

EMAGIN CORP  
Form 10-Q/A  
October 11, 2011

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

Form 10-Q/A

Amendment No. 1 to Form 10-Q

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the quarterly period ended March 31, 2009  
or

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

For the transition period from            to

Commission file number 001-15751

eMAGIN CORPORATION

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

56-1764501  
(I.R.S. Employer  
Identification No.)

3006 Northup Way, Suite 103, Bellevue, Washington 98004  
(Address of principal executive offices)

(425) 284-5200  
(Registrant's telephone number, including area code)

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

Securities registered pursuant to Section 12(g) of the Act: Common Stock, \$.001 Par Value Per Share

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 for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

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(§232.405 of this chapter) during the preceding 12 months ). Yes " No "

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

The number of shares of common stock outstanding as of April 30, 2009 was 16,192,135.

eMagin Corporation  
 Form 10-Q/A  
 For the Quarter ended March 31, 2009

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EXPLANATORY NOTE

This Amendment No. 1 hereby amends our Quarterly Report on Form 10-Q (“Form 10-Q/A”) for the period ended March 31, 2009, which was originally filed with the Securities and Exchange Commission on May 14, 2009 (the “Original 10-Q”). This Amendment is being filed mainly to include restated condensed consolidated financial statements as described in Note 15, Restatement, of the Notes to the Condensed Consolidated Financial Statements. The condensed consolidated financial statements are being restated to correct accounting errors as follows:

Adoption of certain provisions of Accounting Standards Codification (“ASC”) 815 – “Derivatives and Hedging – Contracts in Entity’s Own Equity” (“ASC 815”) (formerly EITF 07-5, “Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity’s Own Stock”). ASC 815 became effective January 1, 2009. The anti-dilution features in certain outstanding warrants (“Warrants”) of the Company require these Warrants to be accounted for as liabilities and measured at fair value. The restated condensed consolidated financial statements reflect the reclassification of the Warrants from shareholders’ equity to warrant liability, the cumulative effect adjustment to the opening balance of accumulated deficit and record changes in the fair value of the warrant liability in the condensed consolidated statements of operations.

Adoption of the two-class method for Earnings Per Share (“EPS”) calculation under ASC 260, “Earnings Per Share” (“ASC 260”) (formerly “SFAS No. 128”). The two-class method is an earnings allocation method under which EPS is calculated for each class of common stock and participating security. Under the two-class method, securities that participate in dividends, such as the Company’s Series B Convertible Preferred stock, are considered ‘participating securities.’ The restated financial statements reflect the restated basic and diluted earnings per share, as applicable and weighted average shares outstanding calculations.

The following sections of this Form 10-Q/A have been amended to reflect the restatement:

- Part I – Item 1 – Financial Statements and Notes to the Condensed Consolidated Financial Statements
- Part I – Item 2 – Management’s Discussion and Analysis of Financial Condition and Result of Operations
- Part I – Item 4 – Controls and Procedures

For the convenience of the reader, this Form 10-Q/A sets forth the Company’s Original 10-Q in its entirety, as amended by, and to reflect the restatement, as described above. Except as discussed above, the Company has not modified or updated disclosures presented in this Amendment. Accordingly, this Amendment does not reflect events occurring after the Original 10-Q or modify or update those disclosures affected by subsequent events, except as specifically referenced herein. Information not affected by the restatement is unchanged and reflects the disclosures made at the time of the Original Filing.

This Form 10-Q/A has been signed as of a current date and all certifications of the Company’s Chief Executive Officer/Principal Executive Officer and Chief Financial Officer/Chief Accounting Officer and Principal Financial Officer are given as of a current date. Accordingly, this Form 10-Q/A should be read in conjunction with the Company’s filings with the Securities and Exchange Commission subsequent to the filing of the Original 10-Q, including any amendments to those filings.



## ITEM 1. Condensed Consolidated Financial Statements

eMAGIN CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEETS  
(In thousands, except share data)

	March 31, 2009 (unaudited) (Restated) See Note 15	December 31, 2008
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 2,329	\$ 2,404
Investments – held to maturity	97	97
Accounts receivable, net	2,950	3,643
Inventory	2,214	2,374
Prepaid expenses and other current assets	1,233	796
Total current assets	8,823	9,314
Equipment, furniture and leasehold improvements, net	391	381
Intangible assets, net	46	47
Deferred financing costs, net	212	362
Total assets	\$ 9,472	\$ 10,104
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 569	\$ 1,026
Accrued compensation	631	837
Other accrued expenses	1,152	804
Advance payments	649	694
Deferred revenue	120	164
Debt	682	1,691
Other current liabilities	917	798
Total current liabilities	4,720	6,014
Warrant liability	2,943	—
Total liabilities	\$ 7,663	\$ 6,014
Commitments and contingencies		
Redeemable common stock: 522,500 redeemable shares	429	429
Shareholders' equity:		
Preferred stock, \$.001 par value: authorized 10,000,000 shares:	—	—
Series B Convertible Preferred stock, (liquidation preference of \$5,739,000) stated value \$1,000 per share, \$.001 par value: 10,000 shares designated and 5,739 issued	—	—

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Common stock, \$.001 par value: authorized 200,000,000 shares, issued and outstanding, 15,429,863 shares as of March 31, 2009 and 15,213,959 as of December 31, 2008, net of redeemable common stock	15	15
Additional paid-in capital	189,995	204,818
Accumulated deficit	(188,630 )	(201,172 )
Total shareholders' equity	1,380	3,661
Total liabilities and shareholders' equity	\$ 9,472	\$ 10,104

See notes to Condensed Consolidated Financial Statements.



eMAGIN CORPORATION  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(In thousands, except share and per share data)  
(unaudited)

	Three Months Ended March 31, 2009 (Restated) See Note 15		2008
<b>Revenue:</b>			
Product revenue	\$	4,356	\$ 2,462
Contract revenue		788	203
Total revenue, net		5,144	2,665
<b>Cost of goods sold:</b>			
Product revenue		2,257	2,181
Contract revenue		428	132
Total cost of goods sold		2,685	2,313
Gross profit		2,459	352
<b>Operating expenses:</b>			
Research and development		362	674
Selling, general and administrative		1,529	1,807
Total operating expenses		1,891	2,481
Income (loss) from operations		568	(2,129)
<b>Other expense:</b>			
Interest expense, net		(175)	(631)
Other income, net		1	86
Change in fair value of warrant liability		(813)	—
Total other expense		(987)	(545)
Provision for income taxes		—	—
Net loss	\$	(419)	\$ (2,674)
Loss per share, basic	\$	(0.03)	\$ (0.21)
Loss per share, diluted	\$	(0.03)	\$ (0.21)
<b>Weighted average number of shares outstanding:</b>			
Basic		15,860,517	12,620,900
Diluted		15,860,517	12,620,900

See notes to Condensed Consolidated Financial Statements.

eMAGIN CORPORATION  
 CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY  
 (In thousands)

