

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)

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

For the quarterly period ended March 31, 2010  
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

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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 (§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, 2010 was 19,668,835.

## 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, 2010, which was originally filed with the Securities and Exchange Commission on May 18, 2010 (the “Original 10-Q”). This Amendment is being filed mainly to include restated 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”). 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”). 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 .



eMagin Corporation  
 Form 10-Q/A  
 For the Quarter ended March 31, 2010

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## ITEM 1. Condensed Consolidated Financial Statements

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

|  | March 31,<br>2010<br>(Restated)<br>See Note 15<br>(unaudited) | December<br>31, 2009 |
|--|---|----------------------|
| <b>ASSETS</b>  |   |                      |
| Current assets:  |   |                      |
| Cash and cash equivalents  | \$ 5,998  | \$ 5,295             |
| Investments – held to maturity   | 100   | 100                  |
| Accounts receivable, net   | 4,360   | 4,563                |
| Inventory  | 2,193   | 2,179                |
| Prepaid expenses and other current assets  | 740   | 687                  |
| Total current assets   | 13,391  | 12,824               |
| Equipment, furniture and leasehold improvements, net   | 1,769   | 1,021                |
| Intangible assets, net   | 42  | 43                   |
| Other assets   | 92  | 92                   |
| Total assets   | \$ 15,294   | \$ 13,980            |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY (CAPITAL DEFICIT)</b>  |   |                      |
| Current liabilities:   |   |                      |
| Accounts payable   | \$ 764  | \$ 1,122             |
| Accrued compensation   | 1,254   | 956                  |
| Other accrued expenses   | 815   | 791                  |
| Advance payments   | 153   | 211                  |
| Deferred revenue   | 366   | 238                  |
| Warrant liability  | 705   | 34                   |
| Other current liabilities  | 858   | 891                  |
| Total current liabilities  | 4,915   | 4,243                |
| Warrant liability  | 14,834  | 6,844                |
| Total liabilities  | 19,749  | 11,087               |
| Commitments and contingencies (Note 12)  |   |                      |
| Shareholders' equity (capital deficit):  |   |                      |
| 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 and outstanding as of March 31, 2010 and December 31, 2009 | —   | —                    |
|  | 17  | 17                   |

|  |           |           |
|--|-----------|-----------|
| Common stock, \$.001 par value: authorized 200,000,000 shares, issued and outstanding, 17,301,852 shares as of March 31, 2010 and 16,967,244 as of December 31, 2009 |           |           |
| Additional paid-in capital   | 194,627   | 193,358   |
| Accumulated deficit  | (199,099) | (190,482) |
| Total shareholders' equity (capital deficit)   | (4,455)   | 2,893     |
| Total liabilities and shareholders' equity (capital deficit)   | \$ 15,294 | \$ 13,980 |

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<br>March 31,   |            |
|---|-----------------------------------|------------|
|   | 2010<br>(Restated)<br>See Note 15 | 2009       |
| Revenue:  |                                   |            |
| Product revenue                                       | \$ 4,486                          | \$ 4,356   |
| Contract revenue                                      | 1,441                             | 788        |
| Total revenue, net                                    | 5,927                             | 5,144      |
| Cost of goods sold:                                   |                                   |            |
| Product revenue                                       | 1,845                             | 2,257      |
| Contract revenue                                      | 764                               | 428        |
| Total cost of goods sold                              | 2,609                             | 2,685      |
| Gross profit  | 3,318                             | 2,459      |
| Operating expenses:                                   |                                   |            |
| Research and development                              | 734                               | 362        |
| Selling, general and administrative                   | 1,682                             | 1,529      |
| Total operating expenses                              | 2,416                             | 1,891      |
| Income from operations                                | 902                               | 568        |
| Other income (expense):                               |                                   |            |
| Interest expense, net                                 | (28)                              | (175)      |
| Other income, net                                     | 7                                 | 1          |
| Change in fair value of warrant liability             | (9,497)                           | (813)      |
| Total other expense, net                              | (9,518)                           | (987)      |
| Loss before provision for income taxes                | (8,616)                           | (419)      |
| Provision for income taxes                            | 1                                 | —          |
| Net loss  | \$ (8,617)                        | \$ (419)   |
| Loss per common share, basic                          | \$ (0.50)                         | \$ (0.03)  |
| Loss per common share, diluted                        | \$ (0.50)                         | \$ (0.03)  |
| Weighted average number of common shares outstanding: |                                   |            |
| Basic   | 17,109,706                        | 15,860,517 |
| Diluted   | 17,109,706                        | 15,860,517 |

See notes to Condensed Consolidated Financial Statements.



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

|   | Preferred Stock |        | Common Stock |        |            | Additional<br>Paid-in<br>Capital<br>(Restated)<br>See Note 15 | Accumulated<br>Deficit<br>(Restated)<br>See Note 15 | Total<br>Shareholders'<br>Equity<br>(Capital<br>Deficit)<br>(Restated)<br>See Note 15 |
|---|-----------------|--------|--------------|--------|------------|---|---|---|
|   | Shares          | Amount | Shares       | Amount | Amount     |   |   |   |
| Balance,<br>December 31,<br>2009  | 6               | \$ —   | 16,967       | \$ 17  | \$ 193,358 | \$ (190,482 )   | \$ 2,893  |   |
| Fair value of<br>warrants<br>reclassified<br>from liability to<br>equity upon<br>exercise | —               | —      | —            | —      | 836        | —   | 836   |   |
| Cashless<br>exercise of<br>common stock<br>warrants                                       | —               | —      | 335          | —      | —          | —   | —   |   |
| Stock-based<br>compensation   | —               | —      | —            | —      | 433        | —   | 433   |   |
| Net loss  | —               | —      | —            | —      | —          | (8,617 )  | (8,617 )  |   |
| Balance, March<br>31, 2010  | 6               | \$ —   | 17,302       | \$ 17  | \$ 194,627 | \$ (199,099 )   | \$ (4,455 )   |   |

See notes to Condensed Consolidated Financial Statements.

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

|  | Three Months Ended<br>March 31,<br>2010<br>(Restated)<br>See Note 15 |         | 2009<br>(unaudited) |
|--|--|---------|---------------------|
| Cash flows from operating activities:  |  |         |                     |
| Net loss   | \$   | (8,617) | \$ (419)            |
| Adjustments to reconcile net loss to net cash provided by operating activities:              |  |         |                     |
| Depreciation and amortization  |  | 16      | 23                  |
| Amortization of deferred financing and waiver fees   |  | —       | 150                 |
| Reduction of provision for sales returns and doubtful accounts                               |  | (161)   | (114)               |
| Stock-based compensation   |  | 433     | 153                 |
| Amortization of common stock issued for services   |  | 1       | 76                  |
| Change in fair value of warrant liability  |  | 9,497   | 813                 |
| Changes in operating assets and liabilities:   |  |         |                     |
| Accounts receivable  |  | 303     | 807                 |
| Inventory  |  | (14)    | 160                 |
| Prepaid expenses and other current assets  |  | (53)    | (398)               |
| Deferred revenue   |  | 128     | (44)                |
| Accounts payable, accrued compensation, other accrued expenses, and advance payments         |  | (94)    | (359)               |
| Other current liabilities  |  | 27      | 119                 |
| Net cash provided by operating activities  |  | 1,466   | 967                 |
| Cash flows from investing activities:  |  |         |                     |
| Purchase of equipment  |  | (763)   | (33)                |
| Net cash used in investing activities  |  | (763)   | (33)                |
| Cash flows from financing activities:  |  |         |                     |
| Payments of debt   |  | —       | (1,009)             |
| Net cash used in financing activities  |  | —       | (1,009)             |
| Net increase (decrease) in cash and cash equivalents   |  | 703     | (75)                |
| Cash and cash equivalents, beginning of period   |  | 5,295   | 2,404               |
| Cash and cash equivalents, end of period   | \$   | 5,998   | \$ 2,329            |
| Cash paid for interest   | \$   | 15      | \$ 38               |
| Cash paid for taxes  | \$   | 115     | \$ 21               |
| Common stock issued for services charged to prepaid expenses                                 | \$   | —       | \$ 39               |
| Issuance of 334,608 shares of common stock for cashless exercise of 669,717 warrants in 2010 | \$   | —       | \$ —                |

See notes to Condensed Consolidated Financial Statements.

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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/A for the year ended December 31, 2009. The results of operations for the period ended March 31, 2010 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, 2010 to correct errors in the accounting for certain warrants as discussed in Note 15, “Restatement”.

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. Product revenue is generally recognized when products are shipped to customers, net of allowances for anticipated returns. 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 (contract revenues) 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.

#### Product warranty

The Company offers a one-year product replacement warranty. In general, the standard policy is to repair or replace the defective products. The Company accrues for estimated returns of defective products at the time revenue is recognized based on historical activity as well as for specific known product issues. The determination of these accruals requires the Company to make estimates of the frequency and extent of warranty activity and estimate future costs to replace the products under warranty. If the actual warranty activity and/or repair and replacement costs differ significantly from these estimates, adjustments to cost of revenue may be required in future periods.

## Research and Development Costs

Research and development costs are expensed as incurred.

### Note 2: Recently Issued Accounting Pronouncements

In April 2010, the FASB amended the authoritative guidance on the milestone method of revenue recognition. The amendment defines a milestone and determines when it may be appropriate to apply the milestone method of revenue recognition for research or development transactions. Consideration that is contingent on achievement of a milestone in its entirety may be recognized as revenue in the period in which the milestone is achieved only if the milestone is judged to meet certain criteria to be considered substantive. This new guidance permits prospective adoption for milestones achieved in fiscal years and interim periods within those years, beginning on or after June 15, 2010. Early adoption is permitted. The Company is evaluating the impact the adoption of this update will have on its condensed consolidated financial statements.

### Note 3: Fair Value Measurement

The Company measures fair value in accordance with ASC 820, “Fair Value Measurements and Disclosures” (“ASC 820”). ASC 820 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, 2010 were as follows (in thousands):

|                                | Fair Value<br>as of<br>March 31,<br>2010 | Fair Value Measurement Using |             |                  |
|--------------------------------|--|------------------------------|-------------|------------------|
|                                |  | Level 1                      | Level 2     | Level 3          |
| Warrant liability, current     | \$ 705                                   | \$ —                         | \$ —        | \$ 705           |
| Warrant liability, long-term   | 14,834                                   | —                            | —           | 14,834           |
| <b>Total Warrant liability</b> | <b>\$ 15,539</b>                         | <b>\$ —</b>                  | <b>\$ —</b> | <b>\$ 15,539</b> |

Note: Classification is based on warrant expiration date.

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



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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, 2010    | \$ 6,878  |
| Change in fair value of warrants | 9,497     |
| Fair value of warrants exercised | (836 )    |
| Balance as of March 31, 2010     | \$ 15,539 |

For the three months ended March 31, 2010, the change in fair value of the warrant liability of \$9.5 million was 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,<br>2010 |   | December<br>31, 2009 |   |
|---------------------------|-------------------|---|----------------------|---|
| Risk-free interest rate   | 0.16% -<br>1.6    | % | 0.06% -<br>2.69      | % |
| Expected volatility       | 59.3% -<br>89.9   | % | 62.8% -<br>90.6      | % |
| Expected life ( in years) | 1.25 - 3.75       |   | 0.25 - 4.0           |   |
| 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,<br>2010<br>(unaudited) |    | December<br>31, 2009 |  |
|--------------------------------------|----------------------------------|----|----------------------|--|
| Accounts receivable                  | \$ 4,844                         | \$ | 5,147                |  |
| Less allowance for doubtful accounts | (484)                            |    | (584)                |  |
| Net receivables                      | \$ 4,360                         | \$ | 4,563                |  |

#### 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 ASC 260, 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<br>March 31, 2010 |            |                     | Three Months Ended<br>March 31, 2009 |            |                     |
|--|--------------------------------------|------------|---------------------|--------------------------------------|------------|---------------------|
|  | Income                               | Shares     | Per Share<br>Amount | Income                               | Shares     | Per Share<br>Amount |
| Basic EPS                                  |                                      |            |                     |                                      |            |                     |
| Loss allocated to common shares            | \$ (8,617 )                          | 17,109,706 | \$ (0.50 )          | \$ (419 )                            | 15,860,517 | \$ (0.03 )          |
| Loss allocated to participating securities | \$ —                                 |            |                     |                                      |            |                     |
| Net loss                                   | \$ (8,617 )                          |            |                     | \$ (419 )                            |            |                     |
| Diluted potential common shares            |                                      | —          |                     |                                      | —          |                     |
| Diluted EPS                                |                                      |            |                     |                                      |            |                     |
| Net loss                                   | \$ (8,617 )                          | 17,109,706 | \$ (0.50 )          | \$ (419 )                            | 15,860,517 | \$ (0.03 )          |

For the three months ended March 31, 2010, the Company has excluded options, warrants and convertible preferred stock to acquire 19,463,750 shares of its common stock since their effect would be anti-dilutive. 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.

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,<br>2010<br>(unaudited) | December<br>31, 2009 |
|-----------------|----------------------------------|----------------------|
| Raw materials   | \$ 746                           | \$ 806               |
| Work in process | 256                              | 709                  |
| Finished goods  | 1,191                            | 664                  |
| Total inventory | \$ 2,193                         | \$ 2,179             |

Note 7 : Prepaid Expenses and Other Current Assets:

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

|  | March 31,<br>2010<br>(unaudited) | December<br>31, 2009 |
|--|----------------------------------|----------------------|
|--|----------------------------------|----------------------|

|   |    |     |    |     |
|---|----|-----|----|-----|
| Vendor prepayments                              | \$ | 256 | \$ | 266 |
| Other prepaid expenses *                        |    | 483 |    | 421 |
| Other assets                                    |    | 1   |    | —   |
| Total prepaid expenses and other current assets | \$ | 740 | \$ | 687 |

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

#### Note 8 : Debt

At March 31, 2010, the Company had available a credit facility with Access Business Finance, LLC (“Access”) under which the Company may borrow up to a maximum of \$3 million based on a borrowing base equivalent of 75% of eligible accounts receivable. The interest on the line of credit is equal to the Prime Rate plus 4.00% but may not be less than 7.25% with a minimum monthly interest payment of \$5,000. The term of the agreement with Access is for one year and automatically renews for successive one year terms unless, at least 60 days prior to the end of the current term, the Company gives Access prior written notice of its intent not to renew or if Access, at least ten days prior to the end of the current term, gives the Company written notice of its intent not to renew. The renewal date is September 1, 2010 and the fees for renewing the credit facility are \$25,000. The Company’s obligations under the agreement are secured by its assets. As of March 31, 2010, the Company had not borrowed on its line of credit.

## Note 9 : Stock-based Compensation

The Company uses the fair value method of accounting for share-based compensation arrangements. The fair value of stock options 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, 2010 and 2009 (in thousands):

|                                     | Three Months Ended<br>March 31, |        |
|-------------------------------------|---------------------------------|--------|
|                                     | 2010                            | 2009   |
| Cost of revenue                     | \$ 97                           | \$ 24  |
| Research and development            | 102                             | 58     |
| Selling, general and administrative | 234                             | 71     |
| Total stock compensation expense    | \$ 433                          | \$ 153 |

At March 31, 2010, total unrecognized compensation costs related to stock options was approximately \$0.4 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 0.9 years.

Options granted to non-employees are measured at the grant date using a fair value options pricing model and remeasured to the current fair market value at each reporting period as the underlying options vest and services are rendered. There were no options granted to consultants in the three months ended March 31, 2010. In May 2009, there were 60,000 options granted to consultants, of which the unvested options were remeasured to the current fair market value at March 31, 2010. The following assumptions were used in the Black-Scholes option pricing model to determine the fair value of stock options granted: dividend yield – 0%; risk free interest rates – 1.44% to 1.60%; expected volatility – 73.7% to 83.6%; and expected term – 3 years.

During the three month period ended March 31, 2010, there were 448,185 stock options granted to employees. During the three month period ended March 31, 2009, there were no stock options granted 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<br>Three<br>Months<br>Ended<br>March 31,<br>2010 |
|--------------------------|--|
| Dividend yield           | 0%   |
| Risk free interest rates | 1.34 – 2.07%   |
| Expected volatility      | 80.6 – 86.9%   |
| Expected term (in years) | 3.5-4  |

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.

For the three months ended March 31, 2010, 10,500 options were granted to employees from the 2008 Plan with a fair value of approximately \$12 thousand and 437,685 options were granted to employees from the 2003 Plan with a fair value of approximately \$500 thousand. The weighted average fair value per share for options granted in the first quarter of 2010 was \$1.16.

A summary of the Company's stock option activity for the three months ended March 31, 2010 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 December 31, 2009                 | 2,817,574        | \$ 1.33                         |  |                           |
| Options granted                                  | 448,185          | 1.95                            |  |                           |
| Options exercised                                | —                |                                 |  |                           |
| Options forfeited                                | —                |                                 |  |                           |
| Options cancelled                                | (52,113)         | 2.62                            |  |                           |
| Outstanding at March 31, 2010                    | 3,213,646        | \$ 1.40                         | 6.11   | \$ 7,818,813              |
| Vested or expected to vest at March 31, 2010 (1) | 3,150,652        | \$ 1.37                         | 6.11   | \$ 5,604,831              |
| Exercisable at March 31, 2010                    | 2,313,721        | \$ 1.43                         | 6.54   | \$ 5,604,831              |

(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 Exercise Price |  |
| 0.34 - \$ 0.98  | 1,221,451           | 6.07   | \$ 0.83                         | 893,385             | \$ 0.81                         |  |
| 1.00 - \$ 1.51  | 1,191,177           | 6.92   | 1.20                            | 893,390             | 1.24                            |  |
| 1.80 - \$ 1.94  | 452,635             | 6.83   | 1.94                            | 216,568             | 1.94                            |  |
| 2.60 - \$ 2.70  | 312,183             | 2.63   | 2.62                            | 275,678             | 2.61                            |  |
| 5.80 - \$ 22.50 | 36,200              | 1.58   | 9.92                            | 34,700              | 9.82                            |  |
|                 | 3,213,646           | 6.11   | \$ 1.40                         | 2,313,721           | \$ 1.43                         |  |

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 3,177,446 options in-the-money at March 31, 2010. The Company's closing stock price was \$3.76 as of March 31, 2010. 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 Series B Convertible Preferred Stock ("the Preferred -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, 2010, there were 5,739 shares of Preferred Stock – Series B issued and outstanding.

## Common Stock

For the three months ended March 31, 2010 and 2009, there were no stock options exercised. For the three months ended March 31, 2010, there were 669,717 warrants exercised on a cashless basis resulting in 334,608 shares of common stock issued. For the three months ended March 31, 2009, there were no warrants exercised.

For the three months ended March 31, 2010, no shares of common stock were issued for payment for services rendered and to be rendered in the future. 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 to be rendered and 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 financial statements for the three months ended March 31, 2009.

## Note 11: Income Taxes

The Company accounts for income taxes under an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. The effect on deferred tax assets and liabilities of changes in tax rates will be recognized as income or expense in the period that the change occurs. A valuation allowance for deferred tax assets is recorded when it is more likely than not that some or all of the benefit from the deferred tax asset will not be realized. Changes in circumstances, assumptions and clarification of uncertain tax regimes may require changes to any valuation allowances associated with the Company's deferred tax assets.

Due to the Company's operating loss carryforwards, all tax years remain open to examination by the major taxing jurisdictions to which the Company is subject. In the event that the Company is assessed interest or penalties at some point in the future, it will be classified in the financial statements as tax expense.

## Note 12 : Commitments and Contingencies

### Royalty Payments

The Company signed a license agreement on March 29, 1999 with Eastman Kodak ("Kodak"), under which it is obligated to make royalty payments. Under this agreement, the Company must pay to Kodak a minimum royalty plus 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. The Company was notified that Kodak sold substantially all rights and obligations under the Company's license agreement to Global OLED Technology, owned by LG Electronics, as of December 30, 2009.

In late 2008, the Company began evaluating the status of its manufacturing process and the use of the IP associated with its license agreement. After this analysis and after making a few changes to its manufacturing process, the Company determined it was no longer using the IP covered under the license agreement. As the Company has determined it is no longer using the IP covered under the license agreement in its manufacturing process, the Company believes that it is no longer required to pay the minimum annual royalty payment of \$125,000 and as such has not paid or accrued this amount in 2010. Going forward, the Company will continue to recognize the reduced royalty liability on sales of product produced prior to the manufacturing process change. There can be no assurance that the licensor will not challenge the Company's position.

As of March 31, 2010, the Company had approximately \$108 thousand of inventory manufactured using the IP which if sold would result in royalty due of approximately \$23 thousand. For the three months ended March 31, 2010, the Company recorded approximately \$6 thousand as royalty expense in its consolidated statements of operations and the associated liability on its consolidated balance sheet as the Company believes this is the amount due under the agreement which is based on applying the royalty formula to only the sold displays produced prior to the manufacturing process changes. Royalty expense was approximately \$308 thousand for the three months ended March 31, 2009.

#### Contractual Obligations

The Company leases office facilities and office, lab and factory equipment under operating leases. Certain leases provide for payments of monthly operating expenses. The Company currently has lease commitments for space in Hopewell Junction, New York and Bellevue, Washington.

The Company's manufacturing facilities are leased from IBM in Hopewell Junction, New York. eMagin leases approximately 37,000 square feet to house its equipment for OLED microdisplay fabrication and for research and development, an assembly area and administrative offices. The lease expires May 31, 2014 with the option of extending the lease for five years. The corporate headquarters are located in Bellevue, Washington where eMagin leases approximately 5,100 square feet. The lease expires on August 31, 2014. For the three months ended March 31, 2010 and 2009, rent expense was approximately \$283 thousand and \$332 thousand, respectively.

Note 13 : Legal Proceedings

On March 17, 2010, Gary Jones, a former executive at the Company, filed a complaint for damages in the Superior Court of the State of Washington for King County (the "Complaint") against the Company and the Company's Chief Financial Officer. The Complaint alleges unspecified damages for failure to pay contractual payments and wages under Washington law and includes, among other claims, breach of contract, breach of the duty of good faith and fair dealing, promissory estoppel and misrepresentation. The Company denies the allegations raised in the Complaint and intends to vigorously defend itself. There can be no assurance of the outcome of this matter.

Note 14 : Subsequent Events

Pursuant to the Employment Agreement between the Company and Susan Jones (as previously amended and extended), the term of Ms. Jones' contract with the Company ended May 12, 2010 and her employment with the Company ceased at that time. Under the terms of the Employment Agreement between Susan Jones and the Company, Susan Jones could be entitled to payment of eighteen months salary totaling approximately \$473 thousand and incentive payments of 1% of revenue paid quarterly for a period of 18 months. The Company and Ms. Jones are negotiating the terms of a settlement agreement which may provide for payments to be made to her although no assurance can be given that any agreement will be reached.

Note 15: Restatement

In this Amended 10-Q, eMagin restated its previously issued condensed consolidated financial statements as of and for the three months ended March 31, 2010 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 provisions of ASC 815. Authoritative guidance, 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 ASC 815. 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 ASC 815 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, 2010, the Company computed the fair value of the warrant liability as \$15.5 million, an increase of \$8.7 million. The change in the warrant liability of \$8.7 million was comprised of the change in the fair value of the warrants of \$9.5 million offset by the fair value of the exercised warrants of \$0.8 million. The change in the fair value from January 1, 2010 through March 31, 2010 of \$9.5 million was recorded as other expense in the Condensed Consolidated Statements of Operations for the three months ended March 31, 2010. The Condensed Consolidated Statement of Changes in Shareholders' Equity (Capital Deficit), 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, 2010 | Exercise Price | Warrant Expiration Dates | Fair Value of Warrants at January 1, 2010 (in thousands) | Fair Value of Warrants at March 31, 2010 (in thousands) |
|------------------------|---|----------------|--------------------------|--|---|
| October 25, 2004       | 650,001   | \$ 2.50        | April 25, 2010           | \$ 34  | \$ 705  |
| July 23, 2007          | 2,061,381   | \$ 1.03        | July 21, 2011            | 2,222  | 4,888   |
| July 23, 2007          | 1,000,000   | \$ 0.48        | July 21, 2011            | 1,293  | 3,028   |
| April 2, 2008          | 552,887   | \$ 1.13        | April 2, 2013            | 1,041  | 1,579   |
| December 22, 2008      | 1,875,467   | \$ 1.03        | December 22, 2013        | 2,288  | 5,339   |
| Total Fair Value       |   |                |                          | \$ 6,878   | \$ 15,539   |

The table below is a reconciliation of the beginning and ending balances for the warrant liability:

|                                  | Number of Warrants | Warrant Issuance Dates | Fair Value of Warrants (in thousands) |
|----------------------------------|--------------------|------------------------|---------------------------------------|
| Balance as of January 1, 2010    |                    |                        | \$ 6,878                              |
| Change in fair value of warrants |                    |                        | 9,497                                 |
| Fair value of warrants exercised | 429,331            | July 23, 2007          | (489 )                                |
| Fair value of warrants exercised | 240,386            | April 2, 2008          | (347 )                                |
| Balance as of March 31, 2010     |                    |                        | \$ 15,539                             |

Additionally, under ASC 260, "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, 2010:

| Condensed Consolidated Balance Sheet | March 31, 2010<br>(As previously reported) | March 31, 2010<br>(As restated) |
|--------------------------------------|--|---------------------------------|
| (in thousands)                       |  |                                 |

|  |            |             |
|--|------------|-------------|
| Warrant liability                            | \$ —       | \$ 705      |
| Total current liabilities                    | 4,210      | 4,915       |
| Warrant liability                            | —          | 14,834      |
| Total liabilities                            | \$ 4,210   | \$ 19,749   |
| Shareholders' equity (capital deficit):      |            |             |
| Additional paid-in capital                   | \$ 207,097 | \$ 194,627  |
| Accumulated deficit                          | (196,030 ) | (199,099 )  |
| Total shareholders' equity (capital deficit) | \$ 11,084  | \$ (4,455 ) |

| Condensed Consolidated Statements of Operations       | Three Months Ended<br>March 31, 2010 |               |
|---|--------------------------------------|---------------|
| (in thousands except share and per share data)        | (As<br>previously<br>reported)       | (As restated) |
| Change in fair value of warrant liability             | \$ —                                 | \$ (9,497 )   |
| Total other expense                                   | \$ (21 )                             | \$ (9,518 )   |
| Net income (loss)                                     | \$ 880                               | \$ (8,617 )   |
| Income (loss) per share, basic                        | \$ 0.05                              | \$ (0.50 )    |
| Income (loss) per share, diluted                      | \$ 0.03                              | \$ (0.50 )    |
| <b>Weighted average number of shares outstanding:</b> |                                      |               |
| Basic   | 17,109,706                           | 17,109,706    |
| Diluted   | 29,553,301                           | 17,109,706    |

| Condensed Consolidated Statements of Cash Flows     | Three Months Ended<br>March 31, 2010 |               |
|---|--------------------------------------|---------------|
| (in thousands)                                      | (As<br>previously<br>reported)       | (As restated) |
| Net income (loss)                                   | \$ 880                               | \$ (8,617 )   |
| Loss from change in fair value of warrant liability | —                                    | 9,497         |
| Net cash provided by operating activities           | \$ 1,466                             | \$ 1,466      |



## 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, 2010 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 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.

### Product Warranty

We offer a one-year product replacement warranty. In general, our standard policy is to repair or replace the defective products. We accrue for estimated returns of defective products at the time revenue is recognized based on historical activity as well as for specific known product issues. The determination of these accruals requires us to make estimates of the frequency and extent of warranty activity and estimate future costs to replace the products under warranty. If the actual warranty activity and/or repair and replacement costs differ significantly from these estimates, adjustments to cost of revenue may be required in future periods.

### 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, and accounts payable 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, 2010, the number of shares of common stock available for issuance was 300,000. As of March 31, 2010, 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. For the three months ended March 31, 2010, there were 437,685 options granted from this plan.

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, 2010, there were 10,500 options were granted from this plan.

We account for the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors by estimating the fair value of stock awards 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 of 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, 2010 COMPARED TO THREE MONTHS ENDED MARCH 31, 2009

##### Revenues

Revenues for the three months ended March 31, 2010 were approximately \$5.9 million, as compared to approximately \$5.1 million for the three months ended March 31, 2009, an increase of approximately 15%. Higher revenue for the three month period was due primarily to an increase in contract revenue.

For the three months ended March 31, 2010, product revenue increased approximately \$130 thousand or 3% as compared to the three months ended March 31, 2009. The slight increase was driven by the mix of products sold in the first quarter of 2010 as compared to the first quarter of 2009. For the three months ended March 31, 2010, contract revenue increased approximately \$0.7 million or 83% as compared to the first quarter of 2009 which was a result of an increase in the number of active projects in the first quarter of 2010 as compared to the first quarter of 2009.

##### Cost of Goods Sold

Cost of goods sold is comprised of costs of product revenue and contract revenue. Cost of product revenue includes materials, labor and manufacturing overhead related to our products. Cost of contract revenue includes direct and allocated indirect costs associated with performing on contracts. Cost of goods sold for the three months ended March 31, 2010 was approximately \$2.6 million as compared to approximately \$2.7 million for the three months ended March 31, 2009, a decrease of approximately \$0.1 million. Cost of goods sold as a percentage of revenues was 44% for the three months ended March 31, 2010 as compared to 52% for the three months ended March 31, 2009.

The following table outlines product, contract and total gross profit and related gross margins for the three months ended March 31, 2010 and 2009 (dollars in thousands):

Three months ended  
March 31,

|                               | 2010        | 2009     |
|-------------------------------|-------------|----------|
|                               | (unaudited) |          |
| Product revenue gross profit  | \$ 2,641    | \$ 2,099 |
| Product revenue gross margin  | 59%         | 48%      |
| Contract revenue gross profit | \$ 677      | \$ 360   |
| Contract revenue gross margin | 47%         | 46%      |
| Total gross profit            | \$ 3,318    | \$ 2,459 |
| Total gross margin            | 56%         | 48%      |

The gross profit for the three months ended March 31, 2010 was approximately \$3.3 million as compared to approximately \$2.5 million for the three months ended March 31, 2009, an increase of \$0.8 million. Gross margin was 56% for the three months ended March 31, 2010 up from 48% for the three months ended March 31, 2009.

The product gross profit for the three months ended March 31, 2010 was approximately \$2.6 million as compared to approximately \$2.1 million for the three months ended March 31, 2009, an increase of \$0.5 million. Product gross margin was 59% for the three months ended March 31, 2010 up from 48% for the three months ended March 31, 2009. The gross margin was favorably impacted by an increase in the headset inventory as of March 31, 2010 and a reduction in royalty expense in the first quarter of 2010 and offset by an increase in personnel expenses, including stock-based compensation.

The contract gross profit for the three months ended March 31, 2010 was approximately \$0.7 million as compared to approximately \$0.4 million for the three months ended March 31, 2009, an increase of \$0.3 million. Contract gross margin was 47% for the three months ended March 31, 2010 up slightly from 46% for the three months ended March 31, 2009. The contract gross margin is dependent upon the mix of costs, internal versus external third party costs, with external third party costs causing a lower gross margin and reducing the contract gross profit.

#### 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, 2010 were approximately \$0.7 million as compared to \$0.4 million for the three months ended March 31, 2009, an increase of approximately \$0.3 million. The increase was primarily related to an increase in internal research and development on new products of approximately \$0.25 million and an increase in personnel expenses, including stock-based compensation, of \$0.05 million.

**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, 2010 were approximately \$1.7 million as compared to approximately \$1.5 million for the three months ended March 31, 2009. The increase of approximately \$0.2 for the three months ended March 31, 2010 was primarily related to an increase in personnel costs, professional fees and offset by a reduction of rent expense.

**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, 2010, interest expense was approximately \$28 thousand as compared to \$175 thousand for the three months ended March 31, 2009. For the three months ended March 31, 2010, the interest expense associated with debt was \$21 thousand and the accrued interest on liquidated damages was \$7 thousand. The breakdown of the interest expense for the three month period in 2009 is as follows: interest expense associated with debt of approximately \$25 thousand and the amortization of the deferred costs associated with the debt of approximately \$150 thousand. The decrease in interest expense for the three months ended March 31, 2010 as compared to the three months ended March 31, 2009 was primarily a result of the Company not having any outstanding debt.

Other income for the three months ended March 31, 2010 was approximately \$7 thousand for the three months ended March 31, 2010 as compared to \$1 thousand for the three months ended March 31, 2009. The other income for the three months ended March 31, 2010 was interest income of approximately \$1 thousand and \$6 thousand from equipment salvage. The other income for the three months ended March 31, 2009 was interest income of approximately \$1 thousand.

Change in Fair Value of Warrant Liability. In accordance with ASC 815, adopted January 1, 2009, certain warrants previously classified within equity were 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, 2010 and 2009 was measured by using the Monte Carlo Simulation model. The revaluation resulted in a charge of approximately \$9.5 million for the three months ended March 31, 2010 as compared to a charge of approximately \$0.8 million for the three months ended March 31, 2009. This revaluation resulted in non-cash changes to other income (expense) and had no impact on our cash balances, operations, or operating income.

#### Liquidity and Capital Resources

As of March 31, 2010, we had approximately \$6.0 million of cash as compared to \$5.3 million as of December 31, 2009. The change in cash of \$0.7 million was primarily due to cash provided by operations of approximately \$1.5 million offset by cash used for investing activities of approximately \$0.8 million.

Cash flow provided by operating activities during the three months ended March 31, 2010 was approximately \$1.5 million, attributable to our net loss of approximately \$8.6 million offset by non-cash expenses of approximately \$9.8 million and approximately \$0.3 million from the change in operating assets and liabilities. 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 used in investing activities during the three months ended March 31, 2010 and 2009 was approximately \$763 thousand and \$33 thousand, respectively, to purchase equipment.

There was no cash used by financing activities during the three months ended March 31, 2010. 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.

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. 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, we may need additional funds. If additional funds are required and if we are unable to obtain sufficient funds we may have to 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 4. Controls and Procedures

##### (a) Evaluation of Disclosure Controls and Procedures.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934 (the "Exchange Act")) as of the end of the period covered by this Quarterly Report on Form 10-Q/A. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

#### 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.

Except as stated above, there were no changes in our internal controls over financial reporting during the fiscal quarter ended March 31, 2010 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

### ITEM 1. Legal Proceedings

On March 17, 2010, Gary Jones, a former executive at the Company filed a complaint for damages in the Superior Court of the State of Washington for King County (the "Complaint") against the Company and the Company's Chief Financial Officer. The Complaint alleges unspecified damages for failure to pay contractual payments and wages under Washington law and includes, among other claims, breach of contract, breach of the duty of good faith and fair dealing, promissory estoppel and misrepresentation. The Company denies the allegations raised in the Complaint and intends to vigorously defend itself. There can be no assurance of the outcome of this matter.

### 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 / A for the year ended December 31, 2009. There were no material changes from the risk factors during the three months ended March 31, 2010.

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

Pursuant to various cashless warrant exercises, the Company issued 334,608 shares of common stock.

### 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.

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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)