EMAGIN CORP
Form S-1/A
February 17, 2009

As filed with the Securities and Exchange Commission on February 17, 2009

Registration No. 333-144865

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

FORM S-1/A

REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933

eMagin Corporation
(Name of small business issuer in its charter)

Delaware	3679	56-1764501
(State or other Jurisdiction of Incorporation or Organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification No.)

10500 N.E. 8 th Street, Suite 1400,
Bellevue, WA 98004
(425)-749-3600
(Address and telephone number of principal executive offices and principal place of business)

Andrew G. Sculley, Chief Executive Officer
eMagin Corporation
10500 N.E. 8 th Street, Suite 1400,
Bellevue, WA 98004
(425)-749-3600
(Name, address and telephone number of agent for service)

Copies to:
Richard A. Friedman, Esq.
Sichenzia Ross Friedman Ference LLP
61 Broadway, 32nd Flr.
New York, New York 10006
(212) 930-9700
(212) 930-9725 (fax)

APPROXIMATE DATE OF PROPOSED SALE TO THE PUBLIC:
From time to time after this Registration Statement becomes effective.

If any securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box: x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. o

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered	Proposed maximum offering price per share	Proposed maximum aggregate offering price (1)	Amount of registration fee (2)
Common Stock, $0.001 par value per share	2,438,096	$ 0.53	$ 1,292,191	$ 50.78

(1) Estimated solely for purposes of calculating the registration fee in accordance with Rule 457(c) and Rule 457(g) under the Securities Act of 1933, using the average of the sale prices as reported on the OTCBB on February 11, 2009 which was $0. 53 per share.

(2) The registrant previously paid a filing fee in the amount of $113.00.

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file a further amendment which specifically states that this registration shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

PRELIMINARY PROSPECTUS SUBJECT TO COMPLETION, DATED FEBRUARY 17, 2009
eMagin Corporation

2,438,096 SHARES OF

COMMON STOCK

This prospectus relates to the resale by the selling stockholder of up to 2,438,096 shares of common stock, consisting of (i) 1,000,000 shares issuable upon the exercise of common stock purchase warrants, and (ii) 1,428,572 shares issued upon conversion of the Stillwater Note (as described herein) representing $500,000 of the principal amount of the Stillwater Note, and (iii) 9,524 shares issued for accrued and unpaid interest under the Stillwater Note. As disclosed below, 50% of the outstanding principal and accrued and unpaid interest on the Stillwater Note was converted into shares of common stock on July 23, 2007 and the remaining 50% of the outstanding principal and accrued and unpaid interest on the Stillwater Note was converted into shares of common stock on December 22, 2008. The selling stockholders may sell common stock from time to time in the principal market on which the stock is traded at the prevailing market price or in negotiated transactions. We will pay the expenses of registering these shares.

Our common stock is listed on the Over-The-Counter Bulletin Board under the symbol “EMAN”. The last reported sales price per share of our common stock as reported by the Over-The-Counter Bulletin Board on February 11, 2009 was $0.55.

Investing in these securities involves significant risks. See “Risk Factors” beginning on page 11 .

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this Prospectus is truthful or complete. Any representation to the contrary is a criminal offense. You should read this prospectus carefully before you invest.

The date of this prospectus is February __, 2009

The information in this Prospectus is not complete and may be changed. This Prospectus is included in the Registration Statement that was filed by eMagin Corporation with the Securities and Exchange Commission. The selling stockholders may not sell these securities until the registration statement becomes effective. This Prospectus is not an offer to sell these securities and is not soliciting an offer to buy these securities in any state where the sale is not permitted.

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PROSPECTUS SUMMARY

The following summary highlights selected information contained in this prospectus. This summary does not contain all the information you should consider before investing in the securities. Before making an investment decision, you should read the entire prospectus carefully, including the “risk factors” section, the financial statements and the notes to the financial statements.

We design, develop, manufacture, and market virtual imaging products which utilize OLEDs, or organic light emitting diodes, OLED-on-silicon microdisplays and related information technology solutions. We integrate OLED technology with silicon chips to produce high-resolution microdisplays smaller than one-inch diagonally which, when viewed through a magnifier, create virtual images that appear comparable in size to that of a computer monitor or a large-screen television. Our products enable our original equipment manufacturer, or OEM, customers to develop and market improved or new electronic products. We believe that virtual imaging will become an important way for increasingly mobile people to have quick access to high resolution data, work, and experience new more immersive forms of communications and entertainment.

Our first commercial product, the SVGA+ (Super Video Graphics Array of 800x600 picture elements plus 52 added columns of data) OLED microdisplay was initially offered for sampling in 2001, and our first SVGA-3D (Super Video Graphics Array plus built-in stereovision capability) OLED microdisplay was shipped in early 2002. 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 OEM customers for military, medical, industrial, and consumer applications. We market our products globally.

In 2006 we introduced our OLED-XL technology, which provides longer luminance half life and enhanced efficiency of eMagin's SVGA+ and SVGA-3D product lines. We are in the process of completing development of 2 additional OLED microdisplays, namely the SVGA 3DS (SVGA 3D shrink, a smaller format SVGA display with a new cell architecture with embedded features) and an SXGA (1280 x 1024 picture elements).

In January 2005 we announced the world's first personal display system to combine OLED technology with head-tracking and 3D stereovision, the Z800 3DVisor(tm), which was first shipped in mid-2005. This product was recognized as a Digital Living Class of 2005 Innovators, and received the Consumer Electronics Association’s coveted Consumer Electronics Show (CES) 2006 Best of Innovation Awards for the entire display category as well as a Design and Innovations Award for the electronic gaming category. In February 2007 the Z800 3DVisor, as integrated in Chatten Associates’ head-aimed remote viewer, was recognized as one of Advanced Imaging's Solutions of the Year.

We believe that our OLED-on-silicon microdisplays offer a number of advantages over current liquid crystal microdisplays, including greatly increased system level power efficiency, less weight and wider viewing angles. Using our active matrix OLED technology, many computer and video electronic system functions can be built directly into the OLED-on-silicon microdisplay, resulting in compact systems with expected lower overall system costs relative to alternative microdisplay technologies. We have developed our own technology to create high performance OLED-on-silicon microdisplays and related optical systems and we have licensed certain fundamental OLED and display technology from Eastman Kodak.

As the first to exploit OLED technology for microdisplays, and with the support of our partners and the development of our intellectual property, we believe that we enjoy a significant advantage in the commercialization of this display technology for virtual imaging. We believe we are the only company to sell full-color active matrix small molecule

OLED-on-silicon microdisplays.

eMagin Corporation was created through the merger of Fashion Dynamics Corporation ("FDC"), which was organized on January 23, 1996 under the laws of the State of Nevada and FED Corporation ("FED"), a developer and manufacturer of optical systems and microdisplays for use in the electronics industry. FDC had no active business operations other than to acquire an interest in a business. On March 16, 2000, FDC acquired FED. The merged company changed its name to eMagin Corporation. Following the merger, the business conducted by eMagin is the business conducted by FED prior to the merger.

Our website is located at www.emagin.com and our e-commerce site is www.3dvisor.com. The contents of our website are not part of this Prospectus.