	Preferred Stock		Common Stock		Additional Paid-in Capital (Restated) See Note 15	Accumulated Deficit (Restated) See Note 15	Total Shareholders' Equity (Restated) See Note 15
	Shares	Amount	Shares	Amount			
Balance, December 31, 2008	6	\$ —	15,214	\$ 15	\$ 204,818	\$ (201,172 )	\$ 3,661
Cumulative effect of change in accounting principle	—	—	—	—	(15,091 )	12,961	(2,130 )
Issuance of common stock for services	—	—	216	—	115	—	115
Stock-based compensation	—	—	—	—	153	—	153
Net loss	—	—	—	—	—	(419 )	(419 )
Balance, March 31, 2009	6	\$ —	15,430	\$ 15	\$ 189,995	\$ (188,630 )	\$ 1,380

See notes to Condensed Consolidated Financial Statements.

eMAGIN CORPORATION  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (In thousands)

	Three Months Ended March 31, 2009 (Restated) See Note 15		2008  (unaudited)
<b>Cash flows from operating activities:</b>			
Net loss	\$	(419)	\$ (2,674)
<b>Adjustments to reconcile net loss to net cash provided by (used in) operating activities:</b>			
Depreciation and amortization		23	68
Amortization of deferred financing and waiver fees		150	448
Reduction of provision for sales returns and doubtful accounts		(114)	(47)
Stock-based compensation		153	356
Issuance of common stock for services		76	—
Change in the fair value of warrant liability		813	—
Amortization of discount on notes payable		—	25
<b>Changes in operating assets and liabilities:</b>			
Accounts receivable		807	329
Inventory		160	(11)
Prepaid expenses and other current assets		(398)	426
Deferred revenue		(44)	(79)
Accounts payable, accrued compensation, other accrued expenses, and advance payments		(359)	830
Other current liabilities		119	(244)
Net cash provided by (used in) operating activities		967	(573)
<b>Cash flows from investing activities:</b>			
Purchase of equipment		(33)	(231)
Net cash used in investing activities		(33)	(231)
<b>Cash flows from financing activities:</b>			
Proceeds from line of credit		—	700
Payments related to deferred financing costs		—	(9)
Payments of debt		(1,009)	(256)
Net cash (used in) provided by financing activities		(1,009)	435
Net decrease in cash and cash equivalents		(75)	(369)
Cash and cash equivalents, beginning of period		2,404	713
Cash and cash equivalents, end of period	\$	2,329	\$ 344
<b>Cash paid for interest</b>			
	\$	38	\$ 158
<b>Cash paid for taxes</b>			
	\$	21	\$ 10
<b>Common stock issued for services charged to prepaid expenses</b>			
	\$	39	\$ —

See notes to Condensed Consolidated Financial Statements.

eMAGIN CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

Note 1: Description of the Business and Summary of Significant Accounting Policies

The Business

eMagin Corporation (the “Company”) designs, develops, manufactures, and markets OLED (organic light emitting diode) on silicon microdisplays, virtual imaging products which utilize OLED microdisplays. The Company’s products are sold mainly in North America, Asia, and Europe.

Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements of eMagin Corporation and its subsidiary reflect all adjustments, including normal recurring accruals, necessary for a fair presentation. Certain information and footnote disclosure normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to instructions, rules and regulations prescribed by the Securities and Exchange Commission. The Company believes that the disclosures provided herein are adequate to make the information presented not misleading when these unaudited condensed consolidated financial statements are read in conjunction with the audited consolidated financial statements contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2008. The results of operations for the period ended March 31, 2009 are not necessarily indicative of the results to be expected for the full year.

In this Amended 10-Q, the Company restated its previously issued condensed consolidated financial statements as of and for the three months ended March 31, 2009 to correct errors in the accounting for certain warrants as discussed in Note 15, “Restatement”.

Reclassifications

Certain items in the prior period’s condensed consolidated financial statements have been reclassified to conform to the current period’s presentation.

Use of Estimates

In accordance with accounting principles generally accepted in the United States of America, management utilizes certain estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments. Management bases its estimates and judgments on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

Revenue and Cost Recognition

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, selling price is fixed or determinable and collection is reasonably assured. The Company records a reserve for estimated sales returns, which is reflected as a reduction of revenue at the time of revenue recognition. The Company defers revenue

recognition on products sold directly to the consumer with a maximum thirty day right of return. Revenue is recognized upon the expiration of the right of return.

The Company also earns revenues from certain R&D activities under both firm fixed-price contracts and cost-type contracts, including some cost-plus-fee contracts. Revenues relating to firm fixed-price contracts are generally recognized on the percentage-of-completion method of accounting as costs are incurred (cost-to-cost basis). Revenues on cost-plus-fee contracts include costs incurred plus a portion of estimated fees or profits based on the relationship of costs incurred to total estimated costs. Contract costs include all direct material and labor costs and an allocation of allowable indirect costs as defined by each contract, as periodically adjusted to reflect revised agreed upon rates. These rates are subject to audit by the other party.

#### Research and Development Costs

Research and development costs are expensed as incurred.

## Note 2: Recently Issued Accounting Pronouncements

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (“SFAS 161”). SFAS 161 requires entities to provide greater transparency about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations and (c) how derivative instruments and related hedged items affect an entity’s financial position, results of operations, and cash flows. SFAS 161 is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. The adoption of SFAS 161 did not have a material impact on the Company’s condensed consolidated financial statements.

In June 2008, the FASB ratified EITF No. 07-5, "Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity's Own Stock" ("EITF 07-5"). EITF 07-5 provides that an entity should use a two-step approach to evaluate whether an equity-linked financial instrument (or embedded feature) is indexed to its own stock, including evaluating the instrument's contingent exercise and settlement provisions. EITF 07-5 is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, and must be applied to all instruments outstanding on the date of adoption.

Effective January 1, 2009, the Company adopted EITF 07-5. As a result, warrants issued with anti-dilution provisions for the holder are no longer considered indexed to the Company’s stock and must be accounted for as derivatives. Upon adoption of this accounting guidance on January 1, 2009, the Company recorded a cumulative effect adjustment based on the grant date fair value of the outstanding warrants at January 1, 2009 and the change in fair value of the warrant liability from the issuance date through January 1, 2009. These warrants are reclassified as liabilities and recorded at estimated fair value at each reporting date using the Monte Carlo Simulation approach. Changes in the liability from period to period are recorded in the Condensed Consolidated Statements of Operations.

The Company has recorded the change in fair value of the warrant liability as a component of other income and expense on the Condensed Consolidated Statements of Operations as the Company believes the amounts recorded relate to financing activities and not as a result of its operations.

The Company recorded the following cumulative effect of change in accounting principle pursuant to its adoption of EITF 07-5 as of January 1, 2009 (in thousands):

	Additional Paid-In Capital	Warrant Liability	Accumulated Deficit
Grant date fair value of Warrants	\$ (15,091 )	\$ 15,091	\$
Change in fair value of Warrants outstanding through January 1, 2009		(12,961 )	12,961
Cumulative effect of change in accounting principle	\$ (15,091 )	\$ 2,130	\$ 12,961

The Company recorded other expense of \$813 thousand for the change in the fair value of the warrant liability during the three months ended March 31, 2009.

