EMAGIN CORP
Form 10QSB/A
November 02, 2005

U.S. Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-QSB/A

(Mark One)

[X] Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended March 31, 2004

[ ] Transition report pursuant section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ____________ to ________________

eMAGIN CORPORATION
(Exact name of small business issuer as specified in its charter)

Commission file number: 000-24757

DELAWARE	56-1764501
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

10500 N.E. 8th Street
Suite 1400
Bellevue, WA 98004
(Address of principal executive offices)

(425) 749-3600
(Issuer's telephone number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 [X] No [ ]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS: Not applicable

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 [X] No [ ]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:
Not applicable

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

APPLICABLE ONLY TO CORPORATE REGISTRANTS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of May 12, 2004 the Registrant had 63,677,618 shares of Common Stock outstanding.

TRANSITIONAL SMALL BUSINESS DISCLOSURE FORMAT (check one): Yes [ ] No [X]

PRELIMINARY NOTE (restated):

This Amended Quarterly Report on Form 10-QSB/A is being filed to provide additional information to clarify the corrections reported in the previously Amended Quarterly Report on Form 10-QSB/A filed by the Company on April 12, 2005. The Consolidated Balance Sheets, Consolidated Statements of Operations, Consolidated Statements of Cash Flows, and Statement of Changes in Stockholders' Equity and Selected Notes to Consolidated Financial Statements are labeled as "restated" where applicable. The restatement was in connection with the preparation of the Company's annual report on Form 10-KSB for the year ended December 31, 2004 where it was determined that the unamortized debt discount and the deferred financing costs should have been recorded as interest expense. The restated statements increase additional paid-in capital by approximately $1.67 million representing unamortized debt discount and deferred financing costs and increase interest expense in relation to the March 3, 2004 debt conversion of approximately $8.567 million in principal and accrued interest. The following table presents the impact of the corrections:

Unaudited Consolidated Statements of Operations
Three Months Ended March 31, 2004

	Originally Filed	Restated
Other income (expense)	$(3,403,110)	$(5,076,082)
Net loss	$(4,932,972)	$(6,605,944)
Basic and diluted loss per common share	$ (0.09)	$ (0.13)

In all other material respects this Amended Quarterly Report on Form 10-QSB/A is unchanged from the Amended Quarterly Report on Form 10-QSB/A previously filed by the Company on April 12, 2005.

In addition, we are revising Item 3, Controls and Procedures, to disclose that the Company's management believes that its controls and procedures were not effective as of the end of the period covered by this report due to the restatements to the Company's financial statements as set forth above.

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PART I. FINANCIAL INFORMATION

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Item 1. Consolidated Financial Statements

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SIGNATURE

CERTIFICATION

31.1 Certification by Chief Executive Officer pursuant to Sarbanes Oxley Section 302.

31.2 Certification by Chief Financial Officer pursuant to Sarbanes Oxley Section 302.

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

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

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eMAGIN CORPORATION
CONSOLIDATED BALANCE SHEETS

ASSETS	March 31, 20
CURRENT ASSETS:	(Unaudited) (Restated)
Cash and cash equivalents	$ 4,714,9
Trade receivables	659,0
Unbilled costs and estimated profits on contracts in progress	
Inventory	513,8
Prepaid expenses and other current assets	827,5
Total current assets	6,715,4

EQUIPMENT AND LEASEHOLE IMPROVEMENTS:	3,460,5
Less: Accumulated Depreciation	(2,309,2
Total equipment and leasehold improvements, net	1,151,3
Intangible Assets	13,5
Less: Accumulated Amortization	(1
Total intangible assets, net	13,3
Other long-term assets	4,4
Total assets	$ 7,884,5

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:	
Accounts payable	$ 255,3
Accrued payroll and benefits	554,7
Other accrued expenses	366,1
Advanced payments	124,6
Current portion of long term debt	27,8
Other current liabilities	14,1
Total current liabilities	1,342,8
Capitalized lease obligations	32,9
Notes payable and short-term debt subsequently converted to equity	
Total liabilities	1,375,7
SHAREHOLDERS' EQUITY (CAPITAL DEFICIENCY):	
Common Stock, par value $0.001 per share	
Shares authorized - 100,000,000	
Shares issued and outstanding - 63,043,682 and 42,695,412	63,0
Additional paid-in capital	149,375,7
Deferred compensation	(3,4
Accumulated deficit	(142,926,5
Total shareholders' equity	6,508,7
Total liabilities and shareholders' equity	$ 7,884,5

See notes to financial statements.

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eMAGIN CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended March 31, 2004 (Restated)	Thr Marc

REVENUE:		
Product revenue, net of returns	$ 540,088	$
Total Revenue	540,088	
Cost of Goods Sold:		
Direct cost of goods sold	208,599	
Production expenses	1,154,123	
Total Cost of Goods Sold	1,362,722	
Gross Loss	(822,634)	
COSTS AND EXPENSES:		
Research and development	7,990	
Amortization of purchased intangibles	156	
Stock based compensation	84,105	
Selling, general and administrative	614,977	
Total costs and expenses, net	707,228	
Interest expense, net	(5,076,082)	
Net loss	$ (6,605,944)	$
Basic and diluted loss per common share	$ (0.13)	$
Weighted average common shares outstanding	51,940,205	

See notes to financial statements.

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eMAGIN CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three Months ended March 31, 2004 (Restated)	T Ma
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$ (6,605,944)	$
Adjustments to reconcile net loss to net cash used in operating activities-		
Depreciation and amortization	159,259	
Bad debt expense	33,656	
Amortization of intangibles	157	
Amortization of financing fees	7,863	
Non-cash charge for stock based compensation	84,105	
Non-cash interest related charges	125,833	

Non-cash charge for services received	8,400	
Non-cash financing expense	4,955,186	
Changes in operating assets and liabilities:		
Trade receivables	151,142	
Unbilled costs and estimated profits on contracts in progress	-	
Inventory	(38,741)	
Prepaid expenses and other current assets	(658,443)	
Other long-term assets	-	
Advanced payment on contracts to be completed	2,291	
Deferred Revenue	-	
Accounts payable, accrued expenses and accrued payroll	(425,247)	
Other current liabilities	(3,899)	
Net cash used in operating activities	(2,204,382)	
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases/Sales of equipment	(109,097)	
Net cash used in investing activities	(109,097)	
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from sales of common stock, net of issuance costs	3,916,536	
Proceeds from exercise of stock options and warrants	2,073,400	
Payments of long term debt and capital leases	(15,393)	
Net cash provided by financing activities	5,974,543	
NET INCREASE IN CASH AND CASH EQUIVALENTS	3,661,064	
CASH AND CASH EQUIVALENTS, beginning of period	1,053,895	
CASH AND CASH EQUIVALENTS, end of period	$ 4,714,959	$
Supplemental Cash Flow Disclosure:		
Conversion of debt to equity	$ 8,567,424	
Payments of A/P through issuance of stock	$ 34,599	
Stock issued for prepaid services	$ 16,800	
Cash payments of interest	$ 2,508	