The Offering

Common stock offered by selling stockholders	Up to 2,438,096 shares, consisting of the following:
	·1,438,096 shares of common stock, consisting of (i) 1,428,572 shares issued upon conversion of the Stillwater Note representing $500,000 of the principal amount of the Stillwater Note and (ii) 9,524 shares issued for accrued and unpaid interest under the Stillwater Note.*
	· up to 1,000,000 shares of common stock issuable upon the exercise of common stock purchase warrants at an exercise price of $0.48 per share.
Common Stock to be outstanding after the offering	16,921,113 shares**
Use of proceeds	We will not receive any proceeds from the sale of the common stock; however we will receive proceeds from the exercise of our warrants.
Over-The-Counter Bulletin Board Symbol	EMAN

* On July, 23 2007, Stillwater elected to convert $252,166.50 of the Stillwater Note, then outstanding, representing $250,000 of the principal amount of the Note due on July 23, 2007 and $2,166.50 of accrued and unpaid interest into shares of common stock. Stillwater received 720,476 shares of the common stock at the conversion price of $0.35. On December 22, 2008, Stillwater elected to convert the $251,166.67 of the remaining Stillwater Note representing $250,000 of the principal amount of the Note due on December 22, 2008 and $1,166.67 of accrued and unpaid interest into shares of common stock. Stillwater received 717,620 shares of the common stock at the conversion price of $0.35.

**The information above regarding the common stock to be outstanding after the offering is based on 15,921,113 shares of the Company's common stock outstanding as of February 11, 2009 and assumes the exercise of the warrants.

Recent Developments

As previously reported on a Form 8-K that was filed with the Securities and Exchange Commission on December 23, 2008, pursuant to a Securities Purchase Agreement (the "Securities Purchase Agreement") entered into on December 18, 2008 between the Company and Stillwater on December 22, 2008 (the "Closing"), the Company sold Stillwater for an aggregate purchase price of $4,033,000 an aggregate of 4,033 shares of its Series B Convertible Preferred Stock (the "Preferred Stock"), which have a stated value of $1,000 per share, a conversion price of $0.75 per share and have the rights and preferences set forth in the Certificate of Designations of Series B Convertible Preferred Stock filed with the Secretary of State for the State of Delaware on December 19, 2008 (the "Certificate of Designations"), and warrants to purchase 1,875,467 shares of common stock at $1.03 per share (the "Warrants"). The Warrants terminate on

December 22, 2013.

Pursuant to the terms of the Securities Purchase Agreement, the Company used the proceeds from the sale of the Preferred Stock exclusively to repay $4,033,000 of its Amended and Restated 8% Senior Secured Convertible Notes (the “Notes”) which matured on December 22, 2008 (per the Notes, the maturity date of December 21, 2008 fell on a Sunday, and therefore the maturity date was extended until the following business day, which was Monday, December 22, 2008, per the terms of the Note).

Pursuant to the Securities Purchase Agreement, the members of the Company’s board of directors, and certain executive officers executed lockup agreements pursuant to which, subject to the terms of the lockup agreement, they are restricted from selling the Company’s stock that they beneficially own for 180 days from the Closing.

On December 22, 2008, the Company entered into an Exchange Agreement (the “Exchange Agreement”) with three holders (“Holders”) of its outstanding Notes. Pursuant to the Exchange Agreement, on December 22, 2008, the Holders exchanged $1,700,000 of their outstanding Notes and accrued and unpaid interest thereon and received 1,706 shares of the Preferred Stock (the amount of the outstanding principal and accrued and unpaid interest due on the Notes exchanged divided by $1,000).

Pursuant to the Securities Purchase Agreement, the Company filed the Certificate of Designations with the State of Delaware on December 19, 2008. The Certificate of Designations designates 10,000 shares of its preferred stock as Series B Convertible Preferred Stock ("the Preferred Stock"). The Preferred Stock has a stated value of $1,000 and has a conversion price of $0.75 per share. The Preferred Stock does not pay interest. The holders of the Preferred Stock are not entitled to receive dividends unless the Company’s Board of Directors declared a dividend for holders of its 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 into shares of its common stock. Each share of Preferred Stock has voting rights equal to (i) the number of shares of its common stock issuable upon conversion of such shares of Preferred Stock 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 votes together with its common stock or any other class or series of its stock and (ii) one vote per share of Preferred Stock when such vote is not covered by the immediately preceding clause. The Company may at its option redeem the Preferred Stock by providing the required notice to the holders of the Preferred Stock 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 to be redeemed.

The Company also entered into a Registration Rights Agreement with Stillwater to register for resale the shares of the common stock issuable upon conversion of the Preferred Stock sold in the offering and the shares of common stock issuable upon exercise of the warrants. Subject to the terms of the Registration Rights Agreement, the Company is required to file a registration statement (the “Registration Statement”) on Form S-1 with the Securities and Exchange Commission (the “SEC”) within 30 days following the date that the Company is permitted to file a registration statement by (i) the rules and regulations of the Securities and Exchange Commission and (ii) the agreements set forth on Schedule B to the Registration Rights Agreement, which as of December 18, 2008 prohibits the Company from filing the initial Registration Statement until certain other registration statements are filed. After filing the Registration Statement, the Company is to cause such Registration Statement to be declared effective under the Securities Act of 1933 (the “Act”) as promptly as possible after the filing thereof, but in no event later than 90 days after the filing date (or no later than 120 days after the filing date in the event of SEC “full review” of the Registration Statement). The Holders of Notes that exchanged their Notes pursuant to the Exchange Agreement received the same registration rights as Stillwater.

Pursuant to the Securities Purchase Agreement, the Company claims an exemption from the registration requirements of the Act for the private placement of these securities pursuant to Section 4(2) of the Securities Act of 1933, as amended (the “Act”) and/or Regulation D promulgated thereunder since, among other things, the transaction did not involve a public offering, the investors were accredited investors and/or qualified institutional buyers, the investors had access to information about the Company and their investment, the investors took the securities for investment and not resale, and the Company took appropriate measures to restrict the transfer of the securities.

Amendment of Stillwater Note Purchase Agreement - April 2007

As previously reported in the Form 8-K dated July 25, 2006, on July 21, 2006, eMagin Corporation (the “Company”) entered into a Note Purchase Agreement (the “Stillwater Agreement”) with Stillwater LLC (“Stillwater”) which provides for the purchase and sale of a 6% senior secured convertible note in the principal amount of up to $500,000 (the "Stillwater Note"), together with a warrant (the “Stillwater Warrant”) to purchase 70% of the number of shares issuable upon conversion of the Stillwater Note, at the sole discretion of the Company by delivery of a notice to Stillwater on December 14, 2006. Interest payments from the Stillwater Note are to be made in cash, unless Stillwater elects to convert any portion of the principal of the Stillwater Note plus any accrued and unpaid interest for such principal amount.

As previously reported in the Form 8-K dated April 13, 2007, by way of amendment to the Stillwater Agreement, dated March 28, 2007 (the “Amendment”), the Company and Stillwater agreed to certain amendments to the Stillwater Agreement. Based upon the provisions of the Stillwater Agreement, Stillwater was bound to purchase the Stillwater Note and the Stillwater Warrant so long as the conditions to closing as set forth in the Stillwater Agreement were satisfied by the Company. However, prior to Stillwater’s obligation to purchase the Stillwater Note and Stillwater Warrant, the Company received notice from the American Stock Exchange (“AMEX”) that it was no longer in compliance with their listing requirements, and the Company was subsequently de-listed in March of 2007. Since compliance with the AMEX listing requirements was a condition of closing in the Stillwater Agreement, Stillwater was no longer obligated to purchase the Stillwater Note and Stillwater Warrant. Therefore, among other things, pursuant to the Amendment, the parties agreed to a new conversion price for the Stillwater Note of $0.35 per share, a new exercise price for the Stillwater Warrant of $0.48 per share, a new closing date, and amended certain closing conditions, including the following: on the closing date, (i) trading in securities on the New York Stock Exchange, Inc., the AMEX, Nasdaq, the Nasdaq Capital Market, the Over-The-Counter Bulletin Board, the Pink Sheets, LLC or any similar organization shall not have been suspended or materially limited, (ii) a general moratorium on commercial banking activities in the State of New York shall not have been declared by either federal or state authorities, and (iii) the Company has obtained waivers from all the note holders of the other notes or has executed an additional Allonge with the majority holders to amend Section 3.2 of the Note and other notes to provide that the Company maintain cash and cash equivalents balances of at least equal to $200,000 from April 1, 2007 through and including May 15, 2007 and that subsequent to May 15, 2007 the Company maintain cash and cash equivalents balances of at least equal to $600,000.

