**13**
Depreciation	0	1	0	0	1
Gross cash flow	**-7**	**-4**	**-1**	**4**	**14**
Change in WC	-2	-1	1	0	-2
Gross CAPEX	0	-2	-1	-2	-4
Free cash flow	**-9**	**-8**	**-1**	**2**	**8**

Capital structure	2015	2016	2017E	2018E	2019E
Equity ratio	31%	43%	23%	26%	37%
Debt/equity ratio	0%	0%	0%	0%	0%
Net debt	-3	-3	-3	-5	-15
Capital employed	-1	1	-1	1	2
Capital turnover rate	1.9	1.1	1.2	1.3	1.1

Growth	2015	2016	2017E	2018E	2019E
Sales growth	134%	-8%	42%	97%	93%
EPS growth (adj)	-48%	-42%	-73%	-331%	262%

DCF valuation		Cash flow, MUSD	
WACC (%)	15.2 %	NPV FCF (2017-2019)	8
		NPV FCF (2020-2026)	71
		NPV FCF (2027-)	55
		Non-operating assets	11
		Interest-bearing debt	0
		Fair value estimate MUSD	145
Assumptions 2017-2023 (%)			
Average sales growth	47.7 %	**Fair value e. per share, USD**	**3.0**
EBIT margin	20.1 %	Share price, USD	1.3

Profitability	2015	2016	2017E	2018E	2019E
ROE	-299%	-155%	-37%	69%	96%
ROCE	-302%	-172%	-44%	75%	110%
ROIC	269%	416%	-227%	-655%	2141%
EBITDA margin	-66%	-43%	-8%	13%	25%
EBIT margin	-69%	-50%	-10%	11%	24%
Net margin	-69%	-48%	-10%	11%	21%

Data per share	2015	2016	2017E	2018E	2019E
EPS	-0.19	-0.11	-0.03	0.07	0.24
EPS adj	-0.19	-0.11	-0.03	0.07	0.24
Dividend	0.00	0.00	0.00	0.00	0.00
Net debt	-0.07	-0.08	-0.07	-0.11	-0.32
Total shares	41.20	45.68	48.84	48.84	48.84

Valuation	2015	2016	2017E	2018E	2019E
EV	-3.1	50.6	48.7	50.1	42.2
P/E	0.0	-12.0	-44.5	19.3	5.3
P/E diluted	0.0	-12.0	-44.5	19.3	5.3
P/Sales	0.0	5.8	4.3	2.2	1.1
EV/Sales	-0.3	5.0	3.4	1.8	0.8
EV/EBITDA	0.4	-11.5	-43.7	13.5	3.0
EV/EBIT	0.4	-9.8	-32.6	15.4	3.2
P/BV	0.0	13.1	19.1	9.3	3.2

Share performance		Growth/year	15/17e
1 month	-15.7 %	Net sales	14.2 %
3 month	-19.4 %	Operating profit adj	-56.0 %
12 month	-24.6 %	EPS, just	-60.5 %
Since start of the year	-29.9 %	Equity	21.4 %

Shareholder structure %	Capital	Votes

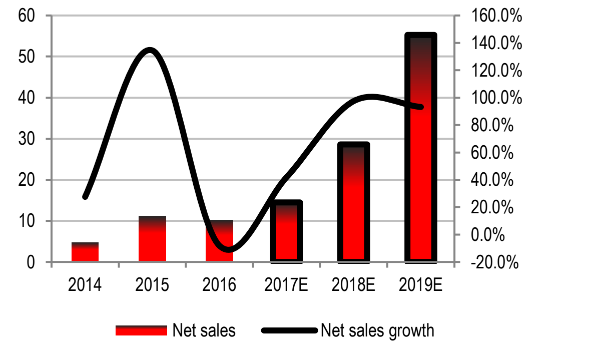
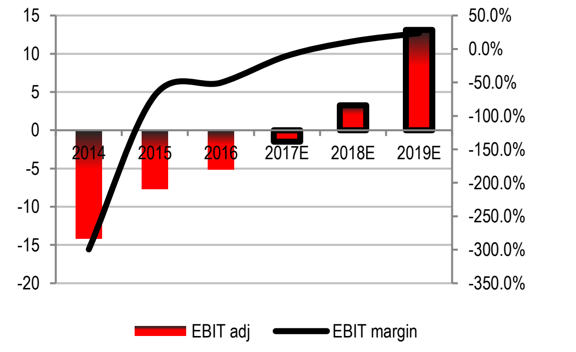
Ownerhip structure newer than December 31 2016 currently not available.

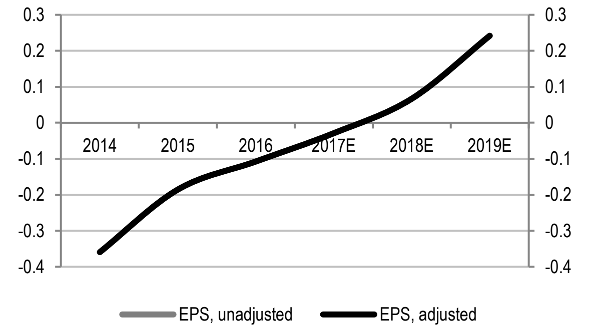
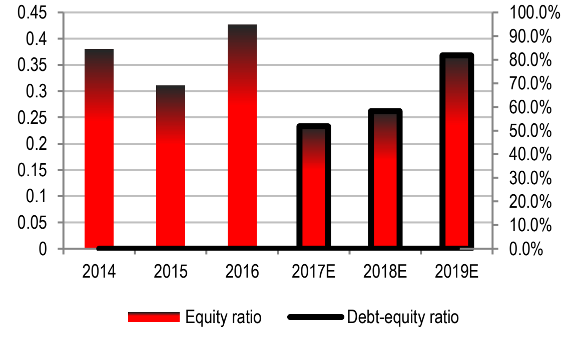
Share information	
Reuters code	NEON.OQ
List	NASDAQ
Share price	1.3
Total shares, million	48.8
Market Cap, MUSD	58.9

Management & board	
CEO	Thomas Eriksson
CFO	Lars Lindqvist
IR	Lars Lindqvist
Chairman	Per Bystedt

Analysts	Redeye AB
Viktor Westman	Mäster Samuelsgatan 42, 10tr
viktor.westman@redeye.se	111 57 Stockholm

Havan Hanna
havan.hanna@redeye.se

Revenue & Growth (%)	EBIT (adjusted) & Margin (%)
	

Earnings per share	Equity & debt-equity ratio (%)
	

Conflict of interests

Viktor Westman owns shares in the company : Yes
Havan Hanna owns shares in the company : No

Redeye performs/have performed services for the Company and receives/have received compensation from the Company in connection with this.

Company description

Neonode (Nasdaq:NEON) is a publicly traded company within human interaction technology, headquartered in Stockholm. The proprietary zForce technology is based on invisible light, which does not need the fragile and expensive glass overlay, in contrast to the traditional capacitive solutions. The result is competitive advantages for NEON in e.g. cost, power consumption and user experience. The solutions are used in e.g. consumer and industrial electronic devices like tablets, e-readers, toys, gaming consoles, printers and automotive.

DISCLAIMER

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Redeye does not issue any investment recommendations for fundamental analysis. However, Redeye has developed a proprietary analysis and rating model, Redeye Rating, in which each company is analyzed and evaluated. This analysis aims to provide an independent assessment of the company in question, its opportunities, risks, etc. The purpose is to provide an objective and professional set of data for owners and investors to use in their decision-making.

Redeye Rating (2017-05-19)

Rating	Management	Ownership	Profit outlook	Profitability	Financial Strength
7,5p - 10,0p	44	44	17	11	21
3,5p - 7,0p	70	62	98	34	44
0,0p - 3,0p	13	22	13	83	63
Company N	127	128	128	128	128

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