See notes to financial statements.

eMAGIN CORPORATION

STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY (CAPITAL DEFICIENCY)

(Unaudited)

(Restated)

	Common Stock		Deferred	Additional paid-in
	Shares	$	Compensation	Capital
Balance, December 31, 2003	42,695,412	$ 42,694	$ (87,565)	$ 131,598,910
Sale of equity	3,333,364	3,334		3,913,203
Conversion of debt to equity	11,394,621	11,395		8,556,029

Issuance of warrants for equity transaction				3,180,000
Stock options exercised	5,089,134	5,089		1,337,784
Stock warrants exercised	498,829	499		730,028
Issuance of common stock for services	32,322	33		59,766
Amortization of deferred compensation			84,105	
Net loss for period				
Balance, March 31, 2004	63,043,682	$ 63,044	$ (3,460)	$ 149,375,720

See notes to financial statements.

eMAGIN CORPORATION

Selected Notes to Consolidated Financial Statements

Note 1 - ACCOUNTING POLICIES

Basis of Presentation (Restated)

In the opinion of management, the accompanying unaudited interim financial information reflects all adjustments, consisting of normal recurring accruals, necessary for a fair presentation. Certain information and footnote disclosure normally included in financial statements prepared in accordance with generally accepted accounting principles 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 interim condensed consolidated financial statements are read in conjunction with the audited consolidated financial statements contained in the company's Annual Report on Form 10-KSB for the year ended December 31, 2003. The results of operations for the period ended March 31, 2004 are not necessarily indicative of the results to be expected for the full year.

As a result of a subsequent analysis of the three months ended March 31, 2004 Statements of Operations, we noted that the Revenue and Cost of Goods Sold related to intercompany transactions had not been eliminated. Accordingly, product revenue, net of returns and direct cost of goods sold have been reduced by $143,028. These amounts offset and do not affect previously reported Gross Margins or Net Loss for the three months ended March 31, 2004. In addition, the footnotes to the March 31, 2004 financial statements have been updated to conform to the results presented in the amended March 31, 2004 quarterly financial statements.

This Amended Quarterly Report is being filed to reflect the reclassification of approximately $1.67 million of unamortized debt discount and deferred financing costs from additional paid-in-capital to interest expense in relation to the March 3, 2004 debt conversion of approximately $8.567 million in principal and accrued interest. In connection with the preparation of the Company's annual report on Form 10-KSB for the year ended December 31, 2004, on March 28, 2005 the Company was advised by its independent registered public accounting firm that the unamortized debt discount and the deferred financing costs should be

recorded as interest expense. In all other material respects this Amended Quarterly Report on Form 10-QSB/A is unchanged from the Amended Quarterly Report on Form 10-QSB/A previously filed by the Company on August 16, 2004.

Stock-Based Compensation (Restated)

The Company has elected to follow Accounting Principles Board Opinion No. 25 ("APB No. 25"), "Accounting for Stock Issued to Employees," and related interpretations in accounting for its employee stock options. Under APB No. 25, when the exercise price of employee stock options equals the market price of the underlying stock on the date of grant no compensation expense is recorded. The Company discloses information relating to the fair value of stock-based compensation awards in accordance with Statement of Financial Accounting Standards No.123 ("SFAS No. 123"), "Accounting for Stock-Based Compensation." The following table illustrates the effect on net loss and loss per share as if the Company had applied the fair value recognition provision of SFAS No. 123. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants in the first quarter of 2004 and 2003, respectively: (1) average expected volatility of 100% and 162%, (2) average risk-free interest rates of 3.31% and 3.64%, and (3) expected lives of seven years and ten years.

The pro forma amounts that are disclosed in accordance with SFAS No. 123 reflect the portion of the estimated fair value of awards that were earned for the three months ended March 31, 2004 and 2003.

For the three months ended March 31,	2004 (Restated)	2003
Net loss applicable to common stockholders', as reported	$ (6,605,944)	$ (2,405,491)
Add: Stock based employee compensation expense included in reported net loss	-	-
Deduct: Stock-based employee compensation expense determined under fair value method	(1,288,000)	(1,441,445)
Pro forma net loss	$ (7,893,944)	$ (3,846,836)
Net loss per share applicable to common stockholders':		
Basic and diluted, as reported	$ (0.13)	$ (0.08)
Basic and diluted, pro forma	$ (0.15)	$ (0.13)

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Note 2 - NATURE OF BUSINESS

Through December 31, 2002, the Company was considered a development stage enterprise, in accordance with Statement of Financial Accounting Standards ("SFAS") No. 7, "Accounting and Reporting by Development Stage Enterprises". As of January 1, 2003, the Company has commenced planned principal operations and as such it is no longer considered to be a development stage enterprise in accordance with SFAS No 7.

Note 3 - REVENUE AND COST RECOGNITION

Revenue is recognized when products are shipped to customers, net of allowances for anticipated returns. The Company's revenue-earning activities generally involve delivering products and revenues are considered to be earned when the Company has completed the process by which it is entitled to such revenues. 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 also earns revenues from certain of eMagin's 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. Amounts can be billed on a bi-monthly basis. Billing is based on subjective cost investment factors.

Note 4 - RECEIVABLES

The majority of our commercial accounts receivable are due from Original Equipment Manufacturers ("OEM"s). Credit is extended based on evaluation of a customers' 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 by considering a number of factors, including the length of time trade accounts receivable are past due, eMagin's previous loss history, the customer's current ability to pay its obligation, and the condition of the general economy and the industry as a whole. The Company writes off accounts receivable when they become uncollectable, and payments subsequently received on such receivables are reported as income in the year the payment is received.

Receivables consist of the following:

	March 31, 2004	December 31, 2003
Trade receivables	$ 848,033	$ 899,174
Contract receivables	73,809	173,809
Unbilled receivables	-	75,359
Total	921,842	1,148,342
Less allowance for doubtful accounts	(262,743)	(304,446)
Net receivables	$ 659,099	$ 843,896

Note 5 - RESEARCH AND DEVELOPMENT COSTS

Research and development costs are expensed as incurred.

Note 6 - NET LOSS PER COMMON SHARE

In accordance with SFAS No. 128, net loss per common share amounts ("basic EPS") were computed by dividing net loss by the weighted average number of common

shares outstanding and excluding any potential dilution. Net loss per common share assuming dilution ("diluted EPS") was computed by reflecting potential dilution from the exercise of stock options and warrants. Common equivalent shares totaling 36,594,874 and 39,686,573 have been excluded from the computation of diluted EPS for the three months ended March 31, 2004 and March 31, 2003, respectively.

Note 7 - INVENTORIES

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 realized value based upon current market prices and contracts for future sales.

