EMAGIN CORP
Form 10-Q
May 15, 2007

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007
or

£ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 001-15751

eMAGIN CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	**56-1764501**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

10500 NE 8th Street, Suite 1400, Bellevue, Washington 98004
(Address of principal executive offices)

(425) 749-3600
(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, $.001 Par Value Per Share

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes R No £

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer £ Accelerated filer £ Non-accelerated filer R

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

The number of shares of common stock outstanding as of April 30, 2007 was 11,049,164.

eMagin Corporation
Form 10-Q
For the Quarter ended March 31, 2007

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ITEM 1. Condensed Consolidated Financial Statements

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

	March 31, 2007 (unaudited)	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 192	$ 1,415
Investments - held to maturity	175	171
Accounts receivable, net	1,466	908
Inventory	1,975	2,485
Prepaid expenses and other current assets	764	656
Total current assets	4,572	5,635
Equipment, furniture and leasehold improvements, net	549	666
Intangible assets, net	54	55
Other assets	233	233
Deferred financing costs, net	283	416
Total assets	$ 5,691	$ 7,005
LIABILITIES AND SHAREHOLDERS' CAPITAL DEFICIT		
Current liabilities:		
Accounts payable	$ 1,434	$ 1,192
Accrued compensation	1,065	959
Other accrued expenses	1,052	749
Advanced payments	254	444
Deferred revenue	64	126
Current portion of capitalized lease obligations	4	6
Current portion of debt	3,916	1,217
Derivative liability - warrants	735	1,195
Other current liabilities	45	52
Total current liabilities	8,569	5,940
Long-term debt	89	2,229
Total liabilities	8,658	8,169
Commitments and contingencies		
Shareholders' capital deficit:		
Preferred stock, $.001 par value: authorized 10,000,000 shares; no shares issued and outstanding	—	—
Common stock, $.001 par value: authorized 200,000,000 shares, issued and outstanding, 11,049,164 shares as of March 31, 2007 and 10,341,029 shares	11	10

as of December 31, 2006				
Additional paid-in capital		180,784		179,651
Accumulated deficit		(183,762)		(180,825)
Total shareholders' capital deficit		(2,967)		(1,164)
Total liabilities and shareholders' capital deficit	$	5,691	$	7,005

See notes to Condensed Consolidated Financial Statements.

eMAGIN CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except share and per share data)
(unaudited)

	Three Months Ended March 31, 2007	2006
Revenue:		
Product revenue	$ 3,523	$ 1,571
Contract revenue	86	70
Total revenue, net	3,609	1,641
Cost of goods sold	3,115	3,029
Gross profit (loss)	494	(1,388)
Operating expenses:		
Research and development	853	1,238
Selling, general and administrative	2,221	2,588
Total operating expenses	3,074	3,826
Loss from operations	(2,580)	(5,214)
Other income (expense):		
Interest expense	(840)	—
Gain on warrant derivative liability	460	—
Other income, net	23	54
Total other (expense) income	(357)	54
Net loss	$ (2,937)	$ (5,160)
Loss per share, basic and diluted	$ (0.27)	$ (0.52)
Weighted average number of shares outstanding:		
Basic and diluted	10,792,074	10,003,839

See notes to Condensed Consolidated Financial Statements.

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

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Accumulated Deficit	Total Shareholders' Deficit
BalaBalance, December 31, 2006	10,341	$ 10	$ 179,651	$ (180,825)	$ (1,164)
StocStock-based compensation	—	—	514	—	514
IssuIssuance of common stock for services	708	1	619	—	620
Net Net loss	—	—	—	(2,937)	(2,937)
BalaBalance, March 31, 2007 (unaudited)	11,049	$ 11	$ 180,784	$ (183,762)	$ (2,967)