In April 2009, the FASB issued FASB Staff Position SFAS 107-1 and APB 28-1, “Interim Disclosures about Fair Value of Financial Instruments,” which requires disclosures about fair value of financial instruments in interim financial information for periods ending after June 15, 2009. The Company believes the adoption of this Staff Position will not have a material impact on our condensed consolidated financial statements.

Note 3: Fair Value Measurement

The Company measures fair value in accordance with SFAS No. 157, “Fair Value Measurements” (“SFAS 157”). SFAS No. 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value and expands disclosures about fair value measurements. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between participants at the measurement date. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1 – valued based on quoted prices at the measurement date for identical assets or liabilities trading in active markets.

Level 2 – quoted prices in active markets for similar assets and liabilities and inputs that are observable for the asset or liability.

Level 3 – valuations derived from valuation techniques in which one or more significant inputs are not readily observable.



## Recurring Fair Value Estimates

The Company's recurring fair value measurements at March 31, 2009 were as follows (in thousands):

	Fair Value as of March 31, 2009	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
Warrant liability	\$ 2,943	\$ —	\$ —	\$ 2,943

Note: Classification is based on warrant expiration date.

## Recurring Level 3 Activity, Reconciliation and Basis for Valuation

The table below provides a reconciliation of the beginning and ending balances for the liabilities measured at fair value using significant unobservable inputs (Level 3) (in thousands).

Balance as of January 1, 2009	\$ 2,130
Change in fair value of warrants	828
Fair value of expired warrants	(15 )
Balance as of March 31, 2009	\$ 2,943

Changes in fair value of the warrant liability are included in other expense in the accompanying unaudited condensed consolidated statements of operations.

The Company estimates the fair value of the warrant liability utilizing the Monte Carlo Simulation method. The use of this method assumes multiple probabilities. The following additional assumptions were used in the Monte Carlo Simulation model to determine the fair value of the warrant liability:

	March 31, 2009		January 1, 2009	
Risk-free interest rate	0.57% -	1.67 %	0.11% -	1.55 %
Expected volatility	96.1	%	94.4	%
Expected life ( in years)	1.0 - 4.75		0.02 - 5.0	
Expected dividend yield	0	%	0	%

## Note 4: Receivables

The majority of the Company's commercial accounts receivable is due from Original Equipment Manufacturers ("OEM's"). Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are payable in U.S. dollars, are due within 30-90 days and are stated at amounts due from customers, net of an allowance for doubtful accounts. Any account outstanding longer than the contractual payment terms is considered past due.

The Company determines the allowance for doubtful accounts by considering a number of factors, including the length of time the trade accounts receivable are past due, historical experience, the customer's current ability to pay its obligations, and the condition of the general economy and the industry as a whole. The Company will record a specific reserve for individual accounts when the Company becomes aware of a customer's inability to meet its

financial obligations, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position. If circumstances related to customers change, the Company would further adjust estimates of the recoverability of receivables.

Receivables consisted of the following (in thousands):

	March 31, 2009 (unaudited)	December 31, 2008
Accounts receivable	\$ 3,692	\$ 4,500
Less allowance for doubtful accounts	(742 )	(857 )
Net receivables	\$ 2,950	\$ 3,643

## Note 5 : Net Loss per Common Share – Restated

Basic loss per share (“Basic EPS”) is computed by dividing net loss by the weighted average number of common shares outstanding during the reporting period. Diluted loss per share (“Diluted EPS”) is computed by dividing the net loss by the weighted average number of common shares outstanding during the reporting period while also giving effect to all potentially dilutive common shares that were outstanding during the reporting period.

In accordance with SFAS No. 128, entities that have issued securities other than common stock that participate in dividends with the common stock (“participating securities”) are required to apply the two-class method to compute basic EPS. The two-class method is an earnings allocation method under which EPS is calculated for each class of common stock and participating security as if all such earnings had been distributed during the period. On December 22, 2008, the Company issued Convertible Preferred Stock – Series B which participates in dividends with the Company’s common stock and is therefore considered to be a participating security. However, the participating convertible preferred stock is not required to absorb any net loss. Thus, the Company calculates EPS using the two-class method. The Company does not intend to pay dividends on its common or preferred stock.

The Company uses the more dilutive method of calculating the diluted earnings per share, either the two class method or “if-converted” method. Under the “if-converted” method, the convertible preferred stock is assumed to have been converted into common shares at the beginning of the period.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except share and per share data):

	Three Months Ended March 31, 2009			Three Months Ended March 31, 2008		
	Loss	Shares	Per Share Amount	Loss	Shares	Per Share Amount
<b>Basic EPS</b>						
Loss allocated to common shares	\$ (419 )	15,860,517	\$ (0.03 )	\$ (2,674 )	12,620,900	\$ (0.21 )
Loss allocated to participating securities	\$ —			\$ —		
Net loss	\$ (419 )			\$ (2,674 )		
Diluted potential common shares		—			—	
<b>Diluted EPS</b>						
Net loss	\$ (419 )	15,860,517	\$ (0.03 )	\$ (2,674 )	12,620,900	\$ (0.21 )

For the three months ended March 31, 2009, the Company has excluded options, warrants, redeemable common stock and convertible preferred stock to acquire 21,957,704 shares of its common stock since their effect would be anti-dilutive. For the three months ended March 31, 2008, the Company has excluded options, warrants, and convertible notes outstanding to acquire 18,689,795 shares of its common stock since their effect would be anti-dilutive.

## Note 6 : Inventory

Inventory is stated at the lower of cost or market. Cost is determined using the first-in first-out method. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. The Company regularly reviews inventory quantities on hand, future purchase commitments with the Company’s suppliers, and the estimated utility of the inventory. If the Company review indicates a reduction in utility below carrying value, the

inventory is reduced to a new cost basis.

The components of inventories are as follows (in thousands):

	March 31, 2009 (unaudited)	December 31, 2008
Raw materials	\$ 1,085	\$ 1,109
Work in process	163	280
Finished goods	966	985
Total inventory	\$ 2,214	\$ 2,374

## Note 7 : Prepaid Expenses and Other Current Assets:

Prepaid expenses and other current assets consist of the following (in thousands):

	March 31, 2009 (unaudited)	December 31, 2008
Vendor prepayments	\$ 466	\$ 180
Other prepaid expenses *	767	383
Other assets	—	233
Total prepaid expenses and other current assets	\$ 1,233	\$ 796

\*No individual amounts greater than 5% of current assets.

## Note 8 : Debt

Debt is as follows (in thousands):

	March 31, 2009 (unaudited)	December 31, 2008
Line of credit, net of deferred debt issuance costs	\$ 632	\$ 1,631
Other debt	50	60
Total debt, net	\$ 682	\$ 1,691

The total debt will mature on or before December 31, 2009. In the three months ended March 31, 2009, approximately \$150 thousand of deferred debt issuance costs were amortized to interest expense. For the three months ended March 31, 2009, interest expense includes interest paid or accrued of \$25 thousand on outstanding debt.

The Company renewed its loan agreement with Moriah Capital, L.P. in August 2008 and the maturity date on its line of credit is August 7, 2009. As of March 31, 2009, the Company was in compliance with the financial covenants of the loan agreement.