If the entire Stillwater Warrant is exercised for cash, the Company would receive $480,000, which would be used for working capital and other corporate purposes. There cannot be any assurances that any of the Stillwater Warrant will be exercised. The closing for the sale of the Stillwater Note and Stillwater Warrant was completed on April 9, 2007 and the Company issued Stillwater the Stillwater Note in a 6% Senior Secured Convertible Note in the principal amount of $500,000 and the Stillwater Warrant to purchase 1,000,000 shares of the Company's common stock at an exercise price of $0.48 in accordance with the terms of the Stillwater Agreement and Amendment. Interest payments from the Stillwater Note are to be made in cash, unless Stillwater elects to convert any portion of the principal of the Stillwater Note plus any accrued and unpaid interest for such principal amount pursuant to the terms of the Stillwater Note. The principal of the Stillwater Note was due in installments as follows:

Principal Amount	Due Date*
$ 250,000	July 23, 2007**
$ 250,000	January 21, 2008***

* If the due date falls on a non-business day, the due date will be the next business day.

**As disclosed above, on July, 23 2007, Stillwater elected to convert $252,166.50 of the Stillwater Note representing $250,000 of the principal amount of the Stillwater Note due on July 23, 2007 and $2,166.50 of accrued and unpaid interest into shares of common stock. Stillwater received 720,476 shares of the common stock at the conversion price of $0.35 pursuant to the terms of the Stillwater Note.

*** As disclosed above, on December 22, 2008 Stillwater elected to convert $251,166.67 of the remaining Stillwater Note representing $250,000 of the principal amount of the Stillwater Note originally due on January 21, 2008 and extended to December 22, 2008 (as discussed below) and $1,116.67 of accrued and unpaid interest into shares of common stock. Stillwater received 717,620 shares of common stock at a conversion price of $0.35 pursuant to the terms of the Stillwater Note.

This prospectus covers the resale by Stillwater of the above-referenced common stock underlying the Stillwater Note and the Stillwater Warrant.

Amendment Agreements - July 2007

As previously reported in the Form 8-K of the Company dated as of July 25, 2006, the Company entered into several Note Purchase Agreements (the "Original Purchase Agreements"), including the Stillwater Agreement, to sell to certain qualified institutional buyers and accredited investors $5,990,000 in principal amount 6% Senior Secured Convertible Notes Due July 21, 2007 and January 21, 2008 (the "Notes"), together with warrants (the "Warrants") to purchase 1,612,700 shares of the Company's common stock, par value $0.001 per share at $3.60 per share.

As previously reported in the Form 8-K of the Company dated as of July 25, 2007, by way of Amendment Agreements dated July 23, 2007 (the "Amendment Agreements") between the Company and each of the holders of the Notes, including Stillwater (each a "Holder" and collectively, the "Holders"), the Company agreed to issue each Holder an amended and restated Note for the outstanding Notes (the "Amended Notes") in the principal amount equal to the principal amount outstanding as of July 23, 2007 and an amended restated Warrant (the "Amended Warrants"). As part of the Amendment Agreements, the maturity date for the Amended Notes was extended to December 22, 2008 (per the Notes, the maturity date of December 21, 2008 fell on a Sunday, and therefore the maturity date was extended until the following business day, which was Monday, December 22, 2008, per the terms of the Note). The outstanding principal and accrued and unpaid interest of Amended Notes were repaid on December 22, 2008 except for those three Holders that elected to exchange their Amended Notes into Preferred Stock pursuant to the Exchange Agreement (as disclosed above). The changes to the Amended Warrants include the following:

- Except for the Stillwater Warrant whose exercise price was unchanged, the Amendment Agreements adjusted the exercise price of the Amended Warrants from $3.60 to $1.03 per share for 1,553,468 shares of common stock and requires the issuance of Warrants exercisable for an additional 3,831,859 shares of common stock at $1.03 per share with an expiration date of July 21, 2011; and
- The Amended Warrants are subject to certain anti-dilution adjustment rights in the event the Company issues shares of its common stock or securities convertible into its common stock at a price per share that is less than the Strike Price, in which case the Strike Price shall be adjusted to the lower of (1) 138% of the price at which such common stock is issued or issuable and (2) the exercise price of warrants, issued in such transaction.

Pursuant to the Amendment Agreements, the Company filed a Certificate of Designations of Series A Senior Secured Convertible Preferred Stock (the "Certificate of Designations"). The Certificate of Designations designates 3,198 shares of the Company's preferred stock as Series A Senior Secured Convertible Preferred Stock (the "Preferred Stock"). Each share of the Preferred Stock has a stated value of $1,000. The Preferred Stock is entitled to cumulative dividends which accrue at a rate of 8% per annum, payable on December 21, 2008. Each share of Preferred Stock has voting rights equal to (1) in any case in which the Preferred Stock votes together with the Company's common stock or any other class or series of stock of the Company, the number of shares of common stock issuable upon conversion of such shares of Preferred Stock 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) and (2) in any case not covered by the immediately preceding clause one vote per share of Preferred Stock. The Certificate of Designations prohibits the Company from entering into a Fundamental Change without consent of the Holders and contains antidilution adjustments rights that are comparable to the antidilution adjustments contained in the Amended Notes. Pursuant to the Certificate of Designations, the Company was to redeem any shares of its outstanding shares of Series A Senior Secured Convertible Preferred Stock that were outstanding on December 21, 2008, however, no such shares were issued or outstanding on such date.

Pursuant to the Amendment Agreements, the Company was required to file a registration statement with the Securities and Exchange Commission by August 31, 2007 covering the resale of 100% of the sum of (a) the number of shares issuable upon conversion of the Amended Notes and Preferred Stock, and (b) the number of shares issuable upon exercise of the Warrants.

The summary of amendment terms contained herein does not include all information included in the Amendment Agreement, the Amended Notes, the Amended Warrants, the Certificate of Designations or the Ancillary Agreements and, consequently, is qualified in its entirety by reference to the entire text of the Amendment Agreements and the forms of the Amended Notes, Amended Warrants, Certificate of Designations, Amendment No. 1 to Pledge and Security Agreement, Amendment No. 1 to Patent and Trademark Security Agreement and Amendment No. 1 to Lockbox Agreement.

Securities Purchase Agreement – April 2008

As previously reported on a Form 8-K that was filed with the Securities and Exchange Commission on April 4, 2008, the Company entered into a Securities Purchase Agreement on April 2, 2008, (the "Purchase Agreement") pursuant to which it sold to certain qualified institutional buyers and accredited investors (the "Investors") an aggregate of 1,586,539 shares of the Company's common stock, par value $0.001 per share (the "Shares"), and warrants to purchase an additional 793,273 shares of common stock, for an aggregate purchase price of $1,650,000. The purchase price of the common stock was $1.04 per share and the strike price of the corresponding warrant was $1.30 per share. The warrants expire April 2, 2013.

The Company entered into a Registration Rights Agreement with the Investors to register the resale of the Shares sold in the offering and the shares of common stock issuable upon exercise of the warrants. Subject to the terms of the Registration Rights Agreement, the Company is required to file a registration statement on Form S-1 with the Securities and Exchange Commission (the "SEC") within 45 days of the closing, to use its best efforts to cause the registration statement to be declared effective under the Securities Act of 1933 (the "Act") as promptly as possible after the filing thereof, but in no event later than 90 days after the filing date and no later than 120 days after the filing date in the event of SEC review of the registration statement. The Company filed the registration statement within the 45 day period however the Company was notified that the registration statement was under review by the SEC. The Company failed to file the amended registration statement by August 2, 2008 which was the 120th day from the signing of the Purchase Agreement and therefore the registration statement is not effective.

As the registration statement was not effective within the grace periods (“Event Date”), the Company must pay partial liquidated damages (“damages”) in cash to each Investor equal to 2% of the aggregate purchase price paid by each Investor under the Purchase Agreement on the Event Date and each monthly anniversary of the Event Date (or on a pro-rata basis for any portion of a month) until the registration statement is effective. The Company is not liable for any damages with respect to the warrants or warrant shares. The maximum damages payable to each Investor is 36% of the aggregate purchase price. If the Company fails to pay the damages to the Investors within 7 days after the date payable, the Company must pay interest at a rate of 15% per annum to each Investor which accrues daily from the date payable until damages are paid in full. The Company estimated $399 thousand to be the maximum potential damages that the Company may be required to pay the Investors if the registration statement is not effective within three years of the signing of the agreement. The Company estimated $186 thousand to be a reasonable estimate of the potential damages that may be due to the Investors based on the anticipated filing date.

The Company claims an exemption from the registration requirements of the Act for the private placement of these securities pursuant to Section 4(2) of the Act and/or Regulation D promulgated thereunder since, among other things, the transaction did not involve a public offering, the investors were accredited investors and/or qualified institutional buyers, the investors had access to information about the company and their investment, the investors took the securities for investment and not resale, and the Company took appropriate measures to restrict the transfer of the securities.

Moriah Capital Loan Agreement and Amendments

As previously reported on a Form 8-K that was filed with the Securities and Exchange Commission on August 10, 2007, the Company and Moriah Capital LP (“Moriah”) entered into a Loan and Security Agreement, dated as of August 7, 2007 (the “Loan and Security Agreement”), which was amended as of January 30, 2008 by Amendment No. 1 and on March 18, 2008 by Amendment No. 2 (collectively, the “Original Agreement”).

As previously reported on a Form 8-K that was filed with the Securities and Exchange Commission on August 26, 2008, the Company and Moriah entered into Amendment No. 3 to the Loan and Security Agreement dated August 20, 2008 (the “Amendment No. 3”). Pursuant to Amendment No. 3, the Company issued Moriah an Amended and Restated Convertible Revolving Loan Note (the “Amended Note”). The maturity date of the Amended Note has been extended to August 7, 2009 and the maximum amount that the Company can borrow pursuant to the Amended Note was increased to $3,000,000. The maturity date of the original revolving loan note had previously been extended to August 20, 2008.

Pursuant to Amendment No. 3, the Company issued Moriah a warrant, which terminates on August 7, 2013, to purchase up to 370,000 shares of the Company’s common stock at an exercise price of $1.30 per share. In connection with Amendment No. 3, the Company paid Moriah $85,000 in fees. As previously reported, pursuant to Original Agreement, the Company issued Moriah warrants to purchase up to 1,000,000 shares of the Company’s common stock at an exercise price of $1.50 per share.

Pursuant to Amendment No. 3, the Company and Moriah entered into an Amended and Restated Securities Issuance agreement (the “Amended and Restated Securities Issuance Agreement”). In connection with a Securities Issuance Agreement, dated as of August 7, 2007 (the “Original Securities Issuance Agreement”), the Company issued Moriah 162,500 shares of the Company’s common stock (the “2007 Shares”). Pursuant to the Amended and Restated Securities Issuance Agreement, Moriah agreed to waive the Company’s obligation to buy back the 2007 Shares with respect to 125,000 of such shares and to defer the Company’s obligation to buy back 37,500 of such 2007 Shares (collectively, the “Put Waiver”). Pursuant to the Amended and Restated Securities Agreement, the Company is issuing Moriah 485,000 shares of its Common Stock (of which 125,000 shares were issued in consideration for the Put Waiver from Moriah and 360,000 shares were issued in lieu of the issuance to Moriah of the Contingent Issued Shares (as described in the Original Securities Issuance Agreement)). Additionally, pursuant to the Amended and Restated Securities Issuance Agreement, the Company has also granted Moriah a put option pursuant to which Moriah can sell to the Company 162,500 shares of its common stock issued under the Amended and Restated Securities Agreement for $195,000, pro-rated for any portion thereof (the “2007 Put Price”). The 2007 Put Option shall automatically be deemed exercised by Moriah unless Moriah delivers written notice to the Company at any time between July 1, 2009 and August 1, 2009 that it does not wish to exercise the 2007 Put Option. The Company also granted Moriah a second put option pursuant to which Moriah can sell 360,000 of the shares issued to Moriah pursuant to the Amended and Restated Securities Purchase Agreement to the Company for $234,000 (the “2008 Put Option”). The 2008 Put Option shall automatically be deemed exercised by Moriah unless Moriah delivers written notice to the Company at any time between July 1, 2009 and August 1, 2009 that Moriah does not wish to exercise the 2008 Put option in whole or in part.

Pursuant to Amendment No. 3, the Company and Moriah entered into an Amendment to Registration Rights Agreement (the “Amended Registration Rights Agreement”). Pursuant to the Amended Registration Rights Agreement, the Company agreed to use its best efforts to file a registration statement to register the 485,000 shares of the Company’s common stock issued pursuant to the Amended and Restated Securities Issuance Agreement and the shares of common stock issuable upon exercise of the Warrant, provided that the Company is permitted under applicable securities rules and regulations and after the certain other registration statements that the Company was obligated to file on behalf of selling shareholders have been declared effective.

On August 19, 2008, the Holders of the Amended Notes and the Investors in the Purchase Agreement consented to the Company's execution of the Amended Note, Amendment No. 3, Amended and Restated Securities Issuance Agreement, and the Amended Registration Rights Agreement. In consideration for the consent, a total of 144,000 shares of common stock were issued to the Holders and Investors based on individual participation in the Amended Notes and Securities Purchase Agreement on September 4, 2008.

The Company claims an exemption from the registration requirements of the Securities Act of 1933, amended (the "Act") for the private placement of the above-referenced securities pursuant to Section 4(2) of the Act since, among other things, these transactions did not involve a public offering and the Company took appropriate measures to restrict the transfer of the securities.

The foregoing description of Amendment No. 3 to the Loan and Security Agreement, the Amended and Restated Revolving Loan Note, the Amended and Restated Securities Issuance Agreement, and the Amendment to the Registration Rights Agreement does not purport to be complete and is qualified in its entirety by reference to the entire text of the agreements.

SUMMARY CONSOLIDATED FINANCIAL DATA

The following summary consolidated financial data should be read in conjunction with our consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations". The statements of operations data for the years ended December 31, 2007, 2006, and 2005 and the balance sheet data at December 31, 2007 and 2006 are derived from our audited financial statements which are included in our Form 10-K/A filed with the Securities and Exchange Commission on January 13, 2009 and included elsewhere herein. The statements of operations data for the years ended December 31, 2004 and 2003 and the balance sheet data at December 31, 2005, 2004, and 2003 are derived from our audited financial statements which are not included herein. The statements of operations data for the nine months ended September 30, 2008 and 2007 and the balance sheet data at September 30, 2008 are derived from our unaudited condensed consolidated interim financial statements filed with the Securities and Exchange Commission on November 14, 2008. The balance sheet data at September 30, 2007 was derived from our unaudited condensed consolidated interim financial statements filed with the Securities and Exchange Commission on November 19, 2007. The historical results are not necessarily indicative of results to be expected for future periods. The following information is presented in thousands, except per share data.

Consolidated Statements of Operations Data:

	Year Ended December 31,					Nine Months Ended September 30, (unaudited)	
	2007	2006	2005	2004	2003	2008	2007
	(In thousands, except per share data)						
Revenue	$ 17,554	$ 8,169	$ 3,745	$ 3,593	$ 2,578	$ 13,469	$ 12,912
Cost of goods sold	12,628	11,359	10,219	5,966	5,141	8,110	9,120
Gross profit (loss)	4,926	(3,190)	(6,474)	(2,373)	(2,563)	5,359	3,792
Operating expenses:							
Research and development	2,949	4,406	4,020	898	19	1,614	2,304
Selling, general and administrative	6,591	8,860	6,316	4,428	5,712	4,797	5,198
Total operating expenses	9,540	13,266	10,336	5,326	5,731	6,411	7,502
Loss from operations	(4,614)	(16,456)	(16,810)	(7,699)	(8,294)	(1,052)	(3,710)
Other income (expense), net	(13,874)	1,190	282	(5,012)	3,571	(1,383)	(13,606)
Net loss	$ (18,488)	(15,266)	$ (16,528)	$ (12,711)	$ (4,723)	$ (2,435)	$ (17,316)
Basic and diluted loss per share	$ (1.59)	(1.52)	$ (1.94)	$ (1.98)	$ (1.31)	$ (0. 18)	$ (1.53)

Shares used in calculation of loss per share:							
Basic and diluted	11,633	10,058	8,541	6,428	3,599	13,855	11,301

Consolidated Balance Sheet Data:

	December 31,					September 30, (unaudited)	
	2007	2006	2005	2004	2003	2008	2007
	(In thousands)						
Cash and cash equivalents	$ 713	1,415	$ 6,727	$ 13,457	$ 1,054	$ 1,272	$ 792
Working (deficit) capital	(4,708)	(305)	8,868	14,925	106	(3,555)	1,587
Total assets	6,648	7,005	14,142	18,436	3,749	9,191	7,068
Long-term obligations	60	2,229	56	22	6,161	38	5,931
Total shareholders' (deficit) equity	$ (4,170)	(1,164)	$ 10,401	$ 16,447	$ (4,767)	$ (2,888)	$ (3,656)

RISK FACTORS

You should carefully consider the following risk factors and the other information included herein as well as the information included in other reports and filings made with the SEC before investing in our common stock. If any of the following risks actually occurs, our business, financial condition or results of operations could be harmed. The trading price of our common stock could decline due to any of these risks, and you may lose part or all of your investment.

RISKS RELATED TO OUR FINANCIAL RESULTS

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

For the three and nine months ended September 30, 2008, we had net income of $361 thousand and a net loss of $2.4 million, respectively. Our accumulated losses are $202 million as of September 30, 2008. We have achieved profitability for the three months ended September 30, 2008, however we cannot give assurance that we will continue to achieve profitability within the foreseeable future as we fund operating and capital expenditures in areas such as market development, sales and marketing, manufacturing equipment, acquisitions, and research and development. We cannot assure investors that we will sustain profitability or that our operating losses will not increase in the future.

We may not be able to execute our business plan and may not generate cash from operations.

As we have reported, our business has experienced and is currently experiencing revenue growth during the nine months ended September 30, 2008. We anticipate that our cash requirements to fund operating or investing activities over the next twelve months may be greater than our current cash on hand and borrowing availability under our revolving credit facility. In the event that cash flow from operations is less than anticipated and we are unable to secure additional funding to cover our expenses, in order to preserve cash, we would be required to reduce expenditures and effect reductions in our corporate infrastructure, either of which could have a material adverse effect on our ability to continue our current level of operations. No assurance can be given that additional financing will be available, or if available, will be on acceptable terms.

We may be subject to fines, sanctions, and/or penalties of an indeterminable nature as a result of potential violations of federal securities laws.

In July 2006, we entered into a Note Purchase Agreement with Stillwater LLC, which provided for the purchase and sale of a 6% senior secured convertible note in principal amount of up to $500,000 (the “Stillwater Note”) and a warrant to purchase 70% percent of the number of shares issuable upon conversion of the Stillwater Note, at our sole discretion by delivery of a notice to Stillwater on December 14, 2006. We then filed a registration statement on Form S-3 up to 41,088,445 shares of common stock issuable upon conversion of our 6% senior secured convertible notes or exercise of warrants, which following the effectuation by the Company of a one-for-ten reverse stock split on November 3, 2006, amounted to 4,108,845 shares. In July 2007, we amended the agreements with Stillwater. Amending the Stillwater agreements without first withdrawing the Registration Statement on Form S-3 may be inconsistent with Section 5 of the Securities Act of 1933, as amended, and we may be subject to fines, sanctions and/or penalties of an indeterminable nature as a result of potential violations of federal securities laws. If we are assessed fines and penalties our business will be materially affected.

The issuance of shares of common stock in connection with the conversion of the Notes may have not have been in compliance with certain state and federal securities laws and any damages that we may have to pay as a result of such issuance could have a material adverse effect on our revenues, profits, results of operations, financial condition and future prospects.

Our financial statements indicate that there is substantial doubt about our ability to continue as a going concern, which may hinder our ability to obtain future financing.

Our unaudited condensed consolidated financial statements as of September 30, 2008 have been prepared under the assumption that we will continue as a going concern. Our independent registered public accounting firm issued a report dated January 8, 2009 in connection with the audit of the 2007 financial statements that included an explanatory paragraph expressing substantial doubt as to our ability to continue as a going concern. Our ability to continue as a going concern ultimately depends on our ability to generate a profit which is likely dependent upon our ability to obtain additional equity or debt financing, attain further operating efficiencies and, ultimately, to achieve profitable operations. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

RISKS RELATED TO MANUFACTURING

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 maintain and attract new 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 currently 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. However, we try to maintain product inventory to fill the requirements under such circumstances. 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 extensive. No assurance can be given that we will not lose potential sales or be unable to meet production orders 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.

We could experience manufacturing interruptions, delays, or inefficiencies if we are unable to timely and reliably procure components from single-sourced suppliers.

We maintain several single-source supplier relationships, either because alternative sources are not available or because the relationship is advantageous due to performance, quality, support, delivery, capacity, or price considerations. If the supply of a critical single-source material or component is delayed or curtailed, we may not be able to ship the related product in desired quantities and in a timely manner. Even where alternative sources of supply are available, qualification of the alternative suppliers and establishment of reliable supplies could result in delays and a possible loss of sales, which could harm operating results.

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 could result in manufacturing delays, increased costs and ultimately in reduced or delayed sales or lost orders which could materially and adversely affect our operating results.

RISKS RELATED TO OUR INTELLECTUAL PROPERTY

We rely on our license agreement with Eastman Kodak for the development of our products.

We rely on our license agreement with Eastman Kodak for the development of our products, and the termination of this license, 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. 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. On April 30, 2007, the U.S. Supreme Court, in KSR International Co. vs. Teleflex, Inc., mandated a more expansive and flexible approach towards a determination as to whether a patent is obvious and invalid, which may make it more difficult for patent holders to secure or maintain existing patents. 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 yearly 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.

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 newtechnologies 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 may be cyclical.

Our business strategy is dependent on OEM manufacturers building and selling products that incorporate our OLED displays as components into those products. Industry-wide fluctuations and downturns in the demand for flat panel displays could cause significant harm to our business. 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. Our competitive position could be damaged if one or more of our competitors’ products get to the market sooner than our products. We cannot assure you that our product will get to market ahead of our competitors or that we will be able to compete successfully against current and future competition. The failure to do so would have a materially adverse effect upon our business, operating results and financial condition.

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. 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.

Our products are subject to lengthy OEM development periods.

We plan to sell most of our microdisplays to OEMs who will incorporate them into 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 often with a duration of between one and three years. 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, that we will have the resources to fund the expenditures necessary to implement certain cost-saving measures, or that our costs can be reduced as quickly as any reduction in unit prices. 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 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 attracting and retaining new personnel may have a materially adverse affect on our business and our 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 and will also need to recruit additional management in order to expand according to our business plan. The failure to attract and retain additional management or personnel could have a material adverse effect on our operating results and financial performance.

The ineffectiveness of our internal control over financial reporting could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002 (“Section 404”), and the rules and regulations promulgated by the SEC to implement Section 404, we are required to include in our Form 10-K an annual report by our management regarding the effectiveness of our internal control over financial reporting. The report includes, among other things, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management.

As of September 30, 2008, our internal control over financial reporting was ineffective due to the presence of material weaknesses, as more fully described in Item 4T of the September 30, 2008 Form 10-Q filed with the SEC on November 14, 2008. This could result in a loss of investor confidence in the accuracy and completeness of our financial reports, which may have an adverse effect on our stock price.

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 has primarily operated on the basis of short-term purchase orders. We are now receiving longer term purchase agreements, such as those which comprise our approximately $4.1 million backlog as of February 11, 2009 , and procurement contracts, but we cannot guarantee that we will continue to do so. Our current purchase agreements can be cancelled or revised without penalty, depending on the circumstances. 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 eMagin may decline.

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.

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 in to 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 foreign entities. Some customers in other countries have longer receivable periods or warranty periods. In addition, many of the foreign OEMs that are the most likely long-term purchasers of our microdisplays expose 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 potential 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 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 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 eMagin 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 February 11, 2009, we have outstanding (i) options to purchase 1,615,673 shares, (ii) warrants to purchase 12,279,239 shares of common stock, and (iii) preferred stock convertible into 7,652,000 shares of common stock.

We have a staggered board of directors and other anti-takeover provisions, which could inhibit potential investors or delay or prevent a change of control that may favor you.

Our Board of Directors is divided into three classes and our Board members are elected for terms that are staggered. This could discourage the efforts by others to obtain control of eMagin. Some of the provisions of our certificate of incorporation, our bylaws and Delaware law could, together or separately, discourage potential acquisition proposals or delay or prevent a change in control. In particular, our board of directors is authorized to issue up to 10,000,000 shares of preferred stock (less any outstanding shares of preferred stock) with rights and privileges that might be senior to our common stock, without the consent of the holders of the common stock.

FORWARD LOOKING STATEMENTS

We and our representatives may from time to time make written or oral statements that are “forward-looking,” including statements contained in this prospectus and other filings with the Securities and Exchange Commission, reports to our stockholders and news releases. All statements that express expectations, estimates, forecasts or projections are forward-looking statements. In addition, other written or oral statements which constitute forward-looking statements may be made by us or on our behalf. Words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “seeks,” “estimate “projects,” “forecasts,” “may,” “should,” variations of such words and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties, and assumptions which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in or suggested by such forward-looking statements. Among the important factors on which such statements are based are assumptions concerning our ability to obtain additional funding, our ability to compete against our competitors, our ability to integrate our acquisitions and our ability to attract and retain key employees.

USE OF PROCEEDS

This prospectus relates to shares of our common stock that may be offered and sold from time to time by the selling stockholders. We will not receive any proceeds from the sale of shares of common stock in this offering. However, we will receive the sale price of any common stock we sell to the selling stockholders upon exercise of the warrants owned by the selling stockholders. We expect to use the proceeds received from the exercise of the warrants, if any, for general working capital purposes. We have not declared or paid any dividends and do not currently expect to do so in the near future.

MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is quoted on the OTC Bulletin Board under the symbol “EMAN.OB.” The following table sets forth the high and low sales prices as reported by the OTC Bulletin Board Market for the periods indicated.

	High	Low
Fiscal 2006		
First Quarter	$ 7.10	$ 4.60
Second Quarter	$ 5.70	$ 2.50
Third Quarter	$ 3.80	$ 1.80
Fourth Quarter	$ 2.50	$ 1.01
Fiscal 2007		
First Quarter`	$ 1.08	$ 0.26
Second Quarter	$ 0.85	$ 0.42
Third Quarter	$ 1.64	$ 0.65
Fourth Quarter	$ 1.75	$ 0.85
Fiscal 2008		
First Quarter	$ 1.47	$ 0.88
Second Quarter	$ 1.05	$ 0.63
Third Quarter	$ 0.83	$ 0.52
Fourth Quarter	$ 0.75	$ 0.21
Fiscal 2009		
First Quarter (as of February 11, 2009)	$ 0.85	$ 0.44

As of February 11, 2009, there were 511 holders of record of our common stock. Because brokers and other institutions hold many of the shares on behalf of shareholders, we are unable to determine the actual number of shareholders represented by these record holders.

Dividends

We have never declared or paid cash dividends on our common stock. We currently anticipate that we will retain all future earnings to fund the operation of our business and do not anticipate paying dividends on our common stock in the foreseeable future.

SELECTED FINANCIAL DATA

The following table summarizes our consolidated financial data for the periods presented. We prepared this information using our consolidated financial statements for each of the periods presented. The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and related notes and “Management’s Discussion and Analysis of Financial Condition and Results of Operations”. The historical results are not necessarily indicative of results to be expected for future periods.

Consolidated Statements of Operations Data:

	Year Ended December 31,					Nine Months Ended September 30, (unaudited)	
	2007	2006	2005	2004	2003	2008	2007
	(In thousands, except per share data)						
Revenue	$ 17,554	$ 8,169	$ 3,745	$ 3,593	$ 2,578	$ 13,469	$ 12,912
Cost of goods sold	12,628	11,359	10,219	5,966	5,141	8,110	9,120
Gross profit (loss)	4,926	(3,190)	(6,474)	(2,373)	(2,563)	5,359	3,792
Operating expenses:							
Research and development	2,949	4,406	4,020	898	19	1,614	2,304
Selling, general and administrative	6,591	8,860	6,316	4,428	5,712	4,797	5,198
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Loss from operations	(4,614)	(16,456)	(16,810)	(7,699)	(8,294)	(1,052)	(3,710)
Other income (expense), net	(13,874)	1,190	282	(5,012)	3,571	(1,383)	(13,606)
Net loss	$ (18,488)	(15,266)	$ (16,528)	$ (12,711)	$ (4,723)	$ (2,435)	$ (17,316)
Basic and diluted loss per share	$ (1.59)	(1.52)	$ (1.94)	$ (1.98)	$ (1.31)	$ (0. 18)	$ (1.53)
Shares used in calculation of loss per share:							
Basic and diluted	11,633	10,058	8,541	6,428	3,599	13,855	11,301

	December 31,					September 30, (unaudited)	
	2007	2006	2005	2004	2003	2008	2007
	(In thousands)						

Cash and cash equivalents	$	713		1,415	$	6,727	$	13,457	$	1,054	$	1,272	$	792
Working (deficit) capital		(4,708)		(305)		8,868		14,925		106		(3,555)		1,587
Total assets		6,648		7,005		14,142		18,436		3,749		9,191		7,068
Long-term obligations		60		2,229		56		22		6,161		38		5,931
Total shareholders' (deficit) equity	$	(4,170)		(1,164)	$	10,401	$	16,447	$	(4,767)	$	(2,888)	$	(3,656)

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MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONAND RESULTS OF OPERATIONS

Introduction

The following discussion should be read in conjunction with the Financial Statements and Notes thereto. Our fiscal year ends December 31. This document contains certain forward-looking statements including, among others, anticipated trends in our financial condition and results of operations and our business strategy. (See Part I, Item 1A, "Risk Factors "). These forward-looking statements are based largely on our current expectations and are subject to a number of risks and uncertainties. Actual results could differ materially from these forward-looking statements. Important factors to consider in evaluating such forward-looking statements include (i) changes in external factors or in our internal budgeting process which might impact trends in our results of operations; (ii) unanticipated working capital or other cash requirements; (iii) changes in our business strategy or an inability to execute our strategy due to unanticipated changes in the industries in which we operate; and (iv) various competitive market factors that may prevent us from competing successfully in the marketplace.

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.

Since our inception in 1996 through 2004, we derived the majority 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 February 11, 2009 , we have a backlog of approximately $4.1 million in products ordered for delivery through December 31, 2009. 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 our Z800 3DVisor personal 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. We are also developing head-wearable displays, including our Z800 3DVisor that incorporate our Microviewer.

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 believe that we are the only company to demonstrate publicly and market full-color small molecule OLED-on-silicon microdisplays.

Company History

Historically, we have been a developmental stage company. As of January 1, 2003, we were no longer classified as 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. Currently, most of our operating expenses are 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 fifteen day right of return. Revenue on consumer products is deferred until the right of return has expired.

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

Use of Estimates

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

Fair Value of Financial Instruments

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.

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 December 31, 2008 , the number of shares of common stock available for issuance was 300,000. As of December 31, 2008 , the plan had not been implemented.

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

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123R, “Share-Based Payment” (“SFAS 123R”), which requires the Company to recognize expense related to the fair value of the Company’s share-based compensation issued to employees and directors. SFAS 123R requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company’s consolidated statement of operations. The Company uses the straight-line method for recognizing compensation expense. An estimate for forfeitures is included in compensation expense for awards under SFAS 123R.

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.   As of December 31, 2008, no options were granted from this plan.

Results of Operations

The following table presents certain financial data as a percentage of total revenue for the periods indicated. Our historical operating results are not necessarily indicative of the results for any future period.

	Year ended December 31,			Nine Months Ended September 30,	
	2007	2006	2005	2008	2007
				(Unaudited)	
Revenue	100%	100%	100%	100%	100%
Cost of goods sold	72	139	273	60	71
Gross profit (loss)	28	(39)	(173)	40	29
Operating expenses:					
Research and development	17	54	107	12	18
Selling, general and administrative	38	109	169	36	40
Total operating expenses	55	163	276	48	58
Loss from operations	(27)	(202)	(449)	(8)	(29)
Other income (expense), net	(78)	15	8	(10)	(105)
Net loss	(105)%	(187)%	(441)%	(18)%	(134)%

The following table presents certain financial data for the periods indicated. Our historical operating results are not necessarily indicative of the results for any future period.

	Year ended December 31,			Nine Months Ended September 30,	
	2007	2006	2005	2008	2007
				(Unaudited)	
	(In thousands, except per share data)				
Revenue	$ 17,554	$ 8,169	$ 3,745	$ 13,469	$ 12,912
Cost of goods sold	12,628	11,359	10,219	8,110	9,120
Gross profit (loss)	4,926	(3,190)	(6,474)	5,359	3,792
Operating expenses:					
Research and development	2,949	4,406	4,020	1,614	2,304
Selling, general and administrative	6,591	8,860	6,316	4,797	5,198
Total operating expenses	9,540	13,266	10,336	6,411	7,502
Loss from operations	(4,614)	(16,456)	(16,810)	(1,052)	(3,710)
Other income (expense), net	(13,874)	1,190	282)	(1,383)	(13,606)
Net loss	$ (18,488)	$ (15,266)	$ (16,528)	$ (2,435)	$ (17,316)
Net loss per share, basic and diluted	$ (1.59)	$ (1.52)	$ (1.94)	$ (0. 18)	$ (1.53)

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Three Months and Nine Months Ended September 30, 2008 Compared to Three Months and Nine Months Ended September 30, 2007

Revenues

Revenues for the three and nine months ended September 30, 2008 were approximately $5.2 million and $13.5 million, respectively, as compared to approximately $5.1 million and $12.9 million for the three and nine months ended September 30, 2007, respectively, an increase of approximately 2% and 5%, respectively. There was relatively no change in revenues for the three month period as compared to the same period of the prior year. The higher revenues of $0.6 million for the nine month period as compared to the same period in the prior year was due to an increase in the contract revenues of $1.4 million as a result of additional contracts the Company has obtained offset by a slight decrease in product revenue of $0.8 million. The decrease in the product revenue was due to a production issue the Company experienced in the first quarter of 2008 which resulted in a shortage of displays. The Company has rectified the production issue and has seen improvement in its production volume and yield.

Cost of Goods Sold

Cost of goods sold includes direct and indirect costs associated with production. Cost of goods sold for the three and nine months ended September 30, 2008 were approximately $2.8 million and $8.1 million, respectively, as compared to approximately $3.1 million and $9.1 million, respectively, for the three and nine months ended September 30, 2007. For the three and nine month periods as compared to the same periods of the prior year there was a decrease of approximately $0.3 million and $1.0 million, respectively. The gross margin for the three and nine months ended September 30, 2008 was approximately $2.4 million and $5.4 million, respectively, as compared to approximately $2.0 million and $3.8 million, respectively, for the three and nine months ended September 30, 2007. As a percentage of revenue this translates to a gross margin for the three and nine months ended September 30, 2008 of 46% and 40%, respectively, as compared to 40% and 29%, respectively, for the three and nine months ended September 30, 2007. The increase in the gross margin was attributed to fuller utilization of our fixed production overhead due to higher unit production volume, improved yields, and a decrease in the third party rebillable R&D costs.

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 nine months ended September 30, 2008 were approximately $0.3 million and $1.6 million, respectively, as compared to $0.6 million and $2.3 million for the three and nine months ended September 30, 2007, a decrease of approximately $0.3 million and $0.7 million, respectively. The decrease was due to the re-deployment of research and development personnel to production contract services which are included in cost of goods sold.

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 nine months ended September 30, 2008 were approximately $1.3 million and $4.8 million, respectively, as compared to approximately $1.4 million and $5.2 million for the three and nine months ended September 30, 2007, a decrease of $0.1 million and $0.4 million, respectively. The decrease of approximately $0.1 million for the three months ended September 30, 2008 was primarily related to a decrease in professional services offset by an increase in the reserve for allowance for bad debts. The decrease of approximately $0.4 million for the nine months ended September 30, 2008 was primarily related to decreases in personnel costs and professional services offset by an increase in reserve for allowance for bad debts.

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

For the three and nine months ended September 30, 2008, interest income was approximately $2 thousand and $6 thousand as compared to approximately $9 thousand and $32 thousand for the three and nine months ended September 30, 2007. The decrease in interest income was primarily a result of lower interest rates on investments.

For the three and nine months ended September 30, 2008, interest expense was approximately $0.5 million and $1.7 million, respectively, as compared to approximately $0.6 million and $2.8 million, respectively, for the three and nine months ended September 30, 2007. The breakdown of the interest expense for the three and nine month period in 2008 is as follows: interest expense associated with debt of approximately $178 thousand and $501 thousand, respectively; the amortization of the deferred costs and waiver fees associated with the debt of approximately $331 thousand and $1.2 million, respectively; and the amortization of the debt discount associated with the debt of approximately $0 and $25 thousand, respectively. The breakdown of the interest expense for the three and nine month period in 2007 is as follows: interest expense associated with debt of approximately $195 and $652 thousand, respectively; the amortization of the deferred costs associated with the notes payable of approximately $0 and $265 thousand, respectively; and the amortization of the debt discount of approximately $397 thousand and $1.96 million, respectively.

The gain from the change in the derivative liability was $0 for the three and nine months ended September 30, 2008 as compared to approximately $1.5 million and $0.9 million, respectively, for the three and nine months ended September 30, 2007 related to an extinguishment of debt.

Other income, net (excluding interest income), for the three and nine months ended September 30, 2008 was approximately $82 thousand and $288 thousand, respectively, as compared to approximately $172 thousand and $762 thousand, respectively, for the three and nine months ended September 30, 2007. Other income, net (excluding interest income) for the three and nine months ended September 30, 2008 consists of approximately $18 thousand of income from equipment salvage; approximately $142 thousand and $396 thousand, respectively, of income from the licensing of intangible assets; and is offset by approximately $60 thousand and $126 thousand, respectively, of expense from registration payment arrangements.

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Revenues

Revenues increased by approximately $9.4 million to a total of approximately $17.6 million for the year ended December 31, 2007 from approximately $8.2 million for the year ended December 31, 2006, representing an increase of 115%. This increase was primarily due to increased microdisplay sales and increased availability of finished displays due to manufacturing improvements. Our contract revenue increased approximately $1.2 million while our product revenue increased approximately $8.2 million. Average price per unit for microdisplays was $371 in 2007 and $386 in 2006. Our current expectation is that revenue will continue to grow in 2008 if we successfully execute our business plan.

Cost of Goods Sold

Cost of goods sold includes direct and indirect costs associated with production of our products. Cost of goods sold for the years ended December 31, 2007 and 2006 was approximately $12.6 million and $11.4, respectively, an increase of $1.3 million. The increase included an inventory write-off of approximately $0.4 million and an increase in our warranty return reserve of approximately $0.6 million, both related to a non-recurring production issue that occurred during the fourth quarter of 2007. The non-recurring production issue involved changing a production procedure without adequate testing prior to implementation. The Company has taken steps to ensure any procedural changes in the production process will be thoroughly tested prior to implementation.

Cost of goods sold as a percentage of revenues improved from 139% in 2006 to 72% in 2007. Cost of goods is comprised primarily of material and labor cost. The labor portion of cost of goods is mostly fixed. Increased volume results in a lower cost of goods sold percentage. The improvement in cost of goods sold in 2007 was due primarily to both a streamlining of the Company's workforce in mid-2006 that had a significant full year effect on the fixed portion of cost of goods sold in 2007 and the effect of the larger revenue increase.

The gross profit was approximately $4.9 million for the year ended December 31, 2007 and the gross loss was approximately ($3.2) million for the year ended December 31, 2006. The gross margin was 28% for the year ended December 31, 2007 as compared to the gross loss of (39%) for the year ended December 31, 2006. The gross margin improvement was attributed to fuller utilization of our fixed production overhead due to higher unit production volume.

Research and Development Expenses

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 year ended December 31, 2007 were approximately $2.9 million as compared to approximately $4.4 million for the year ended December 31, 2006. The decrease was due to the re-deployment of research and development personnel to production contract services which are included in cost of goods sold.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of salaries and fees for professional services, legal fees incurred in connection with patent filings, SEC and related matters, as well as other marketing and administrative expenses. General and administrative expenses decreased by approximately $2.3 million to a total of approximately $6.6 million for the year ended December 31, 2007 from $8.9 million for the year ended December 31, 2006. The decrease was primarily related to a reduction of marketing, tradeshow and personnel costs.

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Other (Expense) Income

Other (expense) income, net consists primarily of interest income earned on investments, interest expense related to the secured debt, loss from the change in the derivative liability, loss on the extinguishment of debt and other income from the licensing of intangible assets.

For the year ended December 31, 2007, interest expense was approximately $3.1 million as compared to $1.3 million for the year ended December 31, 2006. Interest expense for 2007 consisted of interest expense associated with debt of approximately $744 thousand; the amortization of the deferred costs associated with debt of approximately $418 thousand; and the amortization of the debt discount associated with the debt of approximately $1.9 million. Interest expense for the year ended December 31, 2006 was comprised of interest associated with debt of approximately $124 thousand; the amortization of the deferred costs associated with the notes payable of approximately $221 thousand; and the amortization of the debt discount associated with the debt of approximately $956 thousand.

For the year ended December 31, 2007, the change in the derivative liability was a loss of approximately $853 thousand as compared to a gain of approximately $2.4 million ended December 31, 2006.

The loss on extinguishment of debt was $10.7 million for the year ended December 31, 2007 as compared to $0 for the year ended December 31, 2006. See Note 8 to the financial statements: Debt for additional information.

Other income for the year ended December 31, 2007 was approximately $815 thousand which consisted of interest income of approximately $43 million, a gain on the license of intangible assets of $869 thousand, offset by a write-off of a miscellaneous receivable of $103 thousand, and other income of $7 thousand as compared to $91 thousand for the year ended December 31, 2006. See Note 12 to the December 31, 2007 consolidated financial statements: Commitments and Contingencies – Royalties for additional information.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Revenues

Revenues increased by approximately $4.5 million to a total of approximately $8.2 million for the year ended December 31, 2006 from approximately $3.7 million for the year ended December 31, 2005, representing an increase of 118%. This increase was due to increased microdisplay demand and the broadening of our product revenue through the sales of the Z800 3D Visor. Our contract revenue increased approximately $150 thousand while our product revenue increased approximately $4.3 million. Average price per unit for microdisplays was $386 in 2006 and $372 in 2005.

Cost of Goods Sold

Cost of goods sold includes direct and indirect costs associated with production of our products. Cost of goods sold for the years ended December 31, 2006 and 2005 was approximately $11.4 million and approximately $10.2, respectively, an increase of $1.2 million. The gross loss was approximately ($3.2) million and approximately ($6.5) million, respectively, for the years ended December 31, 2006 and 2005, respectively. The gross loss was (39%) for the year ended December 31, 2006 as compared to (173%) for the year ended December 31, 2005. The increase in cost of goods sold for the year ended December 31, 2006 was attributed to higher materials usage to support increased production as well as approximately $343 thousand of stock compensation expense reflected in accordance with SFAS No. 123R in 2006. The decrease in gross loss was attributed to fuller utilization of our fixed production overhead due to higher unit volume.

Research and Development Expenses

Research and development expenses included 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 year ended December 31, 2006 were approximately $4.4 million as compared to approximately $4.0 million for the year ended December 31, 2005. The increase was primarily due to the stock-based compensation expense of approximately $435 thousand in 2006.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of salaries and fees for professional services, legal fees incurred in connection with patent filings and related matters, as well as other marketing and administrative expenses. General and administrative expenses increased by approximately $2.9 million to a total of approximately $8.9 million for the year ended December 31, 2006 from $6.3 million for the year ended December 31, 2005. The increase in selling, general and administrative expenses was due primarily to stock-based compensation expense of approximately $2.9 million and an increase in marketing expenses related to our Z800 3DVisor.

Other Income (Expense)

Other income, net consists primarily of interest income earned on investments, interest expense related to the secured debentures, and gain from the change in the derivative liability. For the year ended December 31, 2006, interest income was approximately $91 thousand as compared to approximately $210 thousand for the year ended December 31, 2005. The decrease in interest income was primarily a result of lower cash balances available for investment. For the year ended December 31, 2006, interest expense was approximately $1.3 million as compared to approximately $4 thousand for the year ended December 31, 2005. The increase in the interest expense was a result of interest associated with our notes payable of approximately $124 thousand, the amortization of the deferred costs associated with the notes payable of approximately $221 thousand, and the amortization of the debt discount of approximately $956 thousand. For the year ended December 31, 2006, income from the change in the derivative liability was approximately $2.4 million as compared to $0 for the year ended December 31, 2005.

Liquidity and Capital Resources

As of September 30, 2008, we had approximately $1.4 million of cash and investments as compared to $0.8 million as of December 31, 2007. The change in cash and investments was primarily due to cash provided by financing activities of $2.7 million offset by cash used for operating activities and investing activities of $2.1 million.

Sources and Uses of Cash

	Year ended December 31,			Nine Months Ended September 30,	
	2007	2006	2005	2008	2007
Cash flow data:				(unaudited)	
Net cash used in operating activities	$ (1,943)	$ (10,389)	$ (15,713)	$ (1,908)	$ (1670)
Net cash provided (used) in investing activities	61	(257)			