See notes to Condensed Consolidated Financial Statements

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

	Three Months Ended March 31, 2007 (unaudited)	Three Months Ended March 31, 2006 (unaudited)
Cash flows from operating activities:		
Net loss	$ (2,937)	$ (5,160)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	117	257
Amortization of deferred financing fees	133	—
Reduction of provision for sales returns and doubtful accounts	(8)	—
Stock-based compensation	514	792
Issuance of common stock for services	620	50
Amortization of discount on notes payable	574	—
Gain on warrant derivative liability	(460)	—
Changes in operating assets and liabilities:		
Accounts receivable	(558)	(367)
Inventory	510	267
Prepaid expenses and other current assets	(108)	(244)
Deferred revenue	(62)	(57)
Accounts payable, accrued compensation, other accrued expenses, and advanced payments	461	(537)
Other current liabilities	—	(1)
Net cash used in operating activities	(1,204)	(5,000)
Cash flows from investing activities:		
Purchase of equipment	—	(54)
Purchase of investments - held to maturity	(4)	—
Purchase of intangibles and other assets	—	(2)
Net cash used in investing activities	(4)	(56)
Cash flows from financing activities:		
Payments of long-term debt and capital leases	(15)	(9)
Net cash used in financing activities	(15)	(9)
Net decrease in cash and cash equivalents	(1,223)	(5,065)
Cash and cash equivalents beginning of period	1,415	6,727
Cash and cash equivalents end of period	$ 192	$ 1,662
Cash paid for interest	$ 87	$ —
Cash paid for taxes	$ 31	$ 26

See notes to Condensed Consolidated Financial Statements.

eMAGIN CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1: Description of the Business and Summary of Significant Account Policies

The Business

eMagin Corporation is a developer and manufacturer of optical systems and microdisplays for use in the electronics industry. eMagin also develops and markets microdisplay systems and optics technology for commercial, industrial and military applications.

Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements of eMagin Corporation and its subsidiary reflects all adjustments, including normal recurring accruals, necessary for a fair presentation. Certain information and footnote disclosure normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to instruction, rules and regulations prescribed by the Securities and Exchange Commission. The Company believes that the disclosures provided herein are adequate to make the information presented not misleading when these unaudited condensed consolidated financial statements are read in conjunction with the audited consolidated financial statements contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. The results of operations for the period ended March 31, 2007 are not necessarily indicative of the results to be expected for the full year.

On November 3, 2006, the Company effected a one-for-ten (1-for-10) reverse stock split of its issued and outstanding common stock. All common and per share amounts in the accompanying financial statements have been adjusted to reflect the 1-for-10 reverse stock split.

The condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company has had recurring losses from operations which it believes will continue through the foreseeable future. The Company's cash requirements over the next twelve months are greater than the Company's cash, cash equivalents, and investments at March 31, 2007. The Company has working capital and shareholders' deficits at March 31, 2007. These factors raise substantial doubt regarding the Company's ability to continue as a going concern without continuing to obtain additional funding. The Company does not have commitments for such financing and no assurance can be given that additional financing will be available, or if available, will be on acceptable terms. If the Company is unable to obtain sufficient funds during the next twelve months, the Company will further reduce the size of its organization and/or curtail operations which will have a material adverse impact on the Company's business prospects. The condensed consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

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.

Revenue Recognition

Revenue is recognized when products are shipped to customers, net of allowances for anticipated returns. The Company's revenue-earning activities generally involve delivering products and revenues are considered to be earned when the Company has completed the process by which it is entitled to such revenues. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, selling price is fixed or determinable and collection is reasonably assured. The Company defers revenue recognition on products sold directly to the consumer with a fifteen day right of return. Revenue is recognized upon the expiration of the right of return.

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

Stock-based Compensation

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 condensed 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. See Note 8 for a further discussion on stock-based compensation.

Note 2: Recently Issued Accounting Pronouncements

The Financial Accounting Standards Board ("FASB") has issued interpretation No. 48, "Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109" ("FIN 48"), regarding accounting for, and disclosure of, uncertain tax positions. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, "Accounting for Income Taxes." FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted the provisions of FIN 48 on January 1, 2007. See Note 10 for further discussion on income taxes.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157"). SFAS 157 provides guidance for using fair value to measure assets and liabilities. It also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value, and does not expand the use of fair value in any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and is required to be adopted by the Company in the first quarter of 2008. The Company is evaluating the effect that the adoption of SFAS 157 will have on its consolidated results of operations and financial condition.

In February 2007, the FASB issued Statement No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities: ("SFAS159"). SFAS159 allows entities the option to measure eligible financial instruments at fair value as of specified dates. Such election, which may be applied on an instrument by instrument basis, is typically irrevocable once elected. SFAS 159 is effective for fiscal years beginning after November 15, 2007, and early application is allowed under certain circumstances. The Company is currently evaluating the impact SFAS 159 will have on its consolidated financial position and results of operations.

