EMAGIN CORP
Form S-1
August 24, 2007

As filed with the Securities and Exchange Commission on August 24, 2007

Registration No. 333-

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON D.C. 20549

FORM S-1

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)

K.C. Park, Interim 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:

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New York, New York 10006
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(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
Common Stock, $0.001 par value per share (2)	1,333,333	$ 1.06	$ 1,413,333	$ 43.40
Common Stock, $0.001 par value per share (3)	162,500	$ 1.06	$ 172,500	$ 5.29
Common Stock, $0.001 par value per share (4)	3,831,859	$ 1.06	$ 4,061,770	$ 124.73
Common Stock, $0.001 par value per share (5)	5,627,960	$ 1.06	$ 5,965,637	$ 183.19
Total	10,955,652	$	$ 11,612,991	$ 356.61

(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 August 17, 2007, which was $1.06 per share.

(2) Represents 1,333,333 shares of our common stock issuable upon conversion pursuant to the Loan Conversion Agreement between us and Moriah Capital, L.P.

(3) Represent 162,500 shares of our common stock issued to Moriah Capital, L.P.

(4) Represents 3,831,859 shares of our common stock underlying warrants.

(5) Represent 5,627,960 shares of our common stock issuable upon conversion of Notes and up to three months of accrued interest.

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 AUGUST 24, 2007

eMagin Corporation

10,955,652 SHARES OF

COMMON STOCK

This prospectus relates to the resale by the selling stockholders of up to 10,955,652 shares of our common stock, including 3,831,859 shares issuable upon the exercise of common stock purchase warrants, 6,961,293 shares of common stock issuable upon conversion of notes and accrued interest, and 162,500 shares of our common stock issued for payment of fees. 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 August 13, 2007 was $1.04.

Investing in these securities involves significant risks. See “Risk Factors” beginning on page 10.

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 , 2007.

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.

TABLE OF CONTENTS

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 10,955,652 shares, consisting of the following:
	· 5,627,960 shares of common stock issuable upon conversion of notes and interest at a conversion price of $0.75 per share;
	· 1,333,333 shares of common stock issuable upon conversion of notes at a conversion price of $1.50 per share;
	· 162,500 shares of common stock issuable for payment of $195,000 of fees; and
	· up to 3,831,859 shares of common stock issuable upon the exercise of common stock purchase warrants.
Common Stock to be outstanding after the offering	23,103,285 shares*
Use of proceeds	We will not receive any proceeds from the sale of the common stock, however, we will receive proceeds if our warrants are exercised.
Over-The-Counter Bulletin Board Symbol	EMAN

* The information above regarding the common stock to be outstanding after the offering is based on 12,147,633 shares of our common stock outstanding as of August 13, 2007.

Recent Developments

Secured Convertible Revolving Note Transaction – August 2007

As previously reported in the Form 8-K of the Company dated as of August 7, 2007, the Company has entered into agreements, effective as of August 7, 2007, with Moriah Capital, L.P. ("Moriah"), pursuant to which the Company may borrow an amount not to exceed $2,500,000. Such funds may be drawn down by the Company in tranches of at least $25,000 up to five times each month. The loan agreements expire on August 7, 2008 but may be extended for an additional one year period. In connection with the transaction, the Company will issue, execute and deliver to Moriah a Secured Convertible Revolving Loan Note with a principal amount not to exceed $2,500,000, of which up to $2,000,000 is convertible into 1,333,333 shares subject to certain restrictions - see pg. 25 (at a conversion price of $1.50 per share), and a Securities Issuance Agreement pursuant to which the Company issued 162,500 shares of its common stock, which shares have an aggregate market value on the Closing Date of $195,000.

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"), 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. Notes valued at $220,000 were converted as of August 13, 2007.

On March 28, 2007, we entered into a purchase agreement to sell to Stillwater, an investor, $500,000 in Notes, together with Warrants to purchase 1,000,000 shares of the Company’s Common Stock at $0.48 per share. On July 23, 2007, Stillwater converted Notes valued at $250,000.

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 (each a “Holder” and collectively, the “Holders”), the Company agreed to issue each Holder an amended and restated Note (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”). The changes to the Amended Notes and Amended Warrants include the following:

- The maturity date for the outstanding Notes (totaling after previous conversions an aggregate of $6,020,000) has been extended to December 21, 2008;
- Liquidated damages of 1% per month related to the Company’s delisting from the American Stock Exchange will no longer accrue and the deferred interest balance of approximately $230,000 has been forgiven;
- The Company no longer has to maintain a minimum cash or cash equivalents balance of $600,000;
- The Amended Notes may not be prepaid without the consent of the Holders;

- As of July 23, 2007 the interest rate was raised from 6% per annum to 8% per annum;
- The Amended Notes are convertible into (i) 8,407,612 shares of the Company's common stock. The conversion price for $5,770,000 of principal was revised from $2.60 to $.75 per share. The conversion price of $.35 per share for $250,000 of principal (which represents the remaining portion of the original principal balance of $500,000) was unchanged;
- In addition to the right to convert the Amended Notes in the Company's common stock, up to $3,010,000 of the Amended Notes can be converted into (ii) 3,198 shares of the Company's newly formed Series A Senior Secured Convertible Preferred Stock (the "Preferred") at a stated value of $1,000 per share and accrued interest on the date of conversion can also be converted at the same rate. The Preferred is convertible into common stock at the same rate of $.75 or $.35 per share allowable by the note they were converted from, subject to adjustment as provided for in the Certificate of Designations (discussed below);
- Except for the Amended Note associated with the Other Purchase Agreement, the Amendment Agreements adjusts 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;
- The Amended Notes eliminate the requirement that the Company comply with certain covenants of management contained in the Note. Specifically, among other things, the requirements to defer management compensation and to maintain a management committee were removed; and
- The Amended Notes and/or the Preferred 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 Conversion Price, in which case the Conversion Price shall be adjusted to such lower price. 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 Amended Notes, the Company cannot enter into a transaction that constitutes a Fundamental Change without the consent of the Holders. A Fundamental Change includes the following:

§ The consolidation or merger of the Company or any of its subsidiaries;
§ The acquisition by a person or group of entities acting in concert of 50% or more of the combined voting power of the outstanding securities of the Company; and
§ The occurrence of any transaction or event in which all or substantially all of the shares of the Company's common stock is exchanged, converted into, acquired for or constitutes the right to receive consideration which is not all or substantially all common stock which is listed on a national securities exchange or approved for quotation on Nasdaq or any similar United States system of automated dissemination of transaction reporting securities prices.

Pursuant to the Amendment Agreements, the Company is required to file 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. The Preferred Stock has a mandatory redemption at December 21, 2008.

Pursuant to the Amendment Agreements, the Company is 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.

Pursuant to the Amendment Agreement, the Company and the Collateral Agent, on behalf of the note holders, executed Amendment No. 1 to the Pledge and Security Agreement; Amendment No. 1 to Patent and Trademark Security Agreement; Amendment No. 1 to Lockbox Agreement. The Pledge and Security Agreement, Trademark Security Agreement and Lockbox Agreement were previously entered into on July 21, 2006 (collectively, the “Ancillary Agreements”). The Ancillary Agreements were amended to cover obligations that may become payable to holders of Preferred Stock, to delete certain definitions used in the Ancillary Agreements and substitute definitions of terms used in the Ancillary Agreements.

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.

SUMMARY CONSOLIDATED FINANCIAL DATA

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 statements of operations data for the years ended December 31, 2006, 2005, and 2004 and the balance sheet data at December 31, 2006 and 2005 are derived from our audited financial statements which are included in our Form 10-K filed with the Securities and Exchange Commission on April 2, 2007. The statements of operations data for the years ended December 31, 2003 and 2002 and the balance sheet data at December 31, 2004, 2003 and 2002 are derived from our audited financial statements which are not included as part of the Form 10-K mentioned above. The statements of operations data for the six months ended June 30, 2007 and 2006 and the balance sheet data at June 30, 2007 are derived from our condensed unaudited consolidated interim financial statements filed with the Securities and Exchange Commission on August 14, 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,					Six Months Ended June 30,	
	2006	**2005**	**2004**	**2003**	**2002**	**2007**	**2006**
			(In thousands, except per share data)			(Unaudited)	
Revenue	$ 8,169	$ 3,745	$ 3,593	$ 2,578	$ 2,128	$ 7,841	$ 3,315
Cost of goods sold	11,359	10,219	5,966	5,141	—	6,061	5,994
Gross (loss) profit	(3,190)	(6,474)	(2,373)	(2,563)	2,128	1,780	(2,679)
Operating expenses:							
Research and development	4,406	4,020	898	19	7,255	1,740	2,542
Stock based compensation (1)	—	—	88	2,183	1,647	—	—
Selling, general and administrative	8,860	6,316	4,340	3,529	5,832	3,764	4,836
Total operating expenses	13,266	10,336	5,326	5,731	14,734	5,504	7,378
Loss from operations	(16,456)	(16,810)	(7,699)	(8,294)	(12,606)	(3,724)	(10,057)
Other income (expense), net	1,190	282	(5,012)	3,571	(2,306)	(941)	59
Net loss	$ (15,266)	$ (16,528)	$ (12,711)	$ (4,723)	$ (14,912)	$ (4,665)	$ (9,998)
Basic and diluted loss per share	$ (1.52)	$ (1.94)	$ (1.98)	$ (1.31)	$ (5.07)	$ (0.42)	$ (1.00)
Shares used in calculation of loss per share:							
Basic and diluted	10,058	8,541	6,428	3,599	2,941	10,984	10,008

(1) Represents amounts reported under APB 25.

Consolidated Balance Sheet Data:

	December 31,	June 30,

	2006	2005	2004	2003	2002	2007	2006
				(In thousands)		(Unaudited)	
Cash and cash equivalents	$ 1,415	$ 6,727	$ 13,457	$ 1,054	$ 83	$ 690	$ 255
Working (deficit) capital	(305)	8,868	14,925	106	(13,602)	(5,008)	945
Total assets	7,005	14,142	18,436	3,749	1,834	5,544	7,051
Long-term obligations	2,229	56	22	6,161	228	78	41
Total shareholders' (deficit) equity	$ (1,164)	$ 10,401	$ 16,447	$ (4,767)	$ (12,808)	$ (4,169)	$ 2,176

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.

Our accumulated losses are approximately $185 million as of June 30, 2007. We have not yet achieved profitability and we can give no assurances that we will achieve profitability within the foreseeable future as we fund operating and capital expenditures in areas such as establishment and expansion of markets, sales and marketing, operating equipment and research and development. We cannot assure investors that we will ever achieve or sustain profitability or that our operating losses will not increase in the future.

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

As we have reported, our business is currently experiencing significant revenue growth during the six months ended June 30, 2007. We anticipate that our cash requirements to fund this growth as well as other operating or investing cash requirements 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.

Our independent registered public accounting firm has expressed doubt about our ability to continue as a going concern, which may hinder our ability to obtain future financing.

Our independent registered public accounting firm had issued a report dated March 27, 2007 in connection with the audit of the financial statements for the year ended December 31, 2006, that included an explanatory paragraph expressing substantial doubt as to our ability to continue as a going concern without additional capital becoming available. Our ability to continue as a going concern ultimately is dependent on our ability to generate a profit which is likely dependant 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. Our condensed unaudited consolidated interim financial statements as of June 30, 2007 have also been prepared under the assumption that we will continue as a going concern.

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 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. We may be required to expend significant resources to monitor and police our intellectual property rights. Any future infringement or other claims or prosecutions related to our intellectual property could have a material adverse effect on our business. Any such claims, with or without merit, could be time consuming to defend, result in costly litigation, divert management's attention and resources, or require us to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us, if at all. Protection of intellectual property has historically been a large 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 new technologies on a timely basis;
- our ability to address the needs of our customers and the quality of our customer services;
- the quality, performance, reliability, features, ease of use and pricing of our products;
- successful expansion of our manufacturing capabilities;
- our efficiency of production, and ability to manufacture and ship products on time;
- the rate at which original equipment manufacturing customers incorporate our product solutions into their own products;
- the market acceptance of our customers' products; and
- product or technology introductions by our competitors.

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

***The display industry is cyclical*.**

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

Competing products may get to market sooner than ours.

Our competitors are investing substantial resources in the development and manufacture of microdisplay systems using alternative technologies such as reflective liquid crystal displays (LCDs), LCD-on-Silicon ("LCOS") microdisplays, active matrix electroluminescence and scanning image systems, and transmissive active matrix LCDs. 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. 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 nor is there any assurance 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 retaining or attracting 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.

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 $6.4 million backlog as of June 30, 2007, 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 a foreign entity. Some customers in other countries have longer receivable periods or warranty periods. In addition, many of the OEMs that are the most likely long-term purchasers of our microdisplays are located abroad exposing us to additional political and currency risk. We may find it necessary to locate manufacturing facilities abroad to be closer to our customers which could expose us to various risks, including management of a multi-national organization, the complexities of complying with foreign laws and customs, political instability and the complexities of taxation in multiple jurisdictions.

Our business may expose us to product liability claims.

Our business may expose us to 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 August 13, 2007, we have outstanding (i) options to purchase 789,277 shares, (ii) warrants to purchase 8,340,509 shares, and (iii) notes to convert into 3,647,805 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,” “esti “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 NASDAQ 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

*Prices as of August 13, 2007

As of August 13, 2007, we had 507 record holders of our common stock. The number of record holders was determined from the records of our transfer agent and does not include beneficial owners of common stock whose shares are held in the names of various security brokers, dealers, and registered clearing agencies.

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,					Six Months Ended June 30,	
	2006	**2005**	**2004**	**2003**	**2002**	**2007**	**2006**
	(In thousands, except per share data)					(Unaudited)	
Revenue	$ 8,169	$ 3,745	$ 3,593	$ 2,578	$ 2,128	$ 7,841	$ 3,315
Cost of goods sold	11,359	10,219	5,966	5,141	—	6,061	5,994
Gross (loss) profit	(3,190)	(6,474)	(2,373)	(2,563)	2,128	1,780	(2,679)
Operating expenses:							
Research and development	4,406	4,020	898	19	7,255	1,740	2,542
Stock based compensation (1)	—	—	88	2,183	1,647	—	—
Selling, general and administrative	8,860	6,316	4,340	3,529	5,832	3,764	4,836
Total operating expenses	13,266	10,336	5,326	5,731	14,734	5,504	7,378
Loss from operations	(16,456)	(16,810)	(7,699)	(8,294)	(12,606)	(3,724)	(10,057)
Other income (expense), net	1,190	282	(5,012)	3,571	(2,306)	(94)	59
Net loss	$ (15,266)	$ (16,528)	$ (12,711)	$ (4,723)	$ (14,912)	$ (4,665)	$ (9,998)
Basic and diluted loss per share	$ (1.52)	$ (1.94)	$ (1.98)	$ (1.31)	$ (5.07)	$ (0.42)	$ (1.00)
Shares used in calculation of loss per share:							
Basic and diluted	10,058	8,541	6,428	3,599	2,941	10,984	10,008

(1) Represents amounts reported under APB 25.

Consolidated Balance Sheet Data:

	December 31,	June 30,

	2006	2005	2004	2003	2002	2007	2006
				(In thousands)		(Unaudited)	
Cash and cash equivalents	$ 1,415	$ 6,727	$ 13,457	$ 1,054	$ 83	$ 690	$ 255
Working (deficit) capital	(305)	8,868	14,925	106	(13,602)	(5,008)	945
Total assets	7,005	14,142	18,436	3,749	1,834	5,544	7,051
Long-term obligations	2,229	56	22	6,161	228	78	41
Total shareholders' (deficit) equity	$ (1,164)	$ 10,401	$ 16,447	$ (4,767)	$ (12,808)	$ (4,169)	$ 2,176

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND 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 by the U.S. federal government, primarily under Department of Commerce or Department of Defense dual use research and development agreements. 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. From inception to December 31, 2006, we have recognized an aggregate of approximately $19.5 million from sales of our products, and as of June 30, 2007, we have a backlog of approximately $6.4 million. 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. Through our operations in Washington State we are also developing head-wearable displays that incorporate our Microviewer. All of our products are designed as commercial off the shelf (COTS) products which are suitable for a wide range of markets and applications.

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 COTS OLED-on-silicon microdisplays.

Company History

Historically, we had 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, derivative liability, 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 and accounts payable are stated at cost which appropriates 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 June 30, 2007, the number of shares of common stock available for issuance was 150,000. As of June 30, 2007, 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 Incentive Stock Option ("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.

On January 1, 2006, we adopted the provisions of Financial Accounting Standards Board ("FASB") Statement No. 123(R), "Share-Based Payments", ("SFAS No. 123R"), which requires us to recognize expense related to the fair value of our share-based compensation issued to employees and directors. Prior to the January 1, 2006, we accounted for share-based compensation under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25 ("APB No. 25"), "Accounting for Stock Issued to Employees", and related interpretations, as permitted by FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). In accordance with APB No. 25, no compensation cost was required to be recognized for options granted that had an exercise price equal to the market value of the underlying common stock on the date of grant.

Under SFAS 123R, the fair value of the stock awards is estimated at the date of grant using the Black-Scholes option valuation model. Stock based compensation is reduced for estimated forfeitures and is amortized over the vesting period using the straight-line method.

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,			Six Months Ended June 30,	
	2006	2005	2004	2007	2006
				(Unaudited)	
Revenue	100%	100%	100%	100%	100%
Cost of goods sold	139	273	166	77	181
Gross (loss)/income	(39)	(173)	(66)	23	(81)
Operating expenses:					
Research and development	54	107	25	22	77
Stock based compensation	—	—	2	—	—
Selling, general and administrative	109	169	121	48	146
Total operating expenses	163	276	148	70	223
Loss from operations	(202)	(449)	(214)	(47)	(304)
Other income (expense)	15	8	(140)	(12)	2
Net loss	(187)%	(441)%	(354)%	(59)%	(302)%

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,			Six Months Ended June 30,	
	2006	2005	2004	2007	2006
				(Unaudited)	
	(In thousands, except per share data)				
Revenue	$ 8,169	$ 3,745	$ 3,593	$ 7,841	$ 3,315
Cost of goods sold	11,359	10,219	5,966	6,061	5,994
Gross (loss)/income	(3,190)	(6,474)	(2,373)	1,780	(2,679)
Operating expenses:					
Research and development	4,406	4,020	898	1,740	2,542
Stock based compensation	—	—	88	—	—
Selling, general and administrative	8,860	6,316	4,340	3,764	4,836
Total operating expenses	13,266	10,336	5,326	5,504	7,378
Loss from operations	(16,456)	(16,810)	(7,699)	(3,724)	(10,057)
Other income (expense)	1,190	282	(5,012)	(941)	59
Net loss	$ (15,266)	$ (16,528)	$ (12,711)	$ (4,665)	$ (9,998)
Net loss per share, basic and diluted	$ (1.52)	$ (1.94)	$ (1.98)	$ (0.42)	$ (1.00)

THREE AND SIX MONTHS ENDED JUNE 30, 2007 COMPARED TO THREE AND SIX MONTHS ENDED JUNE 30, 2006

Revenues

Revenues for the three and six months ended June 30, 2007 were approximately $4.2 million and $7.8 million, respectively, as compared to approximately $1.7 and $3.3 million for the three and six months ended June 30, 2006, an increase of approximately 153% and 137%, respectively. Higher revenue for the three and six month periods in 2007 was primarily due to increased microdisplay demand and increased availability of finished displays due to manufacturing improvements.

Cost of Goods Sold

Cost of goods sold includes direct and indirect costs associated with production. Cost of goods sold for the three months ended June 30, 2007 and 2006 was approximately $3.0 million for both quarters and for the six months ended June 30, 2007 and 2006 was approximately $6.1 million and $6.0 million, respectively, a slight increase of $0.1 million. The gross margin for the three and six months ended June 30, 2007 was approximately $1.3 million and $1.8 million, respectively, as compared to a gross loss of approximately ($1.3) million and ($2.7) million, respectively, for the three and six months ended June 30, 2006. As a percentage of revenue this translates to a gross margin of 30% and 23% for the three and six months ended June 30, 2007 as compared to a gross loss of (77%) and (81%) for the three and six months ended June 30, 2006. The gross margin improvement was attributed to fuller utilization of our fixed production overhead due to higher unit volume. We expect that gross margins will continue to improve in 2007 as a result of continued leverage of our production overhead if unit volume and revenue continue to increase.

Operating Expenses

Research and Development. 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 three and six months ended June 30, 2007 were approximately $0.9 million and $1.7 million, respectively, as compared to $1.3 million and $2.5 million, respectively, for the three and six months ended June 30, 2006, a decrease of approximately $0.5 million and $0.9 million, respectively. The decrease was due to a reduction of research and development expenditures and personnel costs for the three and six months ended June 30, 2007 as compared to the three and six months ended June 30, 2006.

Selling, General and Administrative. Selling, general and administrative expenses consist principally of salaries and fees for professional services, legal fees incurred in connection with patent filings and related matters, as well as other marketing and administrative expenses. Selling, general and administrative expenses for the three and six months ended June 30, 2007 were approximately $1.5 million and $3.8 million, respectively, as compared to approximately $2.2 million and $4.8 million, respectively, for the three and six months ended June 30, 2006. The decrease of approximately $0.7 and $1.0 million, respectively, for the three and six months ended June 30, 2007 was primarily related to a reduction of marketing, tradeshow and personnel costs as compared to the three and six months ended June 30, 2006.

Other Income (Expense), net. Other income (expense), net consists primarily of interest income earned on investments, interest expense related to the secured debentures, gain from the change in the derivative liability, and other income from the licensing of intangible assets. For the three and six months ended June 30, 2007, interest income was approximately $8 and $23 thousand compared to approximately $5 and $59 thousand for the three and six months ended June 30, 2006. The decrease in interest income for the six month period was primarily a result of lower cash balances available for investment. For the three and six months ended June 30, 2007, interest expense was approximately $1.3 million and $2.2 million, respectively, as compared to $0 for the three and six months ended June 30, 2006. The increase in the interest expense for the three and six months periods was a result of interest associated with our notes payable of approximately $305 thousand and $457 thousand, respectively, the amortization of the deferred costs associated with the notes payable of approximately $133 thousand and $266 thousand, respectively, and the amortization of the debt discount of approximately $878 thousand and $1.5 million, respectively. For the three and six months ended June 30, 2007, the change in the derivative liability was a gain of approximately $182 thousand and $642 thousand, respectively, as compared to $0 for the three and six months ended June 30, 2006. Other income for the three and six months ended June 30, 2007 was approximately $568 thousand and $590 thousand, respectively, as compared to approximately $5 thousand and $59 thousand, respectively. The increase in other income for the three and six month periods ended June 30, 2007 was a gain on the license of intangible assets. See Note 11: Commitments and Contingencies – Royalty Payments of the 10-Q for additional information.

YEAR ENDED DECEMBER 31, 2006 COMPARED TO YEAR ENDED DECEMBER 31, 2005

Revenue. 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 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. 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). For the year ended December 31, 2006, interest income was approximately $92 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.

YEAR ENDED DECEMBER 31, 2005 COMPARED TO YEAR ENDED DECEMBER 31, 2004

Revenues. Revenues increased by approximately $152 thousand to a total of approximately $3.7 million for the year ended December 31, 2005 from approximately $3.6 million for the year ended December 31, 2004, representing an increase of 4%. This increase was due primarily to the broadening of our product offerings with the Z800 product and incremental revenue generated by these sales. Our contract revenue decreased approximately $72 thousand while our product revenue increased approximately $224 thousand. Average price per unit for microdisplays was $372 in 2005 and 2004.

Cost of Goods Sold. Cost of goods sold includes direct and indirect costs associated with production of our products. In the year ended December 31, 2005 we recorded approximately $10.2 million in cost of goods sold which resulted in a gross loss of approximately $6.5 million as compared to approximately $6.0 million in costs of goods sold resulting in a gross loss of $2.4 million in the year ended December 31, 2004. The production expenses for 2005 include labor costs related to operating two full eight hour shifts and a partial third shift as compared to a single shift in 2004. To accommodate longer operating hours and expected higher product output in 2005 we initiated modifications to our production process that resulted in less than 10% of our expected capacity while underway. Stabilization of these modifications initially was expected to be completed early in 2005, but took until the first quarter of 2006 to achieve. As a result gross margins in 2005 declined as compared to 2004 due to the higher labor costs.

Research and Development Expenses. Gross research and development expenses increased by approximately $3.1 million to a total of $4.0 million for the year ended December 31, 2005 from approximately $0.9 million for the year ended December 31, 2004. The approximately $3.1 million increase in R&D expenses for the year ended December 31, 2005 reflects efforts to develop two new microdisplays and three visor products.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased by approximately $2.0 million to a total of approximately $6.3 million for the year ended December 31, 2005 from approximately $4.3 million for the year ended December 31, 2004. The increase in selling, general and administrative expenses was due primarily to an increase in staff and personnel costs.

Other Income (Expense). Other income, net, for 2005 was approximately $282 thousand and was comprised of net interest income of approximately $207 thousand; a gain on miscellaneous equipment sales of approximately $38 thousand; and a gain on foreign exchange of approximately $37 thousand. Other expense, net, for 2004 was approximately $5.0 million and was comprised of approximately $3.2 million of charges related to the value of the warrants issued to induce the holders of the approximately $7.8 million in notes to agree to an early conversion of the notes into common stock; approximately $1.6 million in charges related to the remaining unamortized debt discount and beneficial conversion feature associated with aforementioned notes; and approximately $75 thousand in charges related to the write-off of the remaining unamortized deferred financing costs.

Liquidity and Capital Resources

Since our inception, we have incurred significant losses and as of June 30, 2007, we had an accumulated deficit of approximately $181 million. We have not yet achieved profitability.

As of June 30, 2007, we had approximately $0.9 million of cash and investments as compared to $1.6 million as of December 31, 2006. The decrease of approximately $0.7 million was due primarily to cash used for operating activities.

As we have reported, our business experienced significant revenue growth during the six month period ended June 30, 2007. This trend, if continues, may result in higher accounts receivable levels and may require increased production and/or higher inventory levels both of which require working capital.

Sources and Uses of Cash

	Years ended December 31,			Six Months Ended June 30,	
	2006	**2005**	**2004**	**2007**	**2006**
Cash flow data:				(unaudited)	
Net cash used in operating activities	$ (10,389)	$ (15,713)	$ (8,297)	$ (1,151)	$ (6,257)
Net cash used in investing activities	(257)				