

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 June 30, 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 (§232.405 of this chapter) during the preceding 12 months). Yes No

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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
R

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

The number of shares of common stock outstanding as of July 31, 2009 was 16,192,135.

eMagin Corporation
 Form 10-Q/A
 For the Quarter ended June 30, 2009

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SIGNATURES

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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 June 30, 2009, which was originally filed with the Securities and Exchange Commission on August 13, 2009 (the “Original 10-Q”). This Amendment is being filed mainly to include restated condensed consolidated financial statements as described in Note 16, 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)

	June 30, 2009 (unaudited) (Restated) See Note 16	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 2,894	\$ 2,404
Investments – held to maturity	97	97
Accounts receivable, net	2,919	3,643
Inventory	2,561	2,374
Prepaid expenses and other current assets	837	796
Total current assets	9,308	9,314
Equipment, furniture and leasehold improvements, net	819	381
Intangible assets, net	45	47
Deferred financing costs, net	61	362
Total assets	\$ 10,233	\$ 10,104
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 468	\$ 1,026
Accrued compensation	865	837
Other accrued expenses	688	804
Advance payments	266	694
Deferred revenue	132	164
Debt	232	1,691
Warrant liability	70	—
Other current liabilities	955	798
Total current liabilities	3,676	6,014
Warrant liability	5,124	—
Total liabilities	\$ 8,800	\$ 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

Common stock, \$.001 par value: authorized 200,000,000 shares, issued and outstanding, 15,669,635 shares as of June 30, 2009 and 15,213,959 as of December 31, 2008, net of redeemable common stock

	16	15
Additional paid-in capital	190,530	204,818
Accumulated deficit	(189,542)	(201,172)
Total shareholders' equity	1,004	3,661
Total liabilities and shareholders' equity	\$ 10,233	\$ 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 June 30, 2009 (Restated) See Note 16		Six Months Ended June 30, 2009 (Restated) See Note 16	
	2008	2008	2008	2008
Revenue:				
Product revenue	\$ 4,944	\$ 4,496	\$ 9,300	\$ 6,958
Contract revenue	908	1,123	1,696	1,326
Total revenue, net	5,852	5,619	10,996	8,284
Cost of goods sold:				
Product revenue	1,565	2,437	3,822	4,618
Contract revenue	488	559	916	691
Total cost of goods sold	2,053	2,996	4,738	5,309
Gross profit	3,799	2,623	6,258	2,975
Operating expenses:				
Research and development	392	634	754	1,308
Selling, general and administrative	1,941	1,697	3,470	3,504
Total operating expenses	2,333	2,331	4,224	4,812
Income (loss) from operations	1,466	292	2,034	(1,837)
Other expense:				
Interest expense	(166)	(537)	(341)	(1,168)
Other income, net	39	123	40	209
Change in fair value of warrant liability	(2,251)	—	(3,064)	—
Total other expense	(2,378)	(414)	(3,365)	(959)
Net loss	\$ (912)	\$ (122)	\$ (1,331)	\$ (2,796)
Loss per share, basic	\$ (0.06)	\$ (0.01)	\$ (0.08)	\$ (0.21)
Loss per share, diluted	\$ (0.06)	\$ (0.01)	\$ (0.08)	\$ (0.21)

Weighted average number of shares outstanding:

Basic	16,186,482	14,320,570	16,024,400	13,470,735
Diluted	16,186,482	14,320,570	16,024,400	13,470,735

See notes to Condensed Consolidated Financial Statements.

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

	Preferred Stock		Common Stock		Additional Paid-in Capital (Restated) See Note 16	Accumulated Deficit (Restated) See Note 16	Total Shareholders' Equity (Restated) See Note 16
	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	—	—	456	1	258	—	259
Stock-based compensation	—	—	—	—	545	—	545
Net loss	—	—	—	—	—	(1,331)	(1,331)
Balance, June 30, 2009	6	\$ —	15,670	\$ 16	\$ 190,530	\$ (189,542)	\$ 1,004

See notes to Condensed Consolidated Financial Statements.