Note 3: Receivables

The majority of the Company's commercial accounts receivable are due from Original Equipment Manufacturers ("OEM's"). Credit is extended based on evaluation of a customer's financial condition and, generally, collateral is not required. Accounts receivable are payable in U.S. dollars, are due within 30-90 days and are stated at amounts due from customers, net of an allowance for doubtful accounts. Any account outstanding longer than the contractual payment terms is considered past due.

The Company determines the allowance for doubtful accounts by considering a number of factors, including the length of time the trade accounts receivable are past due, eMagin's previous loss history, the customer's current ability to pay its obligation, and the condition of the general economy and the industry as a whole. The Company will record a specific reserve for individual accounts when the Company becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position. If circumstances related to customers change, the Company would further adjust estimates of the recoverability of receivables.

Receivables consisted of the following (in thousands):

	March 31, 2007 (unaudited)	December 31, 2006
Accounts receivable	$ 1,909	$ 1,351
Less allowance for doubtful accounts	(443)	(443)
Net receivables	$ 1,466	$ 908

Note 4: Research and Development Costs

Research and development costs are expensed as incurred.

Note 5: Net Loss per Common Share

In accordance with SFAS No. 128, net loss per common share amounts ("basic EPS") was computed by dividing net loss by the weighted average number of common shares outstanding and excluding any potential dilution. Net loss per common share assuming dilution ("diluted EPS") was computed by reflecting potential dilution from the exercise of stock options and warrants. Common stock equivalent shares are excluded from the computation if their effect is antidilutive. As of March 31, 2007 and 2006, there were stock options and warrants outstanding to acquire 4,363,909 and 4,462,048 shares of our common stock, respectively. These shares were excluded from the computation of diluted loss per share because their effect would be antidilutive.

Note 6: Inventories

Inventory is stated at the lower of cost or market. Cost is determined using the first-in first-out method. The Company reviews the value of its inventory and reduces the inventory value to its net realizable value based upon current market prices and contracts for future sales. The components of inventories are as follows (in thousands):

	March 31, 2007 (unaudited)	December 31, 2006
Raw materials	$ 969	$ 1,146
Work in process	542	558
Finished goods	464	781
Total Inventory	$ 1,975	$ 2,485

Note 7: Debt

Debt is as follows (in thousands):

	March 31, 2007	December 31, 2006
Current portion of long-term debt:		
Capitalized lease obligations	$ 4	$ 6
Other debt	58	58
6% Senior Secured Convertible Notes	5,770	2,880
Less: Unamortized discount on notes payable	(1,912)	(1,721)
Current portion of long-term debt, net	3,920	1,223
Long-term debt:		
Other debt	89	104
6% Senior Secured Convertible Notes	—	2,890
Less: Unamortized discount on notes payable	—	(765)
Long-term debt, net	89	2,229
Total debt, net	$ 4,009	$ 3,452

The 6% Senior Secured Convertible Notes have 50% of the aggregate principal amount maturing on July 21, 2007 and the remaining 50% maturing on January 21, 2008. Interest of approximately $87 thousand was paid to investors on March 1, 2007. For the three months ended March 31, 2007, debt discount of approximately $574 thousand was amortized to interest expense.

The Notes have specific terms that the Company must adhere to, i.e. maintaining minimum cash and cash equivalent balances and trading its stock on specific Exchanges. On March 9, 2007, the terms of the Note were amended to allow the Company to trade its common stock on the Over-The-Counter Bulletin Board and also requiring the Company to maintain cash and cash equivalent balances of $200 thousand from February 26, 2007 through March 31, 2007. Subsequent to March 31, 2007, the company must maintain cash and cash equivalent balances of $600 thousand. On March 12, 2007, the Company was suspended from trading on the AMEX and is currently trading the Company’s common stock on the Over-The Counter Bulletin Board. The delisting from the AMEX triggered a compliance condition on the notes payable. As a result the Company is required to pay the noteholders monthly interest at 1% rather than .5% on the outstanding principal of the notes payable. The Company received a waiver from the noteholders that allows the Company to accrue the interest and delay the interest payment until the earliest of the Company (i) completing $2 million of debt or equity financing or (ii) the occurrence of a Repurchase Event per the note. On May 10, 2007, the requirement to maintain cash and cash equivalents balances of $200 thousand was extended through July 21, 2007 and any previous claim that may have otherwise been made regarding the potential breach by the Company of the minimum cash balance requirement was waived. Subsequent to July 21, 2007, the Company must maintain $600 thousand in cash and cash equivalent balances. See Note 9: Shareholders' Equity for additional information on the Notes.