## Note 9 : Stock-based Compensation

The Company accounts for the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors under Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS 123(R)). Under SFAS 123(R), the fair value of stock awards is estimated at the date of grant using the Black-Scholes option valuation model. Stock-based compensation expense is reduced for estimated forfeitures and is amortized over the vesting period using the straight-line method.

The following table summarizes the allocation of non-cash stock-based compensation to our expense categories for the three month periods ended March 31, 2009 and 2008 (in thousands):

	Three Months Ended March 31,	
	2009	2008
Cost of revenue	\$ 24	\$ 52
Research and development	58	82

Selling, general and administrative		71		222
Total stock compensation expense	\$	153	\$	356

At March 31, 2009, total unrecognized compensation costs related to stock options was approximately \$0.5 million, net of estimated forfeitures. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures and is expected to be recognized over a weighted average period of approximately 1.2 years.

The Company recognizes compensation expense for options granted to non-employees in accordance with the provisions of Emerging Issues Task Force (“EITF”) consensus Issue 96-18, “Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services,” which requires using a fair value options pricing model and re-measuring such stock options to the current fair market value at each reporting period as the underlying options vest and services are rendered.

During the three month period ended March 31, 2009, there were no stock options granted to employees and directors. During the three month period ended March 31, 2008, the Company granted 160,000 stock options to employees and directors. The following key assumptions were used in the Black-Scholes option pricing model to determine the fair value of stock options granted:

	For the Three Months Ended March 31, 2008
Dividend yield	0%
Risk free interest rates	2.46 – 2.82%
Expected volatility	90.9 – 92.3%
Expected term (in years)	5

We have not declared or paid any dividends and do not currently expect to do so in the near future. The risk-free interest rate used in the Black-Scholes option pricing model is based on the implied yield currently available on U.S. Treasury securities with an equivalent term. Expected volatility is based on the weighted average historical volatility of the Company's common stock for the most recent five year period. The expected term of options represents the period that our stock-based awards are expected to be outstanding and was determined based on historical experience and vesting schedules of similar awards.

The 2008 Incentive Stock Plan ("the 2008 Plan") adopted and approved by the Board of Directors on November 5, 2008 provides for shares of common stock and options to purchase shares of common stock to employees, officers, directors and consultants. The 2008 Plan has an aggregate of 2,000,000 shares. As of March 31, 2009, no options were granted from this plan.

A summary of the Company's stock option activity for the three months ended March 31, 2009 is presented in the following tables:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2009	1,615,673	\$ 1.63		
Options granted	—			
Options exercised	—			
Options forfeited	(290)	2.60		
Options cancelled	—			
Outstanding at March 31, 2009	1,615,383	\$ 1.63	6.18	\$ 2,640

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Vested or expected to vest at March 31, 2009 (1)	1,569,799	\$ 1.50	6.18	\$ 2,376
Exercisable at March 31, 2009	1,159,546	\$ 1.80	6.34	\$ —

(1) The expected to vest options are the result of applying the pre-vesting forfeiture rate assumptions to total unvested options.

	Options Outstanding			Options Exercisable		
	Number Outstanding	Weighted Average Remaining Contractual Life (In Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercisable Price	
\$ 0.34 - \$0.97	759,553	7.14	\$ 0.80	406,620	\$ 0.79	
\$ 1.00 - \$1.44	388,577	8.46	1.38	358,397	1.41	
\$ 2.60 - \$2.70	430,053	2.74	2.61	362,059	2.61	
\$ 3.50 - \$5.80	8,000	3.31	5.51	8,000	5.51	
\$ 6.60 - \$22.50	29,200	2.32	10.91	24,500	10.90	
	1,615,383	6.18	\$ 1.63	1,159,546	\$ 1.80	

The aggregate intrinsic value in the table above represents the difference between the exercise price of the underlying options and the quoted price of the Company's common stock. There were 8,000 options in-the-money at March 31, 2009. The Company's closing stock price was \$0.67 as of March 31, 2009. The Company issues new shares of common stock upon exercise of stock options.



Note 10 : Shareholders' Equity

Preferred Stock - Series B Convertible Preferred Stock ("the Preferred Stock – Series B")

The Company has designated 10,000 shares of the Company's preferred stock as Preferred Stock – Series B at a stated value of \$1,000 per share. The Preferred Stock – Series B is convertible into common stock at a conversion price of \$0.75 per share. The Preferred Stock – Series B does not pay interest. The holders of the Preferred Stock – Series B are not entitled to receive dividends unless the Company's Board of Directors declare a dividend for holders of the Company's common stock and then the dividend shall be equal to the amount that such holder would have been entitled to receive if the holder converted its Preferred Stock – Series B into shares of the Company's common stock. Each share of Preferred Stock – Series B has voting rights equal to (i) the number of shares of Common Stock issuable upon conversion of such shares of Preferred Stock – Series B at such time (determined without regard to the shares of Common Stock so issuable upon such conversion in respect of accrued and unpaid dividends on such share of Preferred Stock) when the Preferred Stock – Series B votes together with the Company's Common Stock or any other class or series of stock of the Company and (ii) one vote per share of Preferred Stock when such vote is not covered by the immediately preceding clause. In the event of a liquidation, dissolution, or winding up of the Company, the Preferred Stock – Series B is entitled to receive liquidation preference before the Common Stock. The Company may at its option redeem the Preferred Stock – Series B by providing the required notice to the holders of the Preferred Stock – Series B and paying an amount equal to \$1,000 multiplied by the number of shares for all of such holder's shares of outstanding Preferred Stock – Series B to be redeemed. As of March 31, 2009, there were 5,739 shares of Preferred Stock – Series B issued and outstanding.

Common Stock

For the three months ended March 31, 2009 and 2008, there were no stock options or warrants exercised.

For the three months ended March 31, 2009, the Company issued approximately 216,000 shares of common stock for payment of approximately \$115 thousand for services rendered and to be rendered in the future. For the three months ended March 31, 2008, the Company did not issue any shares of common stock for payment of services rendered or to be rendered in the future. The Company recorded the fair value of the services rendered and to be rendered in the future in prepaid expenses and selling, general and administrative expenses in the accompanying unaudited condensed consolidated statement of operations for the three months ended March 31, 2009.

Note 11 : Income Taxes

The Company adopted the provisions of Financial Standards Accounting Board Interpretation No. 48, Accounting for Uncertainty in Income Taxes ("FIN 48"), an interpretation of FASB Statement No. 109 ("SFAS 109"), on January 1, 2007. As a result of the implementation of FIN 48, we did not recognize any adjustment in the liability for unrecognized income tax benefits. The tax years 2005-2008 remain open to examination by the major taxing jurisdictions to which we are subject. In the event that the Company is assessed interest or penalties at some point in the future, they will be classified in the financial statements as general and administrative expense.

Note 12 : Commitments and Contingencies

Royalty Payments

The Company, in accordance with a royalty agreement with Eastman Kodak, must pay to Eastman Kodak a certain percentage of net sales with respect to certain products, which percentages are defined in the agreement. The

percentages are on a sliding scale depending on the amount of sales generated. Any minimum royalties paid will be credited against the amounts due based on the percentage of sales. The royalty agreement terminates upon the expiration of the issued patent which is the last to expire.

Effective May 30, 2007, Kodak and eMagin entered into an intellectual property agreement where eMagin has assigned Kodak the rights, title, and interest to a Company owned patent currently not being used by the Company and in consideration, Kodak waived the royalties due under existing licensing agreements for the first six months of 2007, and reduced the royalty payments by 50% for the second half of 2007 and for the entire calendar year of 2008. In addition, the minimum royalty payment was delayed until December 1st for the years 2007 and 2008. The Company recorded approximately \$84 thousand for the three months ended March 31, 2008 as income from the license of intangible assets and included this amount as other income in the condensed consolidated statements of operations.

Effective January 1, 2009, the Company royalty payments are back to 100%. The minimum royalty payment of \$125 thousand was paid in January 2009.

Royalty expense was approximately \$308 thousand and \$168 thousand, respectively, for the three months ended March 31, 2009 and 2008.

### Contractual Obligations

The Company leases office facilities and office, lab and factory equipment under operating leases expiring through 2009. Certain leases provide for payments of monthly operating expenses. The Company currently has lease commitments for office space in Bellevue, Washington which will expire August 31, 2009. The Company is currently reviewing potential office spaces for lease. The Company is currently in negotiations to extend the lease on its space in Hopewell Junction, New York which expires May 31, 2009. Rent expense was approximately \$332 thousand for the three months ended March 31, 2009 and 2008.

### Note 13 : Legal Proceedings

A former employee ("Plaintiff") of the Company commenced legal action in the United States District Court for the Southern District of New York, on or about October 12, 2007, alleging that the plaintiff was subject to gender based discrimination and retaliation in violation of Title VII of the Civil Rights Act of 1964 (Case No. 07-CV-8827 (KMK)). The plaintiff sought unspecified compensatory damages, punitive damages and attorneys' fees. The Company and the plaintiff have settled this action in April 2009. This settlement did not have a material effect on the Company's results from operations.

### Note 14 : Subsequent Events

On May 8, 2009 (the "Effective Date"), the Company and Paul Campbell entered in an Employment Agreement (the "Employment Agreement"). Pursuant to the Employment Agreement, Mr. Campbell, who is currently serving as the Company's interim Chief Financial Officer, will serve as the Company's Chief Financial Officer, Senior Vice President and Treasurer. The Employment Agreement terminates 36 months from the Effective Date. Pursuant to the Employment Agreement, Mr. Campbell's salary is \$282,000 per annum. The Company's board may also award a bonus to Mr. Campbell. Pursuant to the Employment Agreement, the Company shall issue Mr. Campbell options to purchase up to 340,000 shares of the Company's common stock, which are exercisable at \$1.09 per share, the market price on the date of grant. The options vest as follows: one third of the options vest as of the Effective Date, one third of the options vest on the first anniversary of the Employment Agreement and one third of the options vest on the second anniversary of the Employment Agreement.

In connection with the employment of Paul Campbell, the Company is entering into an agreement with Tatum LLC ("Tatum"). Pursuant to the agreement with Tatum, the Company will pay Tatum a signing fee of \$97,700 and shall pay Tatum \$1,000 per month for as long as Mr. Campbell is employed by eMagin. In addition, the Company will grant Tatum 60,000 options with the same vesting and exercise price as Mr. Campbell's and will pay Tatum 15% of any cash bonus that is paid to Mr. Campbell.

### Note 15: Restatement

In this Amended 10-Q, eMagin restated its previously issued condensed consolidated financial statements as of and for the quarter ended March 31, 2009 to correct errors in the accounting for certain warrants and the calculation of EPS. The Company determined that certain warrants ("Warrants") issued contain anti-dilution provisions which should have been accounted for as derivatives in accordance with the amended provisions of Statement No. 133. EITF 07-5, effective January 1, 2009, provides an approach for companies to evaluate whether an equity-linked financial instrument or embedded feature in the instrument is indexed to its own stock for the purpose of evaluating the scope exception in Statement No. 133. Since the Company has issued Warrants which contain anti-dilution features for the holder, they are not considered indexed to the Company's own stock, and therefore, do not qualify for the scope exception in Statement No. 133 and must be accounted for as derivatives. Accordingly, beginning January 1, 2009,

the Company should have reclassified the Warrants as liabilities and recorded the Warrants at estimated fair value at each reporting date, computed using the Monte Carlo Simulation approach. Thereafter, changes in the warrant liability from period to period should have been recorded in the condensed consolidated statements of operations. Effective January 1, 2009, the Company should have recorded a cumulative effect adjustment based on the grant date fair value of the outstanding Warrants and the change in fair value of the warrant liability from the issuance date through January 1, 2009.

The Company computed the fair value of the warrant liability using the Monte Carlo Simulation approach. The fair value as of the issuance date was \$15.1 million and as of January 1, 2009 was \$2.1 million. Accordingly as of January 1, 2009, the Company recorded a warrant liability of \$2.1 million, a reduction in additional paid-in capital of \$15.1 million and a reduction in accumulated deficit of \$13.0 million. As of March 31, 2009, the Company computed the fair value of the warrant liability as \$2.9 million, an increase of \$0.8 million. The change in fair value from January 1, 2009 through March 31, 2009 of \$0.8 million was recorded as other expense in the Condensed Consolidated Statements of Operations for the quarter ended March 31, 2009. The Condensed Consolidated Statement of Changes in Shareholders' Equity, Condensed Consolidated Statements of Cash Flows, and Notes to the Condensed Consolidated Financial Statements have been restated where applicable to reflect the adjustments.

The accompanying quarterly financial statements have been restated to report the following Warrants as derivative liabilities measured at estimated fair value, calculated using the Monte Carlo Simulation approach:

Warrant Issuance Dates	Number of Warrants Outstanding as of March 31, 2009	Exercise Price	Warrant Expiration Dates	Fair Value of Warrants at Issue Date (in thousands)	Fair Value of Warrants at January 1, 2009 (in thousands)	Fair Value of Warrants at March 31, 2009 (in thousands)
January 9, 2004	—	\$ 0.35	January 8, 2009	\$ 3,091	\$ 15	\$ —
October 25, 2004	650,001	\$ 2.50	April 25, 2010	4,738	19	25
July 23, 2007	5,390,712	\$ 1.03	July 21, 2011	5,031	1,120	1,519
July 23, 2007	1,000,000	\$ 0.48	July 21, 2011	1,136	304	395
April 2, 2008	793,273	\$ 1.13	April 2, 2013	561	224	279
December 22, 2008	1,875,467	\$ 1.03	December 22, 2013	534	448	725
Total Fair Value				\$ 15,091	\$ 2,130	\$ 2,943

Additionally, under SFAS No. 128, “Earnings Per Share”, entities that have issued securities other than common stock that participate in dividends with the common stock (“participating securities”) are required to apply the two-class method to compute basic EPS. The two-class method is an earnings allocation method under which EPS is calculated for each class of common stock and participating security as if all such earnings had been distributed during the period. However, the participating convertible preferred stock is not required to absorb any net loss. The Company has Convertible Preferred Stock - Series B which participates in dividends with the Company’s common stock and therefore the Company should have calculated EPS using the two-class method. Certain unaudited condensed consolidated financial statements have been restated to reflect EPS calculated using the two-class method. The following tables summarize the effects of the restatement on the specific items presented in the Company’s historical condensed consolidated financial statements previously included in the Company’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2009:

Condensed Consolidated Balance Sheet	March 31, 2009 (As previously reported)	March 31, 2009 (As restated)
(in thousands)		
Warrant liability	\$ —	\$ 2,943
Total liabilities	\$ 4,720	\$ 7,663
Shareholders’ equity:		
Additional paid-in capital	\$ 205,086	\$ 189,995
Accumulated deficit	\$ (200,778 )	\$ (188,630 )
Total shareholders’ equity	\$ 4,323	\$ 1,380
Condensed Consolidated Statements of Operations	Three Months Ended March 31, 2009	
(in thousands except share and per share data)	(As previously reported)	(As restated)

	reported)	
Change in fair value of warrant liability	\$ —	\$ (813 )
Total other expense	\$ (174 )	\$ (987 )
Net income (loss)	\$ 394	\$ (419 )
Income (loss) per share, basic	\$ 0.02	\$ (0.03 )
Income (loss) per share, diluted	\$ 0.02	\$ (0.03 )
Weighted average number of shares outstanding:		
Basic	15,860,517	15,860,517
Diluted	23,899,255	15,860,517

	Three Months Ended March 31, 2009	
Condensed Consolidated Statements of Cash Flows	(As previously reported)	
(in thousands)		(As restated)
Net income (loss)	\$ 394	\$ (419 )
Change in fair value of warrant liability	\$ —	\$ 813
Net cash provided by operating activities	\$ 967	\$ 967

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Statement of Forward-Looking Information

In this quarterly report, references to "eMagin Corporation," "eMagin," "Virtual Vision," "the Company," "we," "us," and "our" refer to eMagin Corporation and its wholly owned subsidiary, Virtual Vision, Inc.

Except for the historical information contained herein, some of the statements in this Report contain forward-looking statements that involve risks and uncertainties. These statements are found in the sections entitled "Business," "Management's Discussion and Analysis of Financial Condition and Results of Operation," and "Risk Factors." They include statements concerning: our business strategy; expectations of market and customer response; liquidity and capital expenditures; future sources of revenues; expansion of our proposed product line; and trends in industry activity generally. In some cases, you can identify forward-looking statements by words such as "may," "will," "should," "expect," "plan," "could," "anticipate," "intend," "believe," "estimate," "predict," "potential," "goal," or "continue" or similar terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including, but not limited to, the risks outlined under "Risk Factors," that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. For example, assumptions that could cause actual results to vary materially from future results include, but are not limited to: our ability to successfully develop and market our products to customers; our ability to generate customer demand for our products in our target markets; the development of our target markets and market opportunities; our ability to manufacture suitable products at competitive cost; market pricing for our products and for competing products; the extent of increasing competition; technological developments in our target markets and the development of alternate, competing technologies in them; and sales of shares by existing shareholders. Although we believe that the expectations reflected in the forward looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Unless we are required to do so under federal securities laws or other applicable laws, we do not intend to update or revise any forward-looking statements.

### Restatement of Previously Issued Condensed Consolidated Financial Statements

In this Amendment No. 1 we have restated our previously issued management's discussion and analysis of financial condition and results of operations, condensed consolidated financial statements and related disclosures for the quarter ended March 31, 2009 for the following:

- To correct errors in the accounting for certain warrants. Specifically, we previously classified as equity instruments warrants that should have been classified as derivative liability instruments based on the terms of the warrants and the applicable accounting guidance.
- To correct an error in the calculation of earnings per share ("EPS"). We issued Preferred Stock – Series B which participates in dividends with our common stock; as a result, we should have used the two-class method for calculating EPS.

### Overview

We design and manufacture miniature displays, which we refer to as OLED-on-silicon-microdisplays, and microdisplay modules for virtual imaging, primarily for incorporation into the products of other manufacturers. Microdisplays are typically smaller than many postage stamps, but when viewed through a magnifier they can contain all of the information appearing on a high-resolution personal computer screen. Our microdisplays use organic light emitting diodes, or OLEDs, which emit light themselves when a current is passed through the device. Our technology

permits OLEDs to be coated onto silicon chips to produce high resolution OLED-on-silicon microdisplays.

We believe that our OLED-on-silicon microdisplays offer a number of advantages in near to the eye applications over other current microdisplay technologies, including lower power requirements, less weight, fast video speed without flicker, and wider viewing angles. In addition, many computer and video electronic system functions can be built directly into the OLED-on-silicon microdisplay, resulting in compact systems with lower expected overall system costs relative to alternate microdisplay technologies.

We hold a license from Eastman Kodak for use of their OLED related technology and we have developed a strong portfolio of our own patents, manufacturing know-how and technology to create high performance OLED-on-silicon microdisplays and related optical systems. We believe our technology and intellectual property portfolio gives us a leadership position in OLED and OLED-on-silicon microdisplay technology. We believe that we are the only company to demonstrate publicly and market full-color small molecule OLED-on-silicon microdisplays.

#### Company History

As of January 1, 2003, we were no longer classified as a development stage company. We transitioned to manufacturing our product and have significantly increased our marketing, sales, and research and development efforts, and expanded our operating infrastructure. Currently, most of our operating expenses are labor related and semi-fixed. If we are unable to generate significant revenues, our net losses in any given period could be greater than expected.

#### CRITICAL ACCOUNTING POLICIES

The Securities and Exchange Commission ("SEC") defines "critical accounting policies" as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Not all of the accounting policies require management to make difficult, subjective or complex judgments or estimates. However, the following policies could be deemed to be critical within the SEC definition.

#### Revenue and Cost Recognition

Revenue on product sales is recognized when persuasive evidence of an arrangement exists, such as when a purchase order or contract is received from the customer, the price is fixed, title and risk of loss to the goods has changed and there is a reasonable assurance of collection of the sales proceeds. We obtain written purchase authorizations from our customers for a specified amount of product at a specified price and consider delivery to have occurred at the time of shipment. We record a reserve for estimated sales returns, which is reflected as a reduction of revenue at the time of revenue recognition. Products sold directly to consumers have a thirty day right of return. Revenue on consumer products is deferred until the right of return has expired.



Revenues from research and development activities relating to firm fixed-price contracts are generally recognized on the percentage-of-completion method of accounting as costs are incurred (cost-to-cost basis). Revenues from research and development activities relating to cost-plus-fee contracts include costs incurred plus a portion of estimated fees or profits based on the relationship of costs incurred to total estimated costs. Contract costs include all direct material and labor costs and an allocation of allowable indirect costs as defined by each contract, as periodically adjusted to reflect revised agreed upon rates. These rates are subject to audit by the other party.

#### Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These estimates and assumptions relate to recording net revenue, collectibility of accounts receivable, useful lives and impairment of tangible and intangible assets, accruals, income taxes, inventory realization and other factors. Management has exercised reasonable judgment in deriving these estimates. Consequently, a change in conditions could affect these estimates.

#### Fair Value of Financial Instruments - Restated

eMagin's cash, cash equivalents, accounts receivable, short-term investments, accounts payable and debt are stated at cost which approximates fair value due to the short-term nature of these instruments. eMagin measures the fair value of our warrants based on the Monte Carlo Simulation approach.

#### Stock-based Compensation

eMagin maintains several stock equity incentive plans. The 2005 Employee Stock Purchase Plan (the "ESPP") provides our employees with the opportunity to purchase common stock through payroll deductions. Employees purchase stock semi-annually at a price that is 85% of the fair market value at certain plan-defined dates. As of March 31, 2009, the number of shares of common stock available for issuance was 300,000. As of March 31, 2009, the plan had not been implemented.

The 2003 Stock Option Plan (the "2003 Plan") provides for grants of shares of common stock and options to purchase shares of common stock to employees, officers, directors and consultants. Under the 2003 plan, an ISO grant is granted at the market value of our common stock at the date of the grant and a non-ISO is granted at a price not to be less than 85% of the market value of the common stock. These options have a term of up to 10 years and vest over a schedule determined by the Board of Directors, generally over a five year period. The amended 2003 Plan provides for an annual increase in common stock available for issuance by 3% of the diluted shares outstanding on January 1 of each year for a period of 9 years which commenced January 1, 2005.

The 2008 Incentive Stock Plan ("the 2008 Plan") adopted and approved by the Board of Directors on November 5, 2008 provides for the issuance of shares of common stock and options to purchase shares of common stock to employees, officers, directors and consultants. The 2008 Plan has an aggregate of 2,000,000 shares. For the three months ended March 31, 2009, there were 215,904 shares of common stock issued to consultants. As of March 31, 2009, no options were granted from this plan.

The Company accounts for the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors under Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS 123(R)). Under SFAS 123(R), the fair value of stock awards is estimated at the date of grant using the Black-Scholes option valuation model. Stock-based compensation expense is reduced for estimated forfeitures and is amortized over the vesting period using the straight-line method. See Note 9 to the condensed consolidated financial statements – Stock Compensation for a further discussion on stock-based compensation.

#### NEW ACCOUNTING PRONOUNCEMENTS

See Note 2 of the Condensed Consolidated Financial Statements in Item 1 for a description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition.

## RESULTS OF OPERATIONS

### THREE MONTHS ENDED MARCH 31, 2009 COMPARED TO THREE MONTHS ENDED MARCH 31, 2008

#### Revenues

Revenues for the three months ended March 31, 2009 were approximately \$5.1 million, as compared to approximately \$2.7 million for the three months ended March 31, 2008, an increase of approximately 93%. For the three months ended March 31, 2009, product revenue increased approximately \$1.9 million or 77% as compared to the three months ended March 31, 2008. The increase was due to higher customer demand for the Company's OLED displays in the first quarter of 2009 as compared to the first quarter of 2008 when the Company experienced a shortage of displays for sale as a result of a temporary production issue. For the three months ended March 31, 2009, contract revenue increased approximately \$0.6 million or 288% as compared to the first quarter of 2008. The projects in the first quarter of 2009 were larger projects and in the middle of their project life as compared to the first quarter of 2008 where the projects were smaller and either in the beginning or completion stage resulting in lower revenues.

#### Cost of Goods Sold

Cost of goods sold includes direct and indirect costs associated with production of our products. Cost of goods sold for the three months ended March 31, 2009 was approximately \$2.7 million as compared to approximately \$2.3 million for the three months ended March 31, 2008, an increase of approximately \$0.4 million.

Cost of goods sold as a percentage of revenues improved from 87% for the three months ended March 31, 2008 to 52% for the three months ended March 31, 2009. Cost of goods is comprised primarily of material and labor cost. The labor portion of cost of goods is mostly fixed. Increased display production output volume and improved manufacturing yield resulted in a lower cost of goods sold percentage.

The gross profit was approximately \$2.5 million for the three months ended March 31, 2009 as compared to approximately \$0.4 million for the three months ended March 31, 2008. The gross margin was 48% for the year ended March 31, 2009 as compared to the gross margin of 13% for the year ended March 31, 2008. The gross margin improvement was attributed primarily to improved manufacturing yield and the increased volume of microdisplays produced.

#### Operating Expenses

**Research and Development.** Research and development expenses include salaries, development materials and other costs specifically allocated to the development of new microdisplay products, OLED materials and subsystems. Research and development expenses for the three months ended March 31, 2009 were approximately \$0.4 million as compared to \$0.7 million for the three months ended March 31, 2008, a decrease of approximately \$0.3 million. The decrease was due to the streamlining of the research and development effort in the subsystems area which resulted in expense reductions and to the allocation of research and development expenses related to contracts to cost of goods sold.

**Selling, General and Administrative.** Selling, general and administrative expenses consist principally of salaries and fees for professional services, legal fees incurred in connection with patent filings and related matters, as well as other marketing and administrative expenses. Selling, general and administrative expenses for the three months ended March 31, 2009 were approximately \$1.5 million as compared to approximately \$1.8 million for the three months ended March 31, 2008. The decrease of approximately \$0.3 for the three months ended March 31, 2009 was primarily

related to a reduction of professional fees, personnel costs, and other cost reductions.

Other Income (Expense), net. Other income (expense), net consists primarily of interest income earned on investments, interest expense related to the secured debt, income from the licensing of intangible assets and expense applicable to the change in fair value of the warrant liability.

For the three months ended March 31, 2009, interest expense was approximately \$175 thousand as compared to \$631 thousand for the three months ended March 31, 2008. For the three months ended March 31, 2009, the interest expense associated with debt was \$25 thousand and the amortization of the deferred costs associated with the debt was \$150 thousand. The breakdown of the interest expense for the three month period in 2008 is as follows: interest expense associated with debt of approximately \$158 thousand; the amortization of the deferred costs and waiver fees associated with the debt of approximately \$448 thousand; and the amortization of the debt discount associated with the debt of approximately \$25 thousand. The decrease in interest expense for the three months ended March 31, 2009 as compared to the three months ended March 31, 2008 was primarily a result of the Company carrying a lower balance on its line of credit, the repayment and conversion of its 8% Senior Secured Convertible Notes in December 2008, and lower deferred debt issuance costs.

Other income for the three months ended March 31, 2009 was approximately \$1 thousand as compared to \$86 thousand for the three months ended March 31, 2008. The other income for the three months ended March 31, 2009 was interest income of approximately \$1 thousand and the other income for the three months ended March 31, 2008 was interest income of approximately \$2 thousand and \$84 thousand was income from a gain on the license of intangible assets. See Note 12: Commitments and Contingencies – Royalty Payments for additional information.

Change in Fair Value of Warrant Liability. In accordance with EITF 07-5, adopted January 1, 2009, certain warrants previously classified within equity are reclassified as liabilities. As a result of this reclassification, the accounting guidance requires revaluation of this liability every reporting period. The fair value of the liability at March 31, 2009 was measured by using the Monte Carlo Simulation model. The revaluation resulted in a charge of approximately \$813 thousand for the three months ended March 31, 2009. This revaluation is a non-cash item and had no impact on our cash balances, operations, or operating income.

#### Liquidity and Capital Resources

As of March 31, 2009, we had approximately \$2.4 million of cash and investments as compared to \$2.5 million as of December 31, 2008. The change in cash and investments was primarily due to cash provided by operations of approximately \$1.0 million offset by cash used for financing and investing activities of approximately \$1.1 million.

Cash flow provided by operating activities during the three months ended March 31, 2009 was approximately \$1.0 million, attributable to our net loss of approximately \$0.4 million offset by non-cash expenses of approximately \$1.1 million and approximately \$0.3 million from the change in operating assets and liabilities. Cash flow used in operating activities during the three months ended March 31, 2008 was approximately \$0.6 million attributable to our net loss of \$2.7 million offset by non-cash expenses of \$0.9 million and working capital items of \$1.2 million.

Cash used in investing activities during the three months ended March 31, 2009 and 2008 was approximately \$33 thousand and \$231 thousand, respectively, to purchase of equipment.

Cash used by financing activities during the three months ended March 31, 2009 was approximately \$1.0 million to pay down the line of credit. Cash provided by financing activities during the three months ended March 31, 2008 was approximately \$0.4 million and was comprised of approximately \$0.7 million from the line of credit and offset by payments on debt of \$0.3 million.

As we have reported, our business continues to experience revenue growth. This trend, if it continues, may result in higher accounts receivable levels and may require increased production and/or higher inventory levels. In addition, in August 2009, we will be obligated to repay any outstanding amounts on our line of credit if we are unable to renew or find a suitable alternative line of credit. As of March 31, 2009, we have drawn approximately \$632 thousand of the \$3 million available on the line. We anticipate that our cash requirements to fund these requirements as well as other operating or investing cash requirements over the next twelve months will be less than our current cash on hand and the cash we anticipate generating from operations. We anticipate that we will not require additional funds over the next twelve months other than perhaps discretionary capital spending. If unanticipated events arise during the next twelve months and we require additional funding and we are unable to obtain sufficient funds we may further reduce the size of our organization and/or be forced to reduce and/or curtail our production and operations, all of which could have a material adverse impact on our business prospects.

#### Off-Balance Sheet Arrangements

We do not have any off balance sheet arrangements that are reasonably likely to have a current or future effect on our financial condition, revenues, results of operations, liquidity or capital expenditures.

#### ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

#### ITEM 4T. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. Based on an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, as of the end of the period covered by this Report, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Our Chief Executive Officer and Chief Financial Officer also concluded that, as of the end of the period covered by this Report, there were material weaknesses in both the design and effectiveness of our internal control over financial reporting. Management has assessed these deficiencies and has determined that there were two general categories of material weaknesses (described below) in eMagin's internal control over financial reporting. As a result of our assessment that material weaknesses in our internal control over financial reporting existed as of March 31, 2009, management has concluded that our internal control over financial reporting was not effective as of March 31, 2009. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. Management recognizes that any disclosure controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving their objectives.

In management's opinion, our assessment as of March 31, 2009 regarding the existence of material weaknesses in our internal control over financial reporting relates to (1) the lack of controls or ineffectively designed controls other than information technology controls and (2) the failure in design and operating effectiveness of information technology controls over financial reporting. Management and our audit committee have assigned a high priority to the short-term and long-term improvement of our internal control over financial reporting.

The material weaknesses we have identified include:

Deficiencies pertaining to the lack of controls or ineffectively designed controls. Our control design analysis and process walk-throughs disclosed a number of instances where review approvals were undocumented, where established policies and procedures were not defined, and controls were not in place.

Deficiencies related to information technology control design and operating effectiveness weaknesses. This material weakness resulted from the absence of key formalized information technology policies and procedures and could result in (1) unauthorized system access, (2) application changes being implemented without adequate reliability testing, (3) inconsistent investigation of system errors and the absence of timely or properly considered remedial actions, and (4) over reliance on spreadsheet applications without quality control assurances. These factors could lead to material errors and misstatements to financial statements occurring without timely detection.

#### Restatement of Condensed Consolidated Financial Statements

On August 10, 2011, the Audit Committee of the Board of Directors (“Audit Committee”) in consultation with the Company’s management concluded that the financial statements included in the Company’s Annual Reports issued on Form 10-K for the years ended December 31, 2009 and 2010 and quarterly reports issued on Form 10-Q for the quarters ended March 31, June 30, and September 30, 2009; March 31, June 30, and September 30, 2010; and March 31, 2011 did not use the proper method to calculate earnings per share and as a result, should not be relied upon. On August 15, 2011, after consulting with the Audit Committee on August 10, 2011 and with the Company’s auditors and former auditors, management concluded that the Company did not properly account for certain common stock warrants as liabilities and as a result, the financial statements, as mentioned above, should not be relied upon. The Audit Committee authorized and directed Company’s management to restate its consolidated financial statements for the above mentioned periods. As a result of a deficiency in our internal control over financial reporting relating to the accounting for common stock warrants, as of the end of the period covered by this report our management has reassessed the effectiveness of our disclosure controls and procedures and has determined that our disclosure controls and procedures were not effective.

#### Remediation Plan

Since the determination regarding this deficiency, we have devoted significant effort and resources to remediation and improvement of our internal control over financial reporting. While we had processes in place to identify and apply developments in accounting standards, we enhanced these processes to better evaluate our research of the nuances of complex accounting standards. Our enhancements included retaining a third party consultant, who is a technical accounting professional, to assist us in the interpretation and application of new and complex accounting guidance. Additionally, we have improved training of accounting personnel and communication among our internal staff, our legal team and our consultant. Management will continue to review and make necessary changes to the overall design of our internal control environment.

(b) Changes in Internal Controls. During the quarter ended March 31, 2009, other than mentioned above, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting





PART II - OTHER INFORMATION

ITEM 1. Legal Proceedings

A former employee (“Plaintiff”) of the Company commenced legal action in the United States District Court for the Southern District of New York, on or about October 12, 2007, alleging that the plaintiff was subject to gender based discrimination and retaliation in violation of Title VII of the Civil Rights Act of 1964 (Case No. 07-CV-8827 (KMK)). The plaintiff sought unspecified compensatory damages, punitive damages and attorneys’ fees. The Company and the plaintiff have settled this action. This settlement did not and will not have a material effect on the Company's results of operations.

ITEM 1A. Risk Factors

In addition to other information set forth in this Report, you should carefully consider the risk factors previously disclosed in “Item 1A to Part 1” of our Annual Report on Form 10-K for the year ended December 31, 2008. There were no material changes from the risk factors during the three months ended March 31, 2009.

ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

ITEM 3. Defaults Upon Senior Securities

None.

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

None.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

31.1 Certification by Chief Executive Officer pursuant to Sarbanes Oxley Section 302 (1)

31.2 Certification by Chief Financial Officer pursuant to Sarbanes Oxley Section 302 (1)

32.1 Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350 (1)

32.2 Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350 (1)

(1) Filed herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on this 7th day of October 2011 .

eMAGIN CORPORATION

By:                   /s/ Andrew G. Sculley  
                          Andrew G. Sculley  
                          Chief Executive Officer  
                          (Principal Executive Officer)

By:/s/ Paul Campbell  
          Paul Campbell  
          Chief Financial Officer  
          (Chief Accounting Officer and  
          Principal Financial Officer)