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

	Six Months Ended June 30, 2009 (Restated) See Note 16		2008 (unaudited)
Cash flows from operating activities:			
Net loss	\$	(1,331)	\$ (2,796)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Depreciation and amortization		46	129
Amortization of deferred financing and waiver fees		301	821
(Reduction of) increase in provision for sales returns and doubtful accounts		(452)	146
Stock-based compensation		545	607
Amortization of common stock issued for services		126	88
Change in the fair value of warrant liability		3,064	—
Amortization of discount on notes payable		—	25
Changes in operating assets and liabilities:			
Accounts receivable		1,175	(1,364)
Inventory		(186)	89
Prepaid expenses and other current assets		92	214
Deferred revenue		(32)	(99)
Accounts payable, accrued compensation, other accrued expenses, and advance payments		(1,074)	539
Other current liabilities		120	(424)
Net cash provided by (used in) operating activities		2,394	(2,025)
Cash flows from investing activities:			
Purchase of equipment		(482)	(236)
Net cash used in investing activities		(482)	(236)
Cash flows from financing activities:			
Proceeds from sale of common stock, net of issuance costs		—	1,580
Proceeds from debt		—	1,700
Payments related to deferred financing costs		—	(9)
Payments of debt and capital leases		(1,422)	(685)
Net cash (used in) provided by financing activities		(1,422)	2,586
Net increase in cash and cash equivalents		490	325
Cash and cash equivalents beginning of period		2,404	713
Cash and cash equivalents end of period	\$	2,894	\$ 1,038
Cash paid for interest			
	\$	54	\$ 314
Cash paid for taxes			
	\$	35	\$ 21
Common stock issued for services charged to prepaid expenses			
	\$	133	\$ 202

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 of America 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 June 30, 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 and six months ended June 30, 2009 to correct errors in the accounting for certain warrants as discussed in Note 16, “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. 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 June 2009, the FASB issued SFAS No. 168, “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162” (“SFAS 168”). The FASB Accounting Standards Codification (“Codification”) will be the single source of authoritative nongovernmental U.S. generally accepted accounting principles. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. SFAS 168 is effective for interim and annual periods ending after September 15, 2009. All existing accounting standards are superseded as described in SFAS 168. All other accounting literature not included in the Codification is non-authoritative. The Company is evaluating the requirements of the adoption of SFAS 168.

In May 2009, the FASB issued SFAS No. 165, “Subsequent Events” (“SFAS 165”). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 sets forth (1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and (3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 is effective for interim or annual financial periods ending after June 15, 2009. The adoption of SFAS 165 did not have a material impact on the Company’s condensed consolidated financial statements.

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

Effective January 1, 2009, the Company adopted EITF 07-5, "Determining Whether an Instrument (or an Embedded Feature) is Indexed to an Entity's Own Stock". 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 \$2,251 thousand and \$3,064 thousand, respectively, for the change in the fair value of the warrant liability during the three and six months ended June 30, 2009.

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 June 30, 2009 were as follows (in thousands):

	Fair Value as of June 30, 2009	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
Warrant liability, current	\$ 70	\$ —	\$ —	\$ 70
Warrant liability, long-term	\$ 5,124	\$ —	\$ —	\$ 5,124
Total Warrant liability	\$ 5,194	\$ —	\$ —	\$ 5,194

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
Increase in fair value of warrants	3,079
Less: value of warrants expired	(15)
Balance as of June 30, 2009	\$ 5,194

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:

	June 30, 2009	January 1, 2009
Risk-free interest rate	0.56% - 2.54 %	0.11% - 1.55 %
Expected volatility	97.3 %	94.4 %
Expected life (in years)	0.75 – 4.50	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):

	June 30, 2009 (unaudited)	December 31, 2008
Accounts receivable	\$3,324	\$4,500
Less allowance for doubtful accounts	(405)	(857)
Net receivables	\$2,919	\$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 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 June 30, 2009			Three Months Ended June 30, 2008		
	Loss	Shares	Per Share Amount	Loss	Shares	Per Share Amount
Basic EPS						
Loss allocated to common shares	\$ (912)	16,186,482	\$ (0.06)	\$ (122)	14,320,570	\$ (0.01)
Loss allocated to participating securities	\$ —			\$ —		
Net loss	\$ (912)			\$ (122)		
Diluted potential common shares		—			—	
Diluted EPS						
Net loss	\$ (912)	16,186,482	\$ (0.06)	\$ (122)	14,320,570	\$ (0.01)

	Six Months Ended June 30, 2009			Six Months Ended June 30, 2008		
	Loss	Shares	Per Share Amount	Loss	Shares	Per Share Amount
Basic EPS						
Loss allocated to common shares	\$ (1,331)	16,024,400	\$ (0.08)	\$ (2,796)	13,470,735	\$ (0.21)
Loss allocated to participating securities	\$ —			\$ —		
Net loss	\$ (1,331)			\$ (2,796)		
		—			—	

Diluted potential common shares						
Diluted EPS						
Net loss	\$ (1,331)	16,024,400	\$ (0.08)	\$ (2,796)	13,470,735	\$ (0.21)

For the three and six months ended June 30, 2009, the Company has excluded options, warrants, redeemable common stock and convertible preferred stock to acquire 22,753,637 of its common stock since their effect would be anti-dilutive. For the three and six months ended June 30, 2008, the Company has excluded options, warrants, and convertible notes outstanding to acquire 19,838,984 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. The Company reviews the value of its inventory and reduces the inventory value to its net realizable value based upon current market prices and contracts for future sales. The components of inventories are as follows (in thousands):

	June 30, 2009 (unaudited)	December 31, 2008
Raw materials	\$ 962	\$ 1,109
Work in process	322	280
Finished goods	1,277	985
Total inventory	\$ 2,561	\$ 2,374

Note 7 : Prepaid Expenses and Other Current Assets:

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

	June 30, 2009 (unaudited)	December 31, 2008
Vendor prepayments	\$ 196	\$ 180
Other prepaid expenses *	503	383
Other assets	138	233
Total prepaid expenses and other current assets	\$ 837	\$ 796

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

Note 8 : Debt

Debt, all of which is current, is as follows (in thousands):

	June 30, 2009 (unaudited)	December 31, 2008
Line of credit	\$ 232	\$ 1,631
Other debt	—	60
Total debt	\$ 232	\$ 1,691

The Company's line of credit with Moriah Capital, L.P. ("Moriah") matured on August 7, 2009 and the Company repaid a total of approximately \$232 thousand in principal and interest due on the line of credit. The Company will not be renewing its loan agreement with Moriah. See Note 15 : Subsequent Events for information regarding the Company's line of credit. As of June 30, 2009, the Company was in compliance with the financial covenants of the loan agreement.

In the three and six months ended June 30, 2009, approximately \$151 thousand and \$301 thousand, respectively, of deferred debt issuance costs were amortized to interest expense. For the three and six months ended June 30, 2009, interest expense includes interest paid or accrued of approximately \$15 thousand and \$40 thousand, respectively, on outstanding debt.

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 and six month periods ended June 30, 2009 and 2008 (in thousands):

Three Months Ended June 30,	Six Months Ended June 30,
--------------------------------	------------------------------

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	2009	2008	2009	2008
Cost of revenue	\$62	\$23	\$86	\$75
Research and development	68	52	126	134
Selling, general and administrative	262	176	333	398
Total stock compensation expense	\$392	\$251	\$545	\$607

At June 30, 2009, total unrecognized non-cash compensation cost related to stock options was approximately \$489 thousand, net of 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 1.5 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. There were 60,000 options granted to consultants for the three and six months ended June 30, 2009. 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 1.64%; expected volatility – 83.6% to 84.1%; and expected term – 3 years.

There were 807,241 options granted to employees and directors during the three and six months ended June 30, 2009 and 588,000 and 748,000 options granted to employees and directors during the three and six months ended June 30, 2008. The following key assumptions were used in the Black-Scholes option pricing model to determine the fair value of stock options granted:

	For the Six Months Ended June 30,			
	2009		2008	
Dividend yield	0	%	0	%
Risk free interest rates	1.46 to 2.15%		2.46 to 3.28 %	
Expected volatility	79.4 to 87.0%		89.6 to 92.3 %	
Expected term (in years)	3.5 to 5		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 June 30, 2009, 867,241 options were granted from this plan with a fair value of approximately \$507 thousand and 455,676 shares were issued with a fair value of approximately \$259 thousand. At June 30, 2009, there were 677,083 shares available for grant.

A summary of the Company’s stock option activity for the six months ended June 30, 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		

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Options granted	867,241	0.97		
Options exercised	—			
Options forfeited	(71,598)	2.60		
Options cancelled	—			
Outstanding at June 30, 2009	2,411,316	\$1.36	6.08	\$327,027
Vested or expected to vest at June 30, 2009 (1)	2,342,242	\$1.31	1.54	\$253,125
Exercisable at June 30, 2009	1,720,569	\$1.43	6.49	\$253,125

	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 - \$ \$0.98	1,226,793	6.81	\$ 0.83	894,407	\$ 0.81	
1.00 - \$ \$1.44	788,577	6.51	1.23	495,270	1.32	
2.60 - \$ \$2.70	358,746	3.00	2.62	298,392	2.61	
3.50 - \$ \$5.80	8,000	3.06	5.51	8,000	5.51	
6.60 - \$ \$22.50	29,200	2.07	10.91	24,500	10.90	
	2,411,316	6.08	\$ 1.36	1,720,569	\$ 1.43	

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

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 1,260,093 options in-the-money at June 30, 2009. The Company's closing stock price was \$1.09 as of June 30, 2009. The Company issues new shares of common stock upon exercise of stock options.

Note 10 : Shareholders' Equity

Preferred Stock

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 June 30, 2009, there were 5,739 shares of Preferred Stock – Series B issued and outstanding.

Common Stock

For the three and six months ended June 30, 2009 and 2008, there were no stock options or warrants exercised.

For the three and six months ended June 30, 2009, the Company issued approximately 240,000 and 456,000 shares of common stock, respectively, for payment of approximately \$144 thousand and \$259 thousand, respectively, for services rendered and to be rendered in the future. For the three and six months ended June 30, 2008, the Company issued approximately 182,000 shares of common stock for payment of approximately \$202 thousand for services rendered and 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 financial statements for the three and six months ended June 30, 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, the Company 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 the 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 is delayed until December 1st for the years 2007 and 2008. The Company recorded approximately \$170 thousand and \$254 thousand for the three and six months ended June 30, 2008, respectively, as income from the license of intangible assets and included this amount as other income in the condensed consolidated statements of operations. Royalty expense (including amounts imputed – see above) was approximately \$341 thousand and \$509 thousand, respectively, for the three and six months ended June 30, 2008.

Effective January 1, 2009, the royalty payments are to be calculated at 100%. The minimum annual royalty payment of \$125 thousand was paid in January 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. The associated royalty liability has been reduced to royalties on inventory produced prior to the manufacturing process changes. The Company is in discussions with the licensor regarding its position on the license agreement and the final outcome of these discussions is yet to be determined. Until a final outcome is reached, the Company will continue to recognize the reduced royalty liability as stated above. For the six months ended June 30, 2009, the Company estimated the range of the potential royalty is between \$227 thousand and \$660 thousand. For the six months ended June 30, 2009, the Company recorded \$227 thousand as royalty expense in its consolidated statements of operations and the associated liability on its consolidated balance sheet as the Company believes that no amount within the range of the potential royalty liability is a better estimate than any other amount.

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. In May 2009, the Company renewed its lease with IBM

until May 31, 2014 with the option of extending the lease for five years. The Company's present lease in Bellevue, Washington expires August 31, 2009. The Company signed a lease agreement for 5,100 square feet of office space effective September 1, 2009 through August 31, 2014 which will reduce the Company's monthly rent by approximately \$30 thousand. Rent expense was approximately \$342 thousand and \$674 thousand, respectively, for the three and six months ended June 30, 2009 and \$332 thousand and \$664 thousand, respectively, for the three and six months ended June 30, 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 settled this action in April 2009. This settlement did not have a material effect on the Company's results of operations.

Note 14 : Employment Agreements

On May 8, 2009, the Company signed a three year executive employment agreement with Paul Campbell to serve as the Company's Chief Financial Officer, Senior Vice President and Treasurer. Mr. Campbell has been serving as the Company's interim Chief Financial Officer since April 15, 2008. Pursuant to the employment agreement, Mr. Campbell is paid an annual salary of \$282,000 and was granted options to purchase 340,000 shares of the Company's common stock which are exercisable at \$1.09 per share, the market price on the date of the grant. The options vest as follows: one third of the options vest immediately and one third will vest annually on the subsequent two anniversary dates.

If Mr. Campbell voluntarily terminates his employment with the Company, other than for Good Reason as defined in the employment agreement, he shall cease to accrue salary, personal time off, benefits and other compensation on the date of voluntary termination. The Company may terminate Mr. Campbell's employment with or without cause. If the Company terminates without cause, Mr. Campbell will be entitled to, at the Company's sole discretion, either (i) monthly salary payments for twelve (12) months, based on his monthly rate of base salary at the date of such termination, or (ii) a lump-sum payment of his salary for such 12 month period, based on his monthly rate of base salary at the date of such termination. Mr. Campbell shall also be entitled to receive (i) payment for accrued and unpaid vacation pay and (ii) all bonuses that have accrued during the term of the employment agreement, but not been paid. Any non-vested options will vest immediately.

In connection with the employment of Paul Campbell, the Company entered into an agreement with Tatum LLC ("Tatum"). Pursuant to the agreement with Tatum, the Company paid Tatum a signing fee of \$98,700 and shall pay Tatum \$1,000 per month for as long as Mr. Campbell is employed by eMagin. In addition, the Company granted 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 : Subsequent Events

In preparing the Company's financial statements, the Company evaluated events and transactions for potential recognition or disclosure through August 13, 2009, the date on which this Quarterly Report on Form 10-Q was filed with the SEC.

The Company did not seek to renew its loan agreement with Moriah, which expired on August 7, 2009. On August 7, 2009, the Company repaid a total of approximately \$232 thousand in principal and interest due on the line of credit. Moriah elected not to exercise its 2007 and 2008 put options as a result the put options expired on August 7, 2009. As a result of the termination of the line of credit, Moriah's security interest in the Company's assets was terminated.

The Company is presently negotiating a new line of credit with a lending institution.

Note 16: Restatement

In this Amended 10-Q, eMagin restated its previously issued condensed consolidated financial statements as of and for the three and six months ended June 30, 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 ASC 815. ASC 815, 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 June 30, 2009, the Company computed the fair value of the warrant liability as \$5.2 million, an increase of \$3.1 million. The net change in fair value from January 1, 2009 through June 30, 2009 of \$3.1 million was recorded as other expense in the Condensed Consolidated Statements of Operations for the six months ended June 30, 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 June 30, 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)	Fair Value of Warrants at June 30, 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	70
July 23, 2007	5,390,712	\$ 1.03	July 21, 2011	5,031	1,120	1,519	2,615
July 23, 2007	1,000,000	\$ 0.48	July 21, 2011	1,136	304	395	728
April 2, 2008	793,273	\$ 1.13	April 2, 2013	561	224	279	571
December 22, 2008	1,875,467	\$ 1.03	December 22, 2013	534	448	725	1,210
Total Fair Value				\$ 15,091	\$ 2,130	\$ 2,943	\$ 5,194

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 June 30, 2009:

Condensed Consolidated Balance Sheet	June 30, 2009 (As previously reported)	June 30, 2009 (As restated)
(in thousands)		
Warrant liability	\$ —	\$ 70
Total current liabilities	3,606	3,676
Warrant liability	—	5,124
Total liabilities	\$ 3,606	\$ 8,800
Shareholders' equity:		
Additional paid-in capital	\$ 205,621	\$ 190,530
Accumulated deficit	(199,439)	(189,542)
Total shareholders' equity	\$ 6,198	\$ 1,004

Condensed Consolidated Statements of Operations	Three Months Ended June 30, 2009		Six Months Ended June 30, 2009	
(in thousands except share and per share data)	(As previously reported)	(As restated)	(As previously reported)	(As restated)
Change in fair value of warrant liability	\$ —	\$ (2,251)	\$ —	\$ (3,064)
Total other expense	\$ (127)	\$ (2,378)	\$ (301)	\$ (3,365)
Net income (loss)	\$ 1,339	\$ (912)	\$ 1,733	\$ (1,331)
Income (loss) per share, basic	\$ 0.08	\$ (0.06)	\$ 0.11	\$ (0.08)
Income (loss) per share, diluted	\$ 0.05	\$ (0.06)	\$ 0.07	\$ (0.08)

Weighted average number of shares outstanding:				
Basic	16,186,482	16,186,482	16,024,400	16,024,400
Diluted	24,606,945	16,186,482	24,326,249	16,024,400

Condensed Consolidated Statements of Cash Flows	Six Months Ended June 30, 2009 (As restated)
(in thousands)	

	(As previously reported)	
Net income (loss)	\$ 1,733	\$ (1,331)
Change in fair value of warrant liability	—	3,064
Net cash provided by operating activities	\$ 2,394	\$ 2,394

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 result of operations, condensed consolidated financial statements and related disclosures for the quarter ended June 30, 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 of America 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 June 30, 2009, the number of shares of common stock available for issuance was 300,000. As of June 30, 2009, no shares have been issued from this plan.

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 and six months ended June 30, 2009, there were 239,772 and 455,676 shares of common stock, respectively, issued to consultants. In addition, there were 867,241 options granted from the plan for the three and six months ended June 30, 2009.

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 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.

SUBSEQUENT EVENTS

The Company did not seek to renew its loan agreement with Moriah which expired on August 7, 2009. On August 7, 2009, the Company repaid a total of approximately \$232 thousand in principal and interest due on the line of credit. Moriah elected not to exercise its 2007 and 2008 put options as a result the put options expired on August 7, 2009. As a result of the termination of the line of credit, Moriah's security interest in the Company's assets was terminated.

The Company is presently negotiating a new line of credit with a lending institution.

RESULTS OF OPERATIONS

THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2009 COMPARED TO THREE MONTHS AND SIX MONTHS ENDED JUNE 30, 2008

Revenues

Revenues for the three and six months ended June 30, 2009 were approximately \$5.9 million and \$11.0 million, respectively, as compared to approximately \$5.6 million and \$8.3 million for the three and six months ended June 30, 2008, respectively, an increase of approximately 4% and 33%, respectively. Higher revenue for the three and six month periods was due to increased customer demand and availability of finished displays as a result of increased production volume and improved yields.

For the three and six months ended June 30, 2009, product revenue increased approximately \$0.5 million and \$2.3 million, respectively, as compared to the three and six months ended June 30, 2008. The increase was due to higher customer demand for the Company's OLED displays in the first six months of 2009 as compared to the first six months of 2008. For the three months ended June 30, 2009, contract revenue decreased approximately \$0.2 million as compared to the three months ended June 30, 2008 and for the six months ended June 30, 2009 increased approximately \$0.4 million as compared to the six months ended June 30, 2008 as a result of fluctuations in contract activity.

Cost of Goods Sold

Cost of goods sold includes direct and indirect costs associated with production. Cost of goods sold for the three and six months ended June 30, 2009 were approximately \$2.1 million and \$4.7 million as compared to approximately \$3.0 million and \$5.3 million for the three and six months ended June 30, 2008. There was a decrease of approximately \$0.9 million and \$0.6 million for the three and six months ended June 30, 2009 as compared to the three and six months ended June 30, 2008.

Cost of goods sold as a percentage of revenues improved from 53% for the three months ended June 30, 2008 to 35% for the three months ended June 30, 2009. Cost of goods sold as a percentage of revenues improved from 64% for the six months ended June 30, 2008 to 43% for the six months ended June 30, 2009. Cost of goods is comprised primarily of material and labor cost. The labor portion of cost of goods is mostly fixed. Improved manufacturing yield, increased production output, and lower royalty expense resulted in a lower cost of goods sold percentage.

The following table outlines product, contract and total gross profit and related gross margins for the three and six months ended June 30, 2009 and 2008 (dollars in thousands):

	Three months ended		Six months ended	
	June 30, 2009	2008	June 30, 2009	2008
	(unaudited)		(unaudited)	
Product revenue gross profit	\$ 3,379	\$ 2,058	\$ 5,478	\$ 2,340
Product revenue gross margin	68%	46%	59%	34%
Contract revenue gross profit	\$ 420	\$ 565	\$ 780	\$ 635
Contract revenue gross margin	46%	50%	46%	48%
Total gross profit	\$ 3,799	\$ 2,623	\$ 6,258	\$ 2,975
Total gross margin	65%	47%	57%	36%

The gross profit for the three and six months ended June 30, 2009 was approximately \$3.8 million and \$6.3 million as compared to approximately \$2.6 million and \$3.0 million for the three and six months ended June 30, 2008, an increase of \$1.2 million and \$3.3 million, respectively. Gross margin was 65% for the three months ended June 30, 2009 up from 47% for the three months ended June 30, 2008. Gross margin was 57% for the six months ended June 30, 2009 up from 36% for the six months ended June 30, 2008. The increase was mainly attributed to the fuller utilization of our fixed production overhead due to improved yields, increased display production output, and a reduction in royalty expense. See Note 12 of the Condensed Consolidated Financial Statements - Commitments and Contingencies for further discussion on the royalty payments.

The product gross profit for the three and six months ended June 30, 2009 was approximately \$3.4 million and \$5.5 million as compared to approximately \$2.1 million and \$2.3 million for the three and six months ended June 30, 2008, an increase of \$1.3 million and \$3.1 million, respectively. Product gross margin was 68% for the three months ended June 30, 2009 up from 46% for the three months ended June 30, 2008. Product gross margin was 59% for the six months ended June 30, 2009 up from 34% for the six months ended June 30, 2008. The increase was attributed to the fuller utilization of our fixed production overhead due to improved yields, increased display production output, and a reduction in royalty expense. See Note 12 of the Condensed Consolidated Financial Statements - Commitments and Contingencies for further discussion on the royalty payments.

The contract gross profit for the three and six months ended June 30, 2009 was approximately \$0.4 million and \$0.8 million as compared to approximately \$0.6 million for the three and six months ended June 30, 2008, a decrease of \$0.1 million and an increase of \$0.1 million, respectively. Contract gross margin was 46% for the three months ended June 30, 2009 down from 50% for the three months ended June 30, 2008. Contract gross margin was 46% for the six months ended June 30, 2009 down from 48% for the six months ended June 30, 2008. The contract gross margin is dependent upon the mix of costs, internal versus external third party costs, with the external third party costs having 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 and six months ended June 30, 2009 were approximately \$0.4 million and \$0.8 million, respectively, as compared to \$0.6 million and \$1.3 million for the three and six months ended June 30, 2008, a decrease of approximately \$0.2 million and \$0.5 million, respectively. The decrease was due to the allocation of research and development resources and expenses related to contracts to cost of goods sold and a streamlining of the research and development effort in the subsystems area which resulted in expense reductions.

Selling, General and Administrative. Selling, general and administrative expenses consist principally of salaries, fees for professional services including legal fees, as well as other marketing and administrative expenses. Selling, general and administrative expenses for the three and six months ended June 30, 2009 were approximately \$2.0 million and \$3.5 million, respectively, as compared to approximately \$1.7 million and \$3.5 million for the three and six months ended June 30, 2008, an increase of \$0.3 million for the three months and no change for the six months. The increase of \$0.3 million for the three months ended June 30, 2009 is primarily related to an increase of personnel costs partially offset by a reduction in professional services.

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 and six months ended June 30, 2009, interest expense was approximately \$166 thousand and \$341 thousand, respectively, as compared to \$537 thousand and \$1.2 million, respectively, for the three and six months ended June 30, 2008. For the three and six months ended June 30, 2009, the interest expense associated with debt was \$15 thousand and \$40, respectively, and the amortization of the deferred costs associated with the debt was \$151 thousand and \$301 thousand, respectively. The breakdown of the interest expense for the three and six month period in 2008 is as follows: interest expense associated with debt of approximately \$164 thousand and \$323 thousand, respectively; the amortization of the deferred costs and waiver fees associated with the debt of approximately \$373 thousand and \$821 thousand, respectively; and the amortization of the debt discount associated with the debt of approximately \$0 and 25 thousand, respectively. The decrease in interest expense for the three and six months ended June 30, 2009 as compared to the three and six months ended June 30, 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 and six months ended June 30, 2009 was approximately \$39 thousand and \$40 thousand, respectively, as compared to \$123 thousand and \$209 thousand, respectively, for the three and six months ended June 30, 2008. The other income for the three and six months ended June 30, 2009 was interest income of approximately \$1 thousand and \$2 thousand, respectively, and \$38 thousand for a settlement of a liability and the other income for the three and six months ended June 30, 2008 was interest income of approximately \$2 thousand and \$4 thousand, respectively, and \$121 thousand and \$205, respectively, 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 June 30, 2009 was measured by using the Monte Carlo Simulation model. The revaluation resulted in a charge of \$2.3 million and \$3.1 million, respectively, for the three and six months ended June 30, 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 June 30, 2009, we had approximately \$2.9 million of cash and investments as compared to \$2.4 million as of December 31, 2008. The change in cash and investments was primarily due to cash provided by operations of approximately \$2.4 million offset by cash used for financing and investing activities of approximately \$1.9 million.

Cash flow provided by operating activities during the six months ended June 30, 2009 was approximately \$2.4 million, attributable to our net loss of approximately \$ 1.3 million offset by non-cash expenses of \$ 3.6 million and approximately \$0. 1 million from the change in operating assets and liabilities. Cash flow used in operating activities during the six months ended June 30, 2008 was approximately \$2.0 million primarily attributable to our net loss of \$2.8 million and an increase in accounts receivable of \$1.4 million offset by non-cash expenses of \$1.8 million.

Cash used in investing activities during the six months ended June 30, 2009 and 2008 was approximately \$482 thousand and \$236 thousand, respectively, used for equipment purchases.

Cash used in financing activities during the six months ended June 30, 2009 was approximately \$1.4 million to pay down the line of credit. Cash provided by financing activities during the six months ended June 30, 2008 was approximately \$2.6 million and was comprised of approximately \$1.6 million from the sale of common stock, \$1.7 million from the line of credit, and offset by payments on debt of \$0.7 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. 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 for discretionary capital spending. If unanticipated events arise during the next twelve months, we believe we can raise sufficient funds. However, if 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 June 30, 2009, management has concluded that our internal control over financial reporting was not effective as of June 30, 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 June 30, 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. We are taking appropriate and reasonable steps to make the necessary improvements to remediate deficiencies.

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 June 30, 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 and six months ended June 30, 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

EXHIBIT NUMBER	DESCRIPTION
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)