Note 8: Stock-based Compensation

Stock based compensation is accounted for in accordance with the provisions of SFAS No. 123R. Under SFAS 123R, the fair value of stock awards is estimated at the date of grant using the Black-Scholes option valuation model. Stock-based compensation expense is reduced for estimated forfeitures and is amortized over the vesting period using the straight-line method.

The following table summarizes the allocation of non-cash stock-based compensation to our expense categories for the three month periods ended March 31, 2007 and 2006 (in thousands):

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Cost of revenue	$ 69	$ 135
Research and development	103	128
Selling, general and administrative	342	529
Total stock compensation expense	$ 514	$ 792

For the three months ended March 31, 2007 and 2006, stock compensation was approximately $514 thousand and $792 thousand, respectively, net of estimated forfeitures. At March 31, 2007, total unrecognized non-cash compensation costs related to stock options was approximately $2.6 million, net of forfeitures. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures and is expected to be recognized over a weighted average period of approximately 2.7 years.

The Company recognizes compensation expense for options granted to non-employees in accordance with the provision of Emerging Issues Task Force ("EITF") consensus Issue 96-18, "*Accounting for Equity Instruments that are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services,"* which requires using a fair value options pricing model and re-measuring such stock options to the current fair market value at each reporting period as the underlying options vest and services are rendered.

There were no stock options granted during the three month period ended March 31, 2007. For the three month period ended March 31, 2006, the following key assumptions were used in the Black-Scholes option pricing model to determine the fair value of stock options granted:

	For the Three Months Ended March 31, 2006
Dividend yield	0%
Risk free interest rates	4.8%
Expected volatility	123.2%
Expected term (in years)	5

We have not declared or paid any dividends and do not currently expect to do so in the near future. The risk-free interest rate used in the Black-Scholes is based on the implied yield currently available on U.S. Treasury securities with an equivalent term. Expected volatility is based on the weighted average historical volatility of the Company's common stock for the most recent five year period. The expected term of options represents the period that our stock-based awards are expected to be outstanding and was determined based on historical experience and vesting schedules of similar awards.

A summary of the Company's stock option activity for the three months ended March 31, 2007 is presented in the following tables:

	Number of Shares		Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (In Years)		Aggregate Intrinsic Value
Outstanding at January 1, 2007	1,065,745	$	2.94			
Options granted	—					
Options exercised	—					
Options forfeited	(193,943)		2.79			
Options cancelled	(56,067)		2.84			
Outstanding at March 31, 2007	815,735	$	2.98	3.92	$	—
Vested or expected to vest at March 31, 2007 (1)	758,634	$	2.98	3.92	$	—
Exercisable at March 31, 2007	540,028	$	2.94	3.20	$	—

	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life (In Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercisable Price
$2.10 - $2.70	726,706	4.11	$ 2.56	470,639	$ 2.53
$3.40 - $5.80	55,679	1.40	3.88	50,179	3.67
$6.60 - $22.50	33,350	4.16	10.66	19,210	11.30
	815,735	3.92	$ 2.98	540,028	$ 2.94

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

The aggregate intrinsic value in the table above represents the difference between the exercise price of the underlying options and the quoted price of the Company's common stock. There were no options in-the-money at March 31, 2007. The Company's closing stock price was $0.72 as of March 31, 2007. The Company issues new shares of common stock upon exercise of stock options.

Note 9: Shareholders' Equity

On November 3, 2006, the Company effected a one-for-ten (1-for-10) reverse stock split of its issued and outstanding common stock. The Company has adjusted its shareholders' equity accounts by reducing its stated capital and increasing its additional paid-in capital by approximately $91 thousand as of December 31, 2006 to reflect the reduction in outstanding shares as a result of the reverse stock split.

On July 21, 2006, the Company entered into several Note Purchase Agreements for the sale of approximately $5.99 million of senior secured debentures (the "Notes") together with warrants to purchase approximately 1.8 million shares of common stock, par value $.001 per share. 50% of the aggregate principal amount matures on July 21, 2007 and the remaining 50% matures on January 21, 2008. For the year ended December 31, 2006, two note holders converted their promissory notes valued at approximately $0.22 million and were issued an aggregate of approximately 85 thousand shares. The Notes pay 6% per annum interest quarterly. The delisting from the AMEX on March 12, 2007 triggered a compliance condition on the notes payable and as a result the Company is required to pay the noteholders monthly interest at 1% rather than .5% on the outstanding principal of the notes payable. The Company received a waiver from the noteholders that allows the Company to accrue the interest and delay the interest payment until the earliest of the Company (i) completing $2 million of debt or equity financing or (ii) the occurrence of a Repurchase Event per the note. The Company received approximately $5.4 million, net of deferred costs of approximately $0.6 million which are amortized over the life of the Notes.