The components of inventories are as follows:

	March 31, 2004	December 31, 2003
Raw materials	$ 229,157	$ 20,416
Work in process	142,811	43,750
Finished goods	141,912	211,251
Total Inventory	$ 513,880	$ 275,417

Note 8 - DEBT (Restated)

The debt consisted of following:

		March 31, 2004	December 31, 2003
a	Current portion of long term debt	$ 27,826	$ 38,184
b	Restructuring Agreement and Original Secured Notes	-	6,124,451
c	Long-term capitalized lease obligations	32,923	36,257
	Total debt	$ 60,749	$ 6,198,892

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a) This amount includes (i) $12,655 due to Citicorp Leasing over the next 12 months in lease payments for equipment; and (ii) $15,171 due to IBM over the next 12 months for leasehold improvements. The remaining balance under the Citicorp lease is due in 2005.

b) In February 2004, we entered into an agreement whereby the holders of our Secured Convertible Notes (the "Notes"), which were due in November 2005, agreed to an early conversion of 100% of the $7.825 million principal amount of the Notes, together with the $742,424 of accrued interest on the Notes, into 11,394,621 shares of common stock of eMagin. The listing of the shares issuable pursuant to such agreement was approved by the American Stock Exchange on March 3, 2004. On the date of the conversion the Company recorded, $1,598,335 in non-cash interest expense related to the unamortized debt discount and beneficial conversion feature and $74,637 in non-cash interest expense related to the writeoff of deferred financing costs.

In consideration of the Noteholders agreeing to the early conversion of the Notes, eMagin issued the Noteholders warrants to purchase an aggregate of 2.5 million shares of common stock (the "Warrants"), which Warrants are exercisable

at a price of $2.76 per share. 1.5 million of the Warrants are exercisable until the later of (i) twelve (12) months from the date upon which a registration statement covering the shares issuable upon exercise of the Warrants is declared effective by the Securities and Exchange Commission, or (ii) December 31, 2005. The remaining 1.0 million of the Warrants are exercisable until four (4) years from the date upon which the registration statement covering such shares is declared effective by the Securities and Exchange Commission. $3.18 million was recorded in interest expense for the fair value estimate of these warrants.

c) This amount is due to Citicorp Leasing as long-term debt for lease payments for equipment.

Note 9 - STOCKHOLDERS' EQUITY (Restated)

The authorized common stock of the Company consists of 200,000,000 shares with a par value of $0.001 per share.

On January 9, 2004, we entered into a Securities Purchase Agreement with several accredited institutional and private investors whereby such investors purchased an aggregate of 3,333,364 shares of common stock for an aggregate purchase price of $4,200,039. The Company also entered into a registration rights agreement with the aforementioned investors with respect to the common stock issued and common stock issuable upon the exercise of the warrants. The Company filed a registration statement for the sales of these shares in February 2004.

The shares of common stock were priced at a 20% discount to the average closing price of the stock from December 30, 2003 to January 6, 2004, which ranged from $1.38 to $1.94 per share during the period for an average closing price of $1.26 per share. In addition, the investors received warrants to purchase an aggregate of 2,000,019 shares of common stock (subject to anti-dilution adjustments) exercisable at a price of $1.74 per share for a period of five (5) years. The warrants were priced at a 10% premium to the average closing price of the stock for the pricing period.

In connection with the private placement, eMagin also issued additional warrants to the investors to acquire an aggregate of 2,312,193 shares of common stock. 1,206,914 of such warrants are exercisable, within 6 months from the effective date of the registration statement covering these securities, at a price of $1.74 per share (a 10% premium to the average closing price of the stock for the pricing period), and 1,105,279 of such warrants are exercisable within 12 months from the effective date of the registration statement covering these securities, at a price of $1.90 per share (a 20% premium to the average closing price of the stock for the pricing period).

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In February 2004, the Company and all of the holders of the Secured Convertible Notes (the "Notes"), which were due in November 2005, entered into an agreement whereby the holders agreed to an early conversion of 100% of the principal amount of the Notes aggregating $7.825 million, together with all of the accrued interest of approximately $742,000 on the Notes, into 11,394,621 shares of common stock of eMagin. The listing of the shares issuable pursuant to such agreement was approved by the American Stock Exchange. On the date of the conversion the Company recorded, $1,598,335 in non-cash interest expense related to the unamortized debt discount and beneficial conversion feature and $74,637 in non-cash interest expense related to the writeoff of deferred financing costs.

In consideration of the Noteholders agreeing to the early conversion of the Notes, eMagin agreed to issue the Noteholders warrants to purchase an aggregate of 2.5 million shares of common stock (the "warrants"), which warrants are exercisable at a price of $2.76 per share. 1.5 million of the Warrants are

exercisable until the later of (i) twelve (12) months from the date upon which a registration statement covering the shares issuable upon exercise of the Warrants is declared effective by the Securities and Exchange Commission, or (ii) December 31, 2005. The remaining 1.0 million of the warrants are exercisable until June 10, 2008. Using the Black Scholes method of valuing warrants, an expense totaling $3.18 million was recorded in interest expense in the first quarter of 2004 to record the estimated fair value of these warrants. The fair value of the warrants was estimated using the Black-Scholes option-pricing model with the following assumptions for the two sets of warrants: (1) average expected volatility of 100%, (2) average risk-free interest rates of 3.52%, (3) Fair Market Value of $2.30, (4) dividends of 0%, and (5) Average Term (in days) of 670 for the 12 month warrants and 1,460 for the 4 year warrants.

In connection with the above conversion, eMagin also entered into a Registration Rights Agreement with the holders of the Notes providing the holders with certain registration rights under the Securities Act of 1933, as amended, with respect to the common stock issuable upon exercise of the warrants.

In the first quarter of 2004, the Company received $2,073,400 for the exercise of 5,089,134 options and 498,829 warrants.

The Company also issued 32,322 shares of common stock for the payment of $59,799 for services rendered and to be rendered in the future. As such, the Company recorded the fair value of the services rendered in selling, general and administrative expenses, prepaid expenses and reduction of accounts payable in the accompanying unaudited consolidated statement of operations for the three months ended March 31, 2004.

Note 10 - STOCK COMPENSATION

As of March 31, 2004, the Company has outstanding options to purchase 7,902,924 shares.

In 2000 the Company issued options below fair market value. The Company recorded $84,105 in the first quarter of 2004, in expense, for the amortization of those options. The amount was recorded in Selling, General & Administrative.

Note 11 - COMMITMENTS AND CONTINGENCIES

[a] Royalty payments:

The Company, in accordance with a royalty agreement, is obligated to make minimum annual royalty payments to a corporation commencing January 1, 2001. The minimum annual royalty of $31,500 per year due under this agreement commences in the first year of the agreement, and increases to minimum royalty payments of $125,000 in 2006. Under this agreement, the Company must pay to the corporation a certain percentage of net sales of 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 may be credited against the amounts due based on the percentage of sales. The royalty agreement terminates upon the expiration of the last-to-expire issued patent.

In the first quarter of 2004, $22,855 was recorded in royalty expense. In April 2004, the Company paid $125,000 for the minimum amount due for 2004. The amount was recorded in prepaid expenses and will be amortized as the Company records the royalty expense as defined in the agreement.

[b] Contractual obligations:

The Company leases certain office facilities and office, lab and factory equipment under operating leases expiring through 2008. Certain leases provide

for payments of monthly operating expenses. The approximate future minimum lease payments for 2004 are as follows:

Operating leases	$ 234,242
Capital leases	29,523
Total contractual obligations	$ 263,765

We currently lease space from IBM for $73,914 per month that houses our principal executive offices, our equipment for OLED microdisplay fabrication and research and development, as well as our assembly operations and storage. We currently occupy such space on a month-to-month basis. We are currently in negotiations with IBM for a new lease. No assurance can be given that we will execute a new lease, or that such new lease will be on terms that are favorable to us. In the event that we are forced to locate new space, we may experience a disruption in our operations, which could have a material adverse affect on our results of operations.

NOTE 12 - SUBSEQUENT EVENTS

eMagin Corporation filed a shelf registration statement on Form S-3 with the Securities and Exchange Commission (SEC). The shelf registration statement, when declared effective by the SEC, will allow the company, from time to time, to raise up to $50 million through the sale of securities, which may consist of common stock, preferred stock and/or warrants, in one or more offerings in the future. Specific terms and prices will be determined at the time of any offering and included in a prospectus supplement to be filed with the SEC relating to that offering.

A registration statement relating to the securities listed in the shelf registration has been filed with the SEC, but has not yet become effective. These securities may not be sold, nor may offers to buy such securities be accepted, before the time that the registration statement becomes effective.

Note 13 - RELATED PARTY TRANSACTIONS

A family member of an outside director of eMagin participated in the Securities Purchase Agreement in January's private placement in the amount of $90,000. The family member received the same considerations as all other investors.

eMagin is party to a financial advisory and investment banking agreement with Larkspur Capital Corporation. An outside director of emagin is a founder and shareholder of Larkspur Capital Corporation. Larkspur Capital Corporation received as compensation for financial advisory and investment banking services in connection with the January 2004 private placement a cash fee of 6 3/4% of the funds raised and warrants to purchase eMagin shares of common stock equal to 2.5% of the cash netted to eMagin. $283,503 and 43,651 common stock purchase warrants exercisable at $2.41 per share which expire in January 2009, were paid under the terms of the agreement.

In February 2004, the Company and all of the holders of the Secured Convertible Notes (the "Notes"), which were due in November 2005, entered into an agreement whereby the holders agreed to an early conversion of 100% of the principal amount of the Notes.

In consideration of the Noteholders agreeing to the early conversion of the Notes, eMagin issued the Noteholders warrants to purchase an aggregate of 2.5 million shares of common stock. Stillwater LLC, a limited liability company and a beneficial owner of more than five percent of the outstanding shares of

eMagin's common stock, held an aggregate of $4 million of the notes converted. Ginola Limited, a beneficial owner of more than five percent of the outstanding shares of eMagin's common stock, held an aggregate of $1.3 million of the notes converted.

An outside director of eMagin, held an aggregate of $0.25 million of the notes converted.

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

Statement of Forward-Looking Information

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential" or "continue," the negative of such terms, or other comparable terminology. These statements are only predictions. Actual events or results may differ materially from those in the forward-looking statements as a result of various important factors. Although we believe that the expectations reflected in the forward-looking statements are reasonable, such should not be regarded as a representation by the Company, or any other person, that such forward-looking statements will be achieved. The business and operations of the Company are subject to substantial risks, which increase the uncertainty inherent in the forward-looking statements contained in this release.

We undertake no duty to update any of the forward-looking statements, whether as a result of new information, future events or otherwise. Readers are cautioned not to place undue reliance on the forward-looking statements contained in this report.

Overview

We design and manufacture miniature display modules, which we refer to as OLED-on-silicon-microdisplays, primarily for incorporation into the products of other manufacturers. Microdisplays are typically smaller than a postage stamp, 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 them. 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.

Since our inception in 1996, we derived substantially all of our revenues from fees paid to us under research and development contracts, primarily with the U.S. federal government. We have devoted significant resources to the development and commercial launch of our products. We commenced limited initial sales of our SVGA+ microdisplay in May 2001 and commenced shipping samples of our SVGA-3D microdisplay in February 2002. As of March 31, 2004, we had recognized approximately $2.6 million from sales of our products, and have a backlog of more than $27 million in products ordered for delivery through 2005.

These products are being applied or considered for near-eye and headset applications in products such as entertainment and gaming headsets, handheld Internet and telecommunication appliances, viewfinders, and wearable computers to be manufactured by original equipment manufacturer (OEM) customers. We have also shipped a limited number of prototypes of our eGlass II Head-wearable Display systems. In addition to marketing OLED-on-silicon microdisplays as components, we also offer microdisplays as an integrated package, which we call Microviewer, that includes a compact lens for viewing the microdisplay and electronic interfaces to convert the signal from our customer's product into a viewable image on the microdisplay. Through our wholly owned subsidiary, Virtual Vision, Inc., we are also developing head-wearable displays that incorporate our Microviewer.

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We license our core OLED technology from Eastman Kodak and we have developed our own technology to create high performance OLED-on-silicon microdisplays and related optical systems. We believe our technology licensing agreement with Eastman Kodak, coupled with our own intellectual property portfolio, gives us a leadership position in OLED and OLED-on-silicon microdisplay technology. We are the only company to demonstrate publicly and market full-color OLED-on-silicon microdisplays.

Company History

Our history has been as a developmental stage company. As of January 1, 2003, we are no longer a development stage Company. We have transitioned to manufacturing our product and intend to significantly increase our marketing, sales, and research and development efforts, and expand our operating infrastructure. Most of our operating expenses are fixed in the near term. 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 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 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. Revenue is recognized at shipment and we record a reserve for estimated sales returns, which is reflected as a reduction of revenue at the time of revenue recognition.

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. Amounts can be billed on a bi-monthly basis. Billing is based on subjective cost investment factors.

Results of Operations

THREE MONTHS ENDED MARCH 31, 2004 COMPARED TO THREE MONTHS ENDED MARCH 31, 2003

Revenues

Revenues for the three months ended March 31, 2004 were $0.5 million, as compared to $0.5 million for the three months ended March 31, 2003.

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Cost of Goods Sold. Cost of goods sold includes direct and indirect costs associated with production. Cost of goods sold for the three months ended March 31, 2004 was $1.4 million, as compared to $1.1 million for the three months ended March 31, 2003. Gross profit (loss) for the three months ended March 31, 2004 was ($0.8) million, as compared to ($0.7) million for the three months ended March 31, 2003. This translates to a Gross Margin of (152%) and (147%) for the three months ended March 31, 2004 and 2003, respectively.

We currently record all expenses associated with manufacturing in Cost of Goods Sold. The full facility over head as well as the expense of non-capitalized raw materials is matched against our units sold. While our production volume is low, the Gross Margin reflects the costs that will be shared when quantities increase.

Costs and Expenses.

Research and Development. Research and development expenses included salaries, development materials and other costs specifically allocated to the development of new products. Gross research and development expenses for the three months ended March 31, 2004 was $8 thousand, as compared to $22 thousand for the three months ended March 31, 2003. Our plans to ramp up our R&D department are directly tied to our cash management and projections. We expect to begin increasing this department when we have sufficient excess capital to fund these expenses.

Amortization of Purchased Intangibles. Amortization of purchased intangibles expense for the three months ending March 31, 2004 was $156 as compared to $0.3 million for the three months ended March 31, 2003. The decrease of $0.3 million in these non-cash charges is the result of the purchased intangibles being fully amortized as of March 31, 2003.

Non-cash Stock Based Compensation. Non-cash expenses related to stock-based compensation amortization for the three months ended March 31, 2004 was $84 thousand, as compared to $111 thousand for the three months ending March 31, 2003. Non-cash stock-based compensation costs are the result of amortization of the intrinsic value ascribed for the issuance of stock options at below fair market values. The amortization is done over the vesting period of such options.

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, amortization, as well as other marketing and administrative expenses. Selling, general and administrative expenses, for the three months ended March 31, 2004 were $0.5 million, as compared to $1.0 million for the three months ended March

31, 2003. The $0.5 million decrease was due to a reduction in legal and accounting fees.

Interest Expense. Interest expense for the three months ending March 31, 2004 was ($5.0) million as compared to ($0.3) million for the three months ended March 31, 2003. The $4.7 million increase in interest expense was recorded in conjunction with the early conversion of the $7.825 million in Notes. The increase in interest expense for the three months ended March 31, 2004 was attributable to three factors; (1) $3.18 million of non-cash charges related to the value of the warrants issued to induce the holders of the $7.825 million in Notes to agree to an early conversion of the Notes into common stock, (2) $1,598,325 in non-cash charges related to the remaining unamortized debt discount and beneficial conversion feature associated with the aforementioned Notes, and (3) $74,637 in non-cash charges related to the write-off of the remaining unamortized deferred financing costs.

Liquidity and Capital Resources

Current Financial Position

We have total liabilities and contractual obligations of $1,217,593 as of March 31, 2004. These contractual obligations, along with the dates on which such payments are due, are described below:

Contractual Obligations	Total	One Year or Less	More than One Year
Operating leases	$ 1,145,202	$ 234,242	$ 910,960
Capital leases	72,391	29,523	42,868
Total contractual obligations	$ 1,217,593	$ 263,765	$953,828

We currently anticipate that we will continue to experience significant growth in our operating expenses for the foreseeable future and that our operating expenses will be the principal use of our cash. In particular, we expect that salaries for employees engaged in production operations, purchase of inventory and expenses of increased sales and marketing efforts would be the principle uses of cash. We expect that our cash requirements over the next 12 months will be met by a combination of cash on hand which as of May 13 was approximately $4.5 million, additional financing, exercising of outstanding options and warrants, and revenues generated by operations. We expect to continue to devote substantial resources to manufacturing, marketing and selling our products.

We have received purchase agreements for approximately $27 million for our products to be delivered now through early 2005. Management believes that the prospects for growth of product revenue remain high.

Scheduled deliveries against our purchase agreements and other customer requirements are subject to change depending on a number of factors including, our production capacity, our customers' production timing of related systems into which they are integrating our products and their other supplier schedules, changes in the expected procurement periods for military programs and the requirements of the individual agreements and contracts that we have with our customers. We currently anticipate the need to ramp our supplies and staffing quickly and efficiently to be prepared to meet the currently anticipated shipping schedules, which may require significant added effort.

We are in the early phases of production, although our past progress had been impeded by our prior cash position. Anticipated increased shipments in the first quarter were delayed, primarily due to our inability to purchase raw materials. Based on the planned schedule, we have resolved our supplier issues and have been able to produce quantities late in the first quarter of 2004. We expect our second quarter revenue to begin to reflect this change.

Our cash requirements depend on numerous factors, including completion of our product development activities, ability to commercialize our products, timely market acceptance of our products and our customers' products, and other factors. We expect to carefully devote capital resources to continue our development programs directed at commercializing our products in our target markets, hire and train additional staff, expand our research and development activities, and develop and expand our manufacturing capacity.

Any delays could change the cash requirements of the company. While we believe that we are in position to handle the anticipated production increase, there can be no assurance that we will not experience some issues relating to yield and throughput risk that could result in production delays.

Factors Which May Affect Future Results

In evaluating our business, prospective investors and shareholders should carefully consider the risks factors, any of which could have a material adverse impact on our business, operating results and financial condition and result in a complete loss of your investment.

Risks Related To Our Financial Results

If we do not obtain additional cash to operate our business, we may not be able to execute our business plan and may not achieve profitability.

In the event that cash flow from operations is less than anticipated and we are unable to secure additional funding to cover these added losses, in order to preserve cash, we would be required to further reduce expenditures and effect further reductions in our corporate infrastructure, either of which could have a material adverse effect on our ability to continue or increase our current level of operations. To the extent that operating expenses increase or we need additional funds to make acquisitions, develop new technologies or acquire strategic assets, the need for additional funding may be accelerated and there can be no assurances that any such additional funding can be obtained on terms acceptable to us, if at all. If we are not able to generate sufficient capital, either from operations or through additional financing, to fund our current operations, we may not be able to continue as a going concern. If we are unable to continue as a going concern, we may be forced to significantly reduce or cease our current operations. This could significantly reduce the value of our securities, which could result in our de-listing from the American Stock Exchange and cause investment losses for our shareholders.

We may not be able to satisfy the American Stock Exchange's continued listing requirements.

The AMEX staff notified us in June 2003 that we have fallen below Section 1003(a)(i) of the AMEX Company Guide for having shareholders' equity of less than $2,000,000 and losses from continuing operations and/or net losses in two out of the three most recent fiscal years. We were afforded the opportunity to submit a plan of compliance to the AMEX and presented a plan to the AMEX in July 2003. On September 9, 2003, we received notice from the staff of the AMEX that

the AMEX had accepted our plan to regain compliance with AMEX's continued listing standards and granted us an extension until December 4, 2004 to regain compliance with those standards. The failure to execute our plan and remain in compliance with the AMEX equity requirement could result in a delisting of our common stock.

We will be subject to periodic review by the AMEX staff during the extension period. During this time, we must make progress consistent with the terms of the plan or maintain compliance with the continued listing standards. While we anticipate that, as a result of our recently completed financing in January 2004 and the conversion of our outstanding promissory notes in March 2004, our balance sheet as of March 31, 2004 will reflect that we meet AMEX's $2 million shareholder equity requirement, there can be no assurance that AMEX will waive this requirement prior to December 2004 or that we will be in compliance with this requirement at December 2004. Other unidentified issues may arise that could adversely affect the financial or the potential listing status of the company.

We have a history of losses since our inception and may incur losses for the foreseeable future.

Accumulated losses excluding non-cash transactions as of March 31, 2004, were $41 million and acquisition related non-cash transactions were $102 million, which resulted in an accumulated net loss of $143 million, the majority of which was related to the March 2000 merger and the subsequent write-down of our goodwill. The non-cash losses were dominated by the amortization and write-down of goodwill and purchased intangibles and write-down of acquired in-process research and development related to the March 2000 acquisition, and also included some non-cash stock-based compensation. We have not yet achieved profitability and we can give no assurances that we will achieve profitability

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within the foreseeable future as we fund our operations and capital expenditures in areas such as establishment and expansion of markets, sales and marketing, operating equipment and research and development. We cannot assure investors that we will ever achieve or sustain profitability or that our operating losses will not increase in the future.

We were previously primarily dependent on U.S. government contracts.

The majority of our revenues to date have been derived from research and development contracts with the U.S. government. We cannot continue to rely on such contracts for revenue. We plan to submit proposals for additional development contract funding; however, funding is subject to legislative authorization and even if funds are appropriated such funds may be withdrawn based on changes in government priorities. No assurances can be given that we will be successful in obtaining new government contracts. Our inability to obtain revenues from government contracts could have a material adverse effect on our results of long-term operations, unless substantial product or non-government contract revenue offsets any lack of government contract revenue.

Risks related to our intellectual property

We rely on our license agreement with Eastman Kodak for the development of our products. Eastman Kodak's licensing of its OLED technology to others for microdisplay applications, or the sublicensing by Eastman Kodak of our OLED technology to third parties, could have a material adverse impact on our business.

Our principal products under development utilize OLED technology that we

license from Eastman Kodak. We rely upon Eastman Kodak to protect and enforce key patents held by Eastman Kodak, relating to OLED display technology. Eastman Kodak's patents expire at various times in the future from near term in 2004 through long term patents that are just being issued in 2004. Our license with Eastman Kodak could terminate if we fail to perform any material term or covenant under the license agreement. Since our license from Eastman Kodak is non-exclusive, Eastman Kodak could also elect to become a competitor itself or to license OLED technology for microdisplay applications to others who have the potential to compete with us. The occurrence of any of these events could have a material adverse impact on our business.

We may not be successful in protecting our intellectual property and proprietary rights.

We rely on a combination of patents, trade secret protection, licensing agreements and other arrangements to establish and protect our proprietary technologies. If we fail to successfully enforce our intellectual property rights, our competitive position could suffer, which could harm our operating results. Patents may not be issued for our current patent applications, third parties may challenge, invalidate or circumvent any patent issued to us, unauthorized parties could obtain and use information that we regard as proprietary despite our efforts to protect our proprietary rights, rights granted under patents issued to us may not afford us any competitive advantage, others may independently develop similar technology or design around our patents, our technology may be available to licensees of Eastman Kodak, and protection of our intellectual property rights may be limited in certain foreign countries. We may be required to expend significant resources to monitor and police our intellectual property rights. Any future infringement or other claims or prosecutions related to our intellectual property could have a material adverse effect on our business. Any such claims, with or without merit, could be time consuming to defend, result in costly litigation, divert management's attention and resources, or require us to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us, if at all. Protection of intellectual property has historically been a large expense for eMagin. We have not been in a financial position to properly protect all of our intellectual property, and may not be in a position to properly protect our position or stay ahead of competition in new research and the protecting of the resulting intellectual property.

Risks related to the microdisplay industry

The commercial success of the microdisplay industry depends on the widespread market acceptance of microdisplay systems products.

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The market for microdisplays is emerging. Our success will depend on consumer acceptance of microdisplays as well as the success of the commercialization of the microdisplay market. As an OEM supplier, our customer's products must also be well accepted. At present, it is difficult to assess or predict with any assurance the potential size, timing and viability of market opportunities for our technology in this market. The viewfinder microdisplay market sector is well established with entrenched competitors with whom we must compete.

The microdisplay systems business is intensely competitive.

We do business in intensely competitive markets that are characterized by rapid technological change, changes in market requirements and competition from both other suppliers and our potential OEM customers. Such markets are typically characterized by price erosion. This intense competition could result in pricing

pressures, lower sales, reduced margins, and lower market share. Our ability to compete successfully will depend on a number of factors, both within and outside our control. We expect these factors to include the following:

- our success in designing, manufacturing and delivering expected new products, including those implementing new technologies on a timely basis;
- our ability to address the needs of our customers and the quality of our customer services;
- the quality, performance, reliability, features, ease of use and pricing of our products;
- successful expansion of our manufacturing capabilities;
- our efficiency of production, and ability to manufacture and ship products on time;
- the rate at which original equipment manufacturing customers incorporate our product solutions into their own products;
- the market acceptance of our customers' products; and

- product or technology introductions by our competitors.

Our competitive position could be damaged if one or more potential OEM customers decide to manufacture their own microdisplays, using OLED or alternate technologies. In addition, our customers may be reluctant to rely on a relatively small company such as eMagin for a critical component. We cannot assure you that we will be able to compete successfully against current and future competition, and the failure to do so would have a materially adverse effect upon our business, operating results and financial condition.

The display industry is cyclical.

The display industry is characterized by fabrication facilities that require large capital expenditures and long lead times for supplies and the subsequent processing time, leading to frequent mismatches between supply and demand. The OLED microdisplay sector may experience overcapacity if and when all of the facilities presently in the planning stage come on line leading to a difficult market in which to sell our products.

Competing products may get to market sooner than ours.

Our competitors are investing substantial resources in the development and manufacture of microdisplay systems using alternative technologies such as reflective liquid crystal displays (LCDs), LCD-on-Silicon ("LCOS") microdisplays, active matrix electroluminescence and scanning image systems, and transmissive active matrix LCDs. Some of these products have been introduced years ahead of our products and some are established in segments of the microdisplay and virtual imaging markets that we have yet to enter. Displacing entrenched competitors may be difficult, especially in long-term projects or products, even if our product proves itself to be better.

Our competitors have many advantages over us.

As the microdisplay market develops, we expect to experience intense competition from numerous domestic and foreign companies including well-established corporations possessing worldwide manufacturing and production facilities, greater name recognition, larger retail bases and significantly greater financial, technical, and marketing resources than us, as well as from emerging companies attempting to obtain a share of the various markets in which our microdisplay products have the potential to compete.

Our products are subject to lengthy OEM development periods.

We plan to sell most of our microdisplays and related products to OEMs who will incorporate them into or with products they sell. OEMs determine during their product development phase whether they will incorporate our products. The time elapsed between initial sampling of our products by OEMs, the custom design of our products to meet specific OEM product requirements, and the ultimate incorporation of our products into OEM consumer products is significant. If our products fail to meet our OEM customers' cost, performance or technical requirements or if unexpected technical challenges arise in the integration of our products into OEM consumer products, our operating results could be significantly and adversely affected. Long delays in achieving customer qualification and incorporation of our products could adversely affect our business.

Our products will likely experience rapidly declining unit prices.

In the markets in which we expect to compete, prices of established products tend to decline significantly over time. In order to maintain our profit margins over the long term, we believe that we will need to continuously develop product enhancements and new technologies that will either slow price declines of our products or reduce the cost of producing and delivering our products. While we anticipate many opportunities to reduce production costs over time, there can be no assurance that these cost reduction plans will be successful. We may also attempt to offset the anticipated decrease in our average selling price by introducing new products, increasing our sales volumes or adjusting our product mix. If we fail to do so, our results of operations would be materially and adversely affected.

Risks related to manufacturing

We expect to depend on semiconductor contract manufacturers to supply our silicon integrated circuits and other suppliers of key components, materials and services.

We do not manufacture the silicon integrated circuits on which we incorporate our OLED technology. Instead, we expect to provide the design layouts to semiconductor contract manufacturers who will manufacture the integrated circuits on silicon wafers. We also expect to depend on suppliers of a variety of other components and services, including circuit boards, graphic integrated circuits, passive components, materials and chemicals, and equipment support. Our inability to obtain sufficient quantities of high quality silicon integrated circuits or other necessary components, materials or services on a timely basis has resulted in delays could result in future manufacturing delays, increased costs and ultimately in reduced or delayed sales or lost orders which could materially and adversely affect our operating results.

The manufacture of OLED-on-silicon is new and OLED microdisplays have not been produced in significant quantities.

If we are unable to produce our products in sufficient quantity, we will be unable to attract customers. In addition, we cannot assure you that once we commence volume production we will attain yields at high throughput that will result in profitable gross margins or that we will not experience manufacturing problems which could result in delays in delivery of orders or product introductions.

We are dependent on a single manufacturing line.

We initially expect to manufacture our products on a single manufacturing line. If we experience any significant disruption in the operation of our manufacturing facility or a serious failure of a critical piece of equipment, we

may be unable to supply microdisplays to our customers. For this reason, some OEMs may also be reluctant to commit a broad line of products to our microdisplays without a second production facility in place. Interruptions in our manufacturing could be caused by manufacturing equipment problems, the introduction of new equipment into the manufacturing process or delays in the delivery of new manufacturing equipment. Lead-time for delivery of manufacturing equipment can be long. No assurance can be given that we will not lose potential sales or be able to meet sales orders delivery requirements due to production interruptions in our manufacturing line. In order to meet the requirements of certain OEMs for multiple manufacturing sites, we will have to expend capital to secure additional sites and may not be able to manage multiple sites successfully.

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We currently lease space from IBM on a month-to-month basis.

We currently lease space from IBM that houses our principal executive offices, our equipment for OLED microdisplay fabrication and research and development, as well as our assembly operations and storage. We currently occupy such space on a month-to-month basis. We are currently in negotiations with IBM for a new lease. No assurance can be given that we will execute a new lease, or that such new lease will be on terms that are favorable to us. In the event that we are forced to locate new space, we may experience a disruption in our operations, which could have a material adverse affect on our results of operations.

Risks related to our business

Our success depends on attracting and retaining highly skilled and qualified technical and consulting personnel.

We must hire highly skilled technical personnel as employees and as independent contractors in order to develop our products. The competition for skilled technical employees is intense and we may not be able to retain or recruit such personnel. We must compete with companies that possess greater financial and other resources than we do, and that may be more attractive to potential employees and contractors. To be competitive, we may have to increase the compensation, bonuses, stock options and other fringe benefits offered to employees in order to attract and retain such personnel. The costs of retaining or attracting new personnel may have a material adverse affect on our business and operating results. In addition, difficulties in hiring and retaining technical personnel could delay the implementation of our business plan.

Our success depends in a large part on the continuing service of key personnel.

Changes in management could have an adverse effect on our business. We are dependent upon the active participation of several key management personnel, including Gary W. Jones, our chief executive officer. This is especially an issue while the company staffing is small. We will also need to recruit additional management in order to expand according to our business plan. We are currently recruiting a chief financial officer. The failure to attract and retain additional management or personnel could have a material adverse effect on our operating results and financial performance.

Our business depends on new products and technologies.

The market for our products is characterized by rapid changes in product, design and manufacturing process technologies. Our success depends to a large extent on our ability to develop and manufacture new products and technologies to match the varying requirements of different customers in order to establish a

competitive position and become profitable. Furthermore, we must adopt our products and processes to technological changes and emerging industry standards and practices on a cost-effective and timely basis. Our failure to accomplish any of the above could harm our business and operating results.

We generally do not have long-term contracts with our customers.

Our business is operated on the basis of short-term purchase orders and we cannot guarantee that we will be able to obtain long-term contracts for some time. Such purchase orders can be cancelled or revised without penalty, depending on the circumstances. In the absence of a backlog of orders that can only be canceled with penalty, we plan production on the basis of internally generated forecasts of demand, which makes it difficult to accurately forecast revenues. If we fail to accurately forecast operating results, our business may suffer and the value of your investment in the Company may decline. Large, long-term supply line commitments and large inventories of various types of displays and other products will be required to support our business and provide reasonable order turn around for customers. Potentially enabling rapid sales growth targets can greatly increase the cash requirement for these accounts. Such supplies and inventories are subject to potential obsolescence, long delays before sale, and potential damage or loss.

Our business strategy may fail if we cannot continue to form strategic relationships with companies that manufacture and use products that could incorporate our OLED-on-silicon technology.

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Our prospects will be significantly affected by our ability to develop strategic alliances with OEMs for incorporation of our OLED-on-silicon technology into their products. While we intend to continue to establish strategic relationships with manufacturers of electronic consumer products, personal computers, chipmakers, lens makers, equipment makers, material suppliers and/or systems assemblers, there is no assurance that we will be able to continue to establish and maintain strategic relationships on commercially acceptable terms, or that the alliances we do enter into will realize their objectives. Failure to do so would have a material adverse effect on our business.

Our business depends to some extent on international transactions.

We purchase needed materials from companies located abroad and may be adversely affected by political and currency risk, as well as the additional costs of doing business with a foreign entity. Some customers in other countries have longer receivable periods or warranty periods. In addition, many of the OEMs that are the most likely long-term purchasers of our microdisplays are located abroad exposing us to additional political and currency risk. We may find it necessary to locate manufacturing facilities abroad to be closer to our customers which could expose us to various risks, including management of a multi-national organization, the complexities of complying with foreign laws and customs, political instability and the complexities of taxation in multiple jurisdictions.

Our business may expose us to product liability claims.

Our business may expose us to product liability claims. Although no such claims have been brought against us to date, and to our knowledge no such claim is threatened or likely, we may face liability to product users for damages resulting from the faulty design or manufacture of our products. While we plan to maintain product liability insurance coverage, there can be no assurance that product liability claims will not exceed coverage limits, fall outside the scope

of such coverage, or that such insurance will continue to be available at commercially reasonable rates, if at all.

Our business is subject to environmental regulations and possible liability arising from governmental claims related to the disposal of hazardous substances and/or potential employee claims of exposure to harmful substances used in the development and manufacture of our products.

We are subject to various governmental regulations related to toxic, volatile, experimental and other hazardous chemicals used in, and disposed of in connection with, our design and manufacturing process. Our failure to comply with these regulations could result in the imposition of fines or in the suspension or cessation of our operations. Compliance with these regulations could require us to acquire costly equipment or to incur other significant expenses. We develop, evaluate and utilize new chemical compounds in the manufacture of our products. While we attempt to ensure that our employees are protected from exposure to hazardous materials, we cannot assure you that potentially harmful exposure will not occur or that we will not be liable to employees as a result.

Risks related to our stock

The substantial number of shares that are or will be eligible for sale could cause our common stock price to decline even if the company is successful.

Sales of significant amounts of common stock in the public market, or the perception that such sales may occur, could materially affect the market price of our common stock. These sales might also make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate. As of April 30, 2004, we have outstanding (i) options to purchase 7,794,856 shares; and (ii) warrants to purchase 18,187,964 shares of common stock.

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ITEM 3: Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of our chief executive officer and chief financial officer of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) of the Exchange Act). Based upon this evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective to ensure 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.

Notwithstanding the foregoing, in connection with the audit of our annual report on Form 10-KSB for the year ended December 31, 2004, on March 28, 2005 we determined that the conversion of the debt to equity during the first quarter of 2004 should have been classified as a debt transaction and therefore an expense should have been recorded in connection with the conversion. As set forth in this report and in our quarterly report on Form 10-QSB/A for the period ended March 31, 2004 which was filed with the SEC on April 12, 2005, the Consolidated Balance Sheets, Consolidated Statements of Operations, Consolidated Statements of Cash Flows, Statement of Changes in Shareholders' Equity and Selected Notes to Consolidated Financial Statements have been restated, where applicable, to classify the conversion as a debt transaction and record an expense in connection with the conversion. Accordingly, these restatements, which were due to interpretations of the accounting treatment of such transactions which was

subsequently determined to be incorrect, has lead management to determine that our disclosure controls and procedures were not effective as of the end of the period covered by this report to ensure 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.

(b) Changes in internal controls. There was no change in our internal controls or in other factors that could affect these controls during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Notwithstanding the foregoing, we engaged John Atherly in June 2004 as our Chief Financial Officer, and in May 2005, we appointed Irwin Engelman to our board of directors and appointed Mr. Engelman as the Chairman of our Audit Committee immediately following our annual meeting of shareholders which was held on September 30, 2005. In addition, we have hired a new Director of Finance to assist the Chief Financial Officer with our filing and other financial reporting obligations. We believe these additions in personnel enhance our ability to meet our financial and other reporting obligations as well as strengthen our disclosure controls and procedures so that they are currently effective to ensure 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.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The company is party to certain legal proceedings arising in the ordinary course of business. In the opinion of management, the outcome of such legal matters will not have a material adverse effect on the company's results of operations or financial position.

Item 2. Changes in Securities and Use of Proceeds

On January 9, 2004, we entered into a Securities Purchase Agreement with several accredited institutional and private investors whereby such investors purchased an aggregate of 3,333,364 shares of common stock for an aggregate purchase price of $4,200,039. The Company also entered into a registration rights agreement with the aforementioned investors with respect to the common stock issued and common stock issuable upon the exercise of the warrants.

The shares of common stock were priced at a 20% discount to the average closing price of the stock from December 30, 2003 to January 6, 2004, which ranged from $1.38 to $1.94 per share during the period for an average closing price of $1.26 per share. In addition, the investors received warrants to purchase an aggregate of 2,000,019 shares of common stock (subject to anti-dilution adjustments) exercisable at a price of $1.74 per share for a period of five (5) years. The warrants were priced at a 10% premium to the average closing price of the stock for the pricing period.

In connection with the private placement, eMagin also issued additional warrants to the investors to acquire an aggregate of 2,312,193 shares of common stock. 1,206,914 of such warrants are exercisable, within 6 months from the effective date of the registration statement covering these securities, at a price of $1.74 per share (a 10% premium to the average closing price of the stock for the pricing period), and 1,105,279 of such warrants are exercisable within 12 months

from the effective date of the registration statement covering these securities, at a price of $1.90 per share (a 20% premium to the average closing price of the stock for the pricing period).

The Company received $4.2 million on the initial purchase of investments, with a potential of another $3.5 million on the 5-year warrants. The additional 2.3 million warrants could potentially allow the company to receive an additional $4.2 million. The Company intends to invest the proceeds in raw materials, supplies and equipment to increase production as well as increasing the sales and marketing of our products.

In February 2004, the Company and all of the holders of the Secured Convertible Notes (the "Notes"), which were due in November 2005, entered into an agreement whereby the holders agreed to an early conversion of 100% of the principal amount of the Notes aggregating $7.825 million, together with all of the accrued interest of approximately $742,000 on the Notes, into 11,394,621 shares of common stock of eMagin. The listing of the shares issuable pursuant to such agreement was approved by the American Stock Exchange.

In consideration of the Noteholders agreeing to the early conversion of the Notes, eMagin has agreed to issue the Noteholders warrants to purchase an aggregate of 2.5 million shares of common stock (the "warrants"), which warrants are exercisable at a price of $2.76 per share. 1.5 million of the warrants are exercisable until the later of (i) twelve (12) months from the date upon which a registration statement covering the shares issuable upon exercise of the Warrants is declared effective by the Securities and Exchange Commission, or (ii) December 31, 2005. The remaining 1.0 million of the warrants are exercisable until four (4) years from the date upon which the registration

statement covering such shares is declared effective by the Securities and Exchange Commission.

In connection with the above conversion, eMagin also entered into a Registration Rights Agreement with the holders of the Notes providing the holders with certain registration rights under the Securities Act of 1933, as amended, with respect to the common stock issuable upon exercise of the warrants.

No proceeds were initially received for this transaction, although the future exercise of the warrants could potentially bring in $6.9 million from the exercise of the 2,500,000 warrants that were issued.

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 and Reports on Form 8-K

(a) Exhibits List

EXHIBIT NUMBER	DESCRIPTION

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

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

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

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

(b) Reports on Form 8-K

The Company filed three reports on form 8-K during the quarter ended March 31, 2004. Information regarding the items reported on is as follows:

DATE OF REPORT	ITEM REPORTED ON
January 9, 2004	eMagin and several accredited institutional investors entered into a Securities Purchase Agreement whereby the Investors agreed purchase an aggregate of $4.2 million in exchange for an aggregate of 3.3 million shares of common stock.

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DATE OF REPORT	ITEM REPORTED ON
March 4, 2004	eMagin Corporation and the holders of its Secured Convertible Notes entered into an agreement whereby the holders agreed to an early conversion of 100% of the principal amount of the Notes, together with all of the accrued interest on the Notes.
March 24, 2004	eMagin Corporation held an earnings call on March 23, 2004 to discuss the preliminary 2003 year end results.

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SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

eMAGIN CORPORATION

Dated: November 2, 2005

By: /S/ Gary W. Jones
Gary W. Jones

Chief Executive Officer