

Neonode, Inc
Form 10-K
March 29, 2010

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

FORM 10-K
b ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2009

or

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

For the transition period from to

Commission File No. 0-8419

NEONODE INC.
(Exact name of Registrant as specified in its charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

94-1517641
(I.R.S. Employer
Identification Number)

Sweden Linnegatan 89, SE-115 23 Stockholm, Sweden
USA 651 Byrdee Way, Lafayette, CA 94549
(Address of principal executive offices and Zip Code)

Sweden + 46 8 667 17 17
USA + 1 925 768 0620
(Registrant's Telephone Numbers, including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock	NONE

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes " No ý

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Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or 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 No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The approximate aggregate market value of the common stock held by non-affiliates of the registrant, based on the closing price for the registrant's common stock on June 30, 2009 (the last business day of the second quarter of the registrant's current fiscal year) as reported on the Nasdaq Capital Markets, was \$3,861,252.

The number of shares of the registrant's common stock outstanding as of March 24, 2010 was 426,985,185.

The number of shares of the registrant's Series A Preferred stock outstanding as of March 24, 2010 was 68,120.

The number of shares of the registrant's Series B Preferred stock outstanding as of March 24, 2010 was 9,875.

DOCUMENTS INCORPORATED BY REFERENCE

Exhibits incorporated by reference are referred to in Part IV.

NEONODE INC.

2009 ANNUAL REPORT ON FORM 10-K

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SPECIAL NOTE ON FORWARD LOOKING STATEMENTS

Certain statements set forth in or incorporated by reference in this Annual Report on Form 10-K constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements include, without limitation, our expectations regarding the adequacy of anticipated sources of cash, planned capital expenditures, the effect of interest rate increases, and trends or expectations regarding our operations. Words such as “may,” “will,” “should,” “believes,” “anticipates,” “expects,” “intends,” “plans,” “estimates” and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Such statements are based on currently available operating, financial and competitive information and are subject to various risks and uncertainties. Readers are cautioned that the forward-looking statements reflect management’s estimates only as of the date hereof, and we assume no obligation to update these statements, even if new information becomes available or other events occur in the future. Actual future results, events and trends may differ materially from those expressed in or implied by such statements depending on a variety of factors, including, but not limited to those set forth under “Item 1A Risk Factors” and elsewhere in this Annual Report on Form 10-K.

PART I

ITEM 1. BUSINESS

We provide optical touchscreen solutions for handheld consumer and industrial electronic devices. We license our touchscreen technology to Original Equipment Manufacturers (OEMs) and Original Design Manufacturers (ODMs) who imbed our touchscreen technology into electronic devices that they develop and sell, such as mobile phones, e-book readers, mobile internet devices, global positioning systems (GPS), digital picture frames and micro PCs. The cornerstone of our solution is our innovative optical infrared touchscreen technology, zForce™. We believe that keyboards and keypads with moving parts will become obsolete for handheld devices and that our touchscreen solutions will be at the forefront of a new wave of finger-based and pen input technologies that will enable the user to interact and operate everything from small mobile devices to large industrial applications using a combination of touches, swipes, and hand gestures.

Our History

Neonode Inc. (the Company), formerly known as SBE, Inc., was incorporated in the State of Delaware on September 4, 1997.

On August 10, 2007, SBE, Inc. consummated a reverse merger transaction with Neonode Inc., and SBE, Inc.’s name was subsequently changed to “Neonode Inc.” on the completion of the Merger. Neonode Inc. prior to the Merger was incorporated in the State of Delaware in 2006 and was the parent of Neonode AB, a company founded in February 2004 and incorporated in Sweden. Following the closing of the Merger, the business and operations of Neonode Inc. prior to the Merger became the primary business and operations of the newly-combined company. The newly-combined company’s headquarters was located in Stockholm, Sweden.

Through our previously wholly-owned subsidiary, Neonode AB, we developed our touchscreen technology and an optical touchscreen mobile phone product, the N2. We began shipping the N2 to our first customers in July 2007 but faced difficult circumstances in finding a viable market for our N2 mobile phone. We did not generate sufficient cash flow from the sale of N2 mobile phones to continue operations and Neonode AB filed for liquidation under the Swedish bankruptcy laws on December 9, 2008. As of that date, Neonode AB ceased to be owned and operated by Neonode Inc. Effective with Neonode AB’s bankruptcy filing on December 9, 2008, Neonode Inc. ceased to have any financial obligations related to the accounts payable or other debts of Neonode AB. The operations of Neonode AB

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for the period January 1, 2008 through December 9, 2008 are included in the consolidated accounts of Neonode Inc. for the year ended December 31, 2008.

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2008 Corporate Restructuring

AB Cypresen AB nr 9683 (Cypresen) (subsequently renamed Neonode Technologies AB), a company incorporated in Sweden, was acquired by Neonode Inc. on December 29, 2008 and became a wholly-owned subsidiary of Neonode Inc. on that date. Neonode Inc. issued shares of its Series A Preferred stock to the stockholders of Neonode Technologies AB in exchange for all of the outstanding stock of Neonode Technologies AB. The Neonode Technologies AB stockholders were employees of the Company and/or Neonode AB and, as such, are related parties. Neonode Technologies AB did not have any operations in 2008. The Consolidated Balance Sheet of the Company as of December 31, 2008 includes the accounts of Neonode Technologies AB which is comprised of cash totaling approximately \$12,000. The acquisition of Neonode Technologies AB by Neonode Inc. does not qualify as a business combination, and accordingly the fair value of the shares of Series A Preferred Stock issued to the sellers of Neonode Technologies AB shares are accounted for as compensation. As there is an 18 month service requirement related to the Neonode Inc. shares issued to the Neonode Technologies AB shareholders, the value of the Series A Preferred Stock is amortized over the 18 month service period beginning December 31, 2008.

In 2008, as a result of our inability to sell a sufficient number of mobile phones to support our operations, we took the following actions to restructure and refinance the Company:

- On October 22, 2008, Neonode Inc.'s previously wholly-owned Swedish subsidiary, Neonode AB, filed for company reorganization in compliance with the Swedish Reorganization Act (1996:764). Mr. Anders W. Bengtsson of the Stockholm-based law firm Nova was appointed to administer the process. In accordance with §16 of the Swedish Reorganization Act, a Neonode AB creditors' meeting was held at the district court of Stockholm, Sweden on November 11, 2008;
- On October 22, 2008, we terminated our agreement with Distribution Management Consolidators Worldwide, LLC (DMC Worldwide) and dissolved Neonode USA, which had been created for the sole purpose of distributing the N2 in the US and China and licensing our technology worldwide;
- On December 1, 2008, we transferred the intellectual property of Neonode AB, including all patents, copyrights and trademarks to Neonode Inc. pursuant to an intercompany debt pledge agreement.
- On December 9, 2008, Neonode AB filed a petition for bankruptcy in compliance with the Swedish Bankruptcy Act (1987:672) as a direct result of the failure to reach a satisfactory settlement agreement with the creditors of Neonode AB. Mr. Hans Ödén of the Stockholm-based Ackordscentralen AB, a consultancy firm specializing in insolvency, was appointed by the district court of Stockholm to administer the process. Under Swedish bankruptcy law, effective with the bankruptcy filing we no longer have an ownership interest in Neonode AB, and, as such, we are no longer responsible for the liabilities of Neonode AB and we no longer have title or an ownership interest in the assets of Neonode AB. The Swedish bankruptcy court appointed a Swedish legal firm as receiver with the expressed duty to liquidate all the assets of Neonode AB and enter into final settlements with the creditors of Neonode AB.
- On December 29, 2008, we entered into a Share Exchange Agreement with Neonode Technologies AB, a Swedish engineering company, and the stockholders of Neonode Technologies AB: Iwo Jima SARL, Wirelesstoys AB, and Athemis Ltd. (the "Neonode Technologies AB Stockholders"), pursuant to which we agreed to acquire all of the issued and outstanding shares of Neonode Technologies AB in exchange for the issuance of shares of Neonode Inc. Series A Preferred Stock to the Neonode Technologies AB Stockholders. Pursuant to the terms of the Share Exchange Agreement, upon the closing of the transaction, Neonode Technologies AB became a wholly-owned subsidiary of the Company;

- On December 30, 2008, we entered into a restructuring transaction in which we converted the majority of the outstanding warrants and convertible debt that had been issued in previous financing transactions to shares of Series A and B Preferred stock, respectively, that are convertible into shares of our common stock in accordance with the Company's Certificate of Designations filed with the Delaware Secretary of State;

- On December 30, 2008, we entered into a financing transaction in which we raised approximately \$1.1 million as of December 31, 2008 through the sale of shares of Series A Preferred Stock that are convertible into shares of our common stock in accordance with the Company's Certificate of Designations filed with the Delaware Secretary of State;

2009 Corporate Financing

- On January 21, 2009, we entered into a settlement agreement with Alpha Capital Anstalt (Alpha) whereby we issued shares of our common stock to settle a claim that Alpha made that we had failed to issue certain stock certificates pursuant to the terms and conditions of certain prior investment subscription agreements;
- On January 23, 2009, we issued shares of our common stock to vendors of Neonode Inc. in settlement of approximately \$53,000 in outstanding Neonode Inc. accounts payable;
- On September 8, 2009, we entered into a private placement financing transaction and issued \$986,983 in notes with a 7% annual interest rate, due December 31, 2010, that are convertible into approximately 49.4 million shares of our common stock. We also issued warrants that, if exercised, are convertible into 24.7 million shares of our common stock at an exercise price of \$0.04 per share.

We have not generated sufficient cash from the sale of our products or licensing of our technology to support our operations and have incurred significant losses. During the twelve months ended December 31, 2008 and 2009, we raised approximately \$9.6 million and \$1.0 million, respectively, net cash proceeds through the sale of our securities and convertible debt. Unless we are able to increase our revenues and/or decrease expenses substantially in addition to securing additional sources of financing, we will not have sufficient cash to support our operations through June 2010.

Touchscreen Product Solutions

We develop touchscreen technologies that enrich the user's experience in interacting with the user's mobile computing, communications, and entertainment devices. Our innovative touchscreen technology can be engineered to accommodate many diverse platforms and our experience in human factors and usability can be utilized to improve the features and functionality of our solutions. Our extensive array of technology includes software, mechanical and electrical designs, and pattern recognition and touch sensing technologies.

Our touchscreen solutions for our customers include sensor design, module layout, and software features for which we provide design support and device testing. This allows us to be a one-stop supplier for complete touchscreen design from the early design stage to testing and support. Through our technologies and expertise, we seek to provide our customers with solutions that address their individual design issues and that will result in high-performance, feature-rich, and reliable touchscreen interface solutions.

Technologies

Our touchscreen solutions are based on our patented zForce™ and Neno™ hardware and software technology. zForce™ is our optical infrared touchscreen technology that supports one-handed navigation, allowing the user to operate the functionality with finger gestures passing over the screen. Neno™ is our software-based user interface.

zForce™ has been patented in several countries and is patent-pending in the US. It uses infrared light that is projected as a grid over the screen. The infrared light pulses 120 times a second so that the grid is constantly being refreshed. Coordinates are produced on the screen and are then converted into mathematical algorithms when a user's fingers move across the screen. This input method is unique to Neonode and is enabled by the zForce™ technology.

Currently, there are two dominant types of touchscreen technologies available in the market - capacitive and resistive. Capacitive technology is the technology that the Apple iPhone uses and resistive technology is what is found on most stylus-based PDAs. Resistive technology is pressure sensitive technology. Best used for detailed work and for selection of a particular spot on a screen, resistive technology is not useful for sweeping gestures or motion, such as zooming in and out. Capacitive technology, which is used on a laptop computer mouse pad, is very good for sweeping gestures and motion. The screen actually reacts to the finger's tiny electric impulses. Capacitive touchscreens work only if the user has unimpeded contact between his finger and the screen.

Our zForce™ optical touchscreen technology has a number of key advantages over each of these technologies, including:

- No additional layers are added to the screen that may dilute the screen resolution and clarity. Layering technology is required to activate the capacitive and resistive technologies and can be very costly;
- The zForce™ grid technology is more responsive than the capacitive screen technology and, as a result, is quicker and less prone to misreads. It allows movement and sweeping motions as compared to point-sensitive, stylus-based resistive screens;
- zForce™, an abbreviation for zero force necessary, obviates the need to use any force to select or move items on the screen as would be the case with a stylus;
- zForce™ is cost-efficient due to the lower cost of materials and extremely simple manufacturing process when compared to the expensive layered capacitive and resistive screens; and
- zForce™ allows multiple methods of input, such as simple finger taps to hit keys, sweeps to zoom in or out, and gestures to write text or symbols directly on the screen.

zForce™ incorporates some of the best functionalities of both the capacitive and resistive touchscreen technologies. It works in all climates and, unlike the competing technologies, can be used with gloves. In addition, zForce™ allows for waterproofing of the device.

Because of its uniqueness and flexibility, we believe that our zForce™ technology presents a tremendous licensing opportunity for Neonode. The market is vast, given the current rapid increase in touchscreen-based devices such as cell phones, PCs, media players, and GPS navigation devices.

Our software user interface, Neno™, runs on Windows CE and is completely unique. Neno™ is designed to operate complex and full feature applications on a small screen. It allows for a number of input methods and is designed to deliver high precision, fast response, and ease of use on a complex device.

Neno™ includes the following features:

- Media players for streaming video, movies and music that support all the standard applications, including WMA, WMV, MP3, WAV, DivX and AVI MPEG4;
- Internet explorer 6.0 browser;
- Image viewer with camera preview and capture;

- Organizer with calendar and task with Microsoft Outlook synchronization;
- Calendar, alarm, calculator and call list;
- Telephony manager for voice calls;
- Messaging manager for SMS, MMS, IM and T9;
- File manager;
- Task manager for switching between applications;
- Notebook; and
- Games.

Intellectual Property

We believe that innovation in product engineering, sales, marketing, support, and customer relations, and protection of this proprietary technology and knowledge, will impact our future success. In addition to certain patents that are pending, we rely on a combination of copyright, trademark, trade secret laws and contractual provisions to establish and protect the proprietary rights in our products.

We have applied for patent protection of our invention named “On a substrate formed or resting display arrangement” in six countries through a patent cooperation treaty (PCT) application and in 24 designated countries through an application to the European Patent Office (EPO). We applied for a patent in Sweden relating to a mobile phone and have also applied for a patent in the United States regarding software named “User Interface.”

We have been granted trademark protection for the word NEONODE in the European Union (EU), Sweden, Norway, and Australia. In addition, we have been granted protection for the figurative mark NEONODE in Sweden. Additional applications for the figurative trademark are still pending in Switzerland, China, Russia, and the United States.

Our “User Interface” may also be protected by copyright laws in most countries, especially Sweden and the EU (which do not grant patent protection for the software itself), if the software is new and original. Protection can be claimed from the date of creation.

Consistent with our efforts to maintain the confidentiality and ownership of our trade secrets and other confidential information, and to protect and build our intellectual property rights, we require our employees and consultants, and certain customers, manufacturers, suppliers and other persons with whom we do business or may potentially do business, to execute confidentiality and invention assignment agreements upon commencement of a relationship with us, typically extending for a period of time beyond termination of the relationship.

Distribution, Sales and Marketing

We consider both OEMs and ODMs and their contract manufacturers to be our primary customers. Both the OEMs, ODMs and their contract manufacturers may determine the design and pricing requirements and make the overall decision regarding the use of our user interface solutions in their products. The use and pricing of our interface solutions will be governed by a technology licensing agreement.

Our sales staff solicits prospective customers and our sales personnel receive substantial technical assistance and support from our internal engineering resources because of the highly technical nature of our product solutions. We expect that sales will frequently result from multi-level sales efforts that involve senior management, design engineers, and our sales personnel interacting with our potential customers’ decision-makers throughout the product development and order process.

Our sales are normally negotiated and executed in U.S. Dollars or Euros.

Our sales force and marketing operations are managed out of our corporate headquarters in Stockholm, Sweden, and our current sales force is comprised of consultants located in Stockholm, Korea and Australia.

Research and Development

We continue to invest in research and development of current and emerging technologies that we deem critical to maintaining our competitive position in the touchscreen user interface markets. Many factors are involved in determining the strategic direction of our product development focus, including trends and developments in the

marketplace, competitive analyses, market demands, business conditions, and feedback from our customers and strategic partners. In fiscal years 2009 and 2008, we spent \$1.0 million and \$3.3 million, respectively, on research and development activities.

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We carefully monitor innovations in other technologies and are constantly seeking new areas for application of zForce™. We have developed a technology roadmap that we believe will result in a steady stream of new innovations and areas of use. We no longer develop mobile phone products, but now focus our development efforts on our touchscreen technology.

Our research and development is predominantly in-house, but is also done in close collaboration with external partners and specialists. Our development areas can be divided into the following areas:

- Software
- Optical
- Mechanical
- Electrical

Recent Developments

During the period from August 25, 2009 through December 31, 2009, we completed a private placement of convertible notes totaling \$987,000 that can be converted, at the holder's option, into 49,349,151 shares of our common stock at a conversion price of \$0.02 per share. The convertible note holders have the right to have the conversion price adjusted to equal the lower stock price if we issue stock or convertible notes at a lower conversion price than \$0.02 during the period that the notes are outstanding. These convertible notes are due on December 31, 2010 and bear an annual interest rate of 7%, payable on June 30 and December 31 of each year that the convertible notes are outstanding. In addition, we issued 24,674,576 three-year warrants to the convertible note holders with an exercise price of \$0.04 per share. The warrants may be exercised and converted to common stock, at the warrant holder's option, beginning on the six-month anniversary date of issuance until the warrant expiration date. We are not obligated to register the common stock related to the convertible debt or the warrants.

In the three months ended March 31, 2010, we received \$1.2 million proceeds related to a private placement of convertible notes and stock purchase warrants that can be converted, at the holder's option, into 60,160,564 shares of our common stock at a conversion price of \$0.02 per share and 30,080,282 stock purchase warrants that have an exercise price of \$0.04 per share. The convertible note holders have the right to have the conversion price adjusted to equal the lower stock price if we issue stock or convertible notes at a lower conversion price than \$0.02 during the period that the notes are outstanding. These convertible notes are due on December 31, 2010 and bear an annual interest rate of 7%, payable on June 30 and December 31 of each year that the convertible notes are outstanding. The warrants may be exercised and converted to common stock, at the warrant holder's option, beginning on the six month anniversary date of issuance until the warrant expiration date. We are not obligated to register the common stock related to the convertible debt or the warrants. On March 21, 2010, we issued 875,000 shares of our common stock and a warrant to purchase 875,000 of our common stock an exercise price of \$0.04 per share to DAVIS Ltd for services provided for the private placement of convertible note and warrant in the March 2010 financing transaction.

Overview of the Touchscreen Market and Competition

Competing Touchscreen Technologies:

Today there are different touchscreen technologies available in the market. all of them with different or slightly different profiles, level of maturity, and cost price:

- Resistive -- uses conductive and resistive layers separated by thin space;
- Surface acoustic wave -- uses ultrasonic waves that pass over the touchscreen panel;

-

Capacitive and projected capacitive -- a capacitive touchscreen panel is coated with a material, typically indium tin oxide, that conducts a continuous electrical current across the sensor. When the sensor's 'normal' capacitance field (its reference state) is altered by another capacitance field, e.g., someone's finger, electronic circuits located at each corner of the panel measure the resultant 'distortion' in the sine wave characteristics to detect a touch;

- Infrared -- uses infrared beams that are broken by finger or heat from the finger sensed from a camera to detect a touch;
- Strain gauge -- uses a spring mounted on the four corners and strain gauges are used to determine deflection when the screen is touched;
- Optical imaging -- uses two or more image sensors placed around the edges (mostly the corners) of the screen and a light source to create a shadow of the finger;
- In-cell optical touch technology -- embeds photo sensors directly into an LCD glass. By integrating the touch function directly into an LCD glass, the LCD acts like a low resolution camera to “see” the shadow of the finger;
- Dispersive signal technology -- uses sensors to detect the mechanical energy in the glass that occur due to a touch; and
- Acoustic pulse recognition -- uses more than two piezoelectric transducers located at some positions of the screen to turn the mechanical energy of a touch (vibration) into an electronic signal.

The following are the advantages and disadvantages of the most common competing touchscreen technologies:

Resistive Touchscreen Technology:

1. Uses conductive and resistive layers separated by a thin space.
2. Touch creates contact between resistive circuit layers closing a switch.
3. A controller layer is inserted between layers to determine touch coordinates.

Advantages:

- § High resolution
- § Low cost
- § Proven solution for low cost touchscreen applications
- § Support for large screen sizes

Disadvantages:

- § Not fully transparent (more backlight needed, which requires high power consumption; reflections; loss of colors)
 - § Requires frequent recalibration to work properly
- § Large frame size (limited active area of the total display area and outer dimensions of the device)
 - § Sensitive to scratches

Surface Capacitive Touchscreen Technology:

1. Two sides of a glass substrate are coated with uniform conductive indium tin oxide coating (ITO). Silicon dioxide hard coating is coated on the front side of ITO coating layer. There are electrodes on the four corners for launching electric current.
 2. Voltage is applied to the electrodes on the four corners.
 3. A finger touches the screen and draws a minute amount of current to the point of contact.
4. The controller precisely calculates the proportion of the current passed through the four electrodes and calculates the X/Y coordinate of a touch point.

Advantages:

- § No “edge” or bezel on the top of the on the screen display
- § Medium to high resolution
- § Support for large screen sizes

Disadvantages:

- § Expensive, typically three to four times the cost of a resistive touchscreen solution
- § Not fully transparent (more backlight needed, which requires high power consumption; reflections; loss of colors)
 - § Cannot be used with gloves or pen. Only supports fingers
 - § Limited temperature range for operation
 - § Limited capturing speed (for gestures)