The Company accounted for the net proceeds from the issuance of the Notes as two separate components: a detachable warrant component and a debt component. The Company determined the relative fair value of warrants to be $3.4 million which was recorded as debt discount, a reduction of the carrying value of the Notes. The following assumptions were used to determine the fair value of the warrants:

Dividend yield	0%
Risk free interest rates	4.99%
Expected volatility	122%
Expected term (in years)	5.0 years

The discount is being amortized to interest expense using the straight-line method as it approximates the effective interest method over the term of the Notes.

Under EITF 00-19 "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in, a Company's Own Stock", the fair value of the warrants, $3.6 million, have been recorded as a liability since the warrant agreement requires a potential net-cash settlement in the first year of the warrant agreement if the registration statement is not effective. As of December 31, 2006, the registration statement is effective. The liability will be adjusted to fair value at each reporting period. The change in the fair value of the warrants will be recorded in the Consolidated Statement of Operations as other income (expense). For the three months ended March 31, 2007, the Company recorded approximately $0.46 million of gain from the change in the fair value of the derivative liability.

A registration rights agreement was entered into in connection with the Notes which requires the Company to file a registration statement for the resale of the common stock underlying the Notes and the warrants. The Company must use its best efforts to have the registration statement declared effective by the end of a specified grace period and also maintain the effectiveness of the registration statement until all shares of common stock underlying the Notes and the warrants have been sold or may be sold without volume restrictions pursuant to Rule 144(k) of the Securities Act. If the Company fails to have the registration statement declared effective within the grace period or fails to maintain the effectiveness as set forth in the preceding sentence, the Company is required to pay each investor cash payments equal to 1.0% of the aggregate purchase price monthly until the failure is cured. If the Company fails to pay the liquidated damages, interest at 16.0% will accrue until the liquidated damages are paid in full. The registration statement was filed and declared effective by the Securities and Exchange Commission within the specified grace period. As of March 31, 2007, the registration statement remains effective.

The Company accounts for the registration rights agreement as a separate freestanding instrument and accounts for the liquidated damages provision as a derivative liability subject to SFAS 133. The estimated fair value of the liability is based on an estimate of the probability and costs of cash penalties being incurred. The Company determined that the fair value of the liability was immaterial and it is not recorded in accrued liabilities. The Company will revalue the potential liability at each balance sheet date.

As a result of the issuance of the Notes, the outstanding 116,576 Series A Common Stock Purchase Warrants, that were issued to certain accredited and/or institutional investors pursuant to the Securities Purchase Agreement dated January 9, 2004, were re-priced from $5.50 to $2.60 and the outstanding 650,001 Series F Common Stock Purchase Warrants, that were issued to certain accredited and/or institutional investors pursuant to the Securities Purchase Agreement dated October 25, 2004, were re-priced from $10.90 to $8.60.

For the three months ended March 31, 2007 and 2006, there were no options or warrants exercised.

For the three months ended March 31, 2007 and 2006, the Company also issued approximately 708 thousand and 12 thousand shares of common stock, respectively, for the payment of approximately $620 thousand and $12 thousand, respectively, for services rendered and to be rendered in the future. As such, the Company recorded the fair value of the services rendered in prepaid expenses and selling, general and administrative expenses in the accompanying unaudited condensed consolidated statement of operations for the three months ended March 31, 2007 and 2006, respectively.

Note 10: Income Taxes

The Company adopted the provisions of FIN 48 on January 1, 2007. The Company continues to fully recognize its tax benefits which are offset by a valuation allowance due to the uncertainty that the deferred tax assets will be realized. We will continue to evaluate the realizability of our domestic net deferred tax assets and may record additional benefits in future earnings if we determine the realization of these assets is more likely than not. As at January 1, 2007 and March 31, 2007, the Company did not have any unrecognized tax benefits.

The Company files Federal and State corporate tax returns. All tax years since inception are open to tax examination by the taxing authorities for possible adjustments to the net operating losses but not for assessment. The Statute of Limitations for assessment of tax is generally three years for Federal and four years for State tax returns. The years currently open for Federal income tax assessment include calendar years 2003 through 2006 and calendar years 2002 through 2006 for State tax assessment purposes. The Company is not currently under examination by any jurisdictions for any of the open years listed.

The Company is in the process of preparing its Section 382 study and has not determined the impact that such study will have on its NOL carryforward.

The implementation of FIN 48 has not resulted in any adjustment to the Company's beginning tax position or tax position for the three month period ended March 31, 2007.

Note 11: Commitments and Contingencies

Royalty Payments

The Company, in accordance with a royalty agreement with Eastman Kodak, is obligated to make minimum annual royalty payments of $125 thousand which commenced on January 1, 2001. Under this agreement, the Company must pay to Eastman Kodak a certain percentage of net sales with respect to certain products, which percentages are defined in the agreement. The percentages are on a sliding scale depending on the amount of sales generated. Any minimum royalties paid will be credited against the amounts due based on the percentage of sales. The royalty agreement terminates upon the expiration of the issued patent which is the last to expire. Royalty expense was approximately $255 thousand and $85 thousand, respectively, for the three months ended March 31, 2007 and 2006, respectively.

Contractual Obligations

The Company leases office facilities and office, lab and factory equipment under operating leases expiring through 2009. Certain leases provide for payments of monthly operating expenses. The Company currently has lease commitments for space in Hopewell Junction, New York and Bellevue, Washington. Rent expense was approximately $332 thousand and $347 thousand for the three months ended March 31, 2007 and 2006, respectively.

Note 12: Legal Proceedings

None.

Note 13: Separation and Employment Agreements

Executive Separation and Consulting Agreement

On January 11, 2007, Gary Jones resigned as the President, Chief Executive Officer, and as a Director of the Company. Mr. Jones and the Company entered into an Executive Separation and Consulting Agreement ("the Agreement"). Under the Agreement, the Company made a payment to Mr. Jones in an amount equal to: all accrued salary as of the date of the Agreement plus an additional 30 days of salary (approximately $47 thousand); 360 hours of unused vacation (approximately $55 thousand); advance for legal and accounting fees associated with 2004 stock options ($30 thousand); and an advance for future travel expenditures ($5 thousand). Mr. Jones also received 500 thousand shares of registered common stock of the Company valued at $430 thousand. In his consulting relationship, Mr. Jones will be paid $460 thousand upon the consummation of a strategic transaction. The Company will provide up to $7.5 thousand for reasonable moving expenses of personal property from the New York office. In addition, the Company will pay up to an additional $30 thousand to Mr. Jones related to personal legal fees.

Compensation Agreement

On January 11, 2007, Dr. K.C. Park was appointed Interim Chief Executive Office, President, and a Director of the Company. On February 12, 2007, the Company entered into a Compensation Agreement ("the Agreement") with Dr. Park. Under the Agreement, the Company has agreed to pay Dr. Park an annual base salary equal to $300 thousand plus a quarterly increase in his base salary in the amount of $12.5 thousand per fiscal quarter through December 31, 2007. The Company agreed to issue Dr. Park an aggregate of 250 thousand restricted shares of common stock within 10 business days of the completion of a change of control of the Company. In addition, if a change of control transaction is completed and Dr. Park is not offered a senior executive position in the new organization, the Company has agreed to pay Dr. Park three month's salary.

Note 14: AMEX Delisting

On October 9, 2006, the Company received notice from the American Stock Exchange (the “AMEX”) Listing Qualifications Department stating that the Company does not meet certain continued listing standards as set forth in Part 10 of the AMEX Company Guide (the “Company Guide”). Specifically, pursuant to a review by the AMEX of the Company’s 10-Q for the three and six months ended June 30, 2006, the AMEX has determined that the Company is not in compliance with Sections 1003(a)(ii) and 1003(a)(iii) of the Company Guide, respectively, which state, in relevant part, that the AMEX will normally consider suspending dealings in, or removing from the list, securities of a company that (a) has stockholders' equity of less than $4.0 million if such company has sustained losses from continuing operations and/or net losses in three of its four most recent fiscal years; or (b) has stockholders' equity of less than $6.0 million if such company has sustained losses from continuing operations and/or net losses in its five most recent fiscal years, respectively.

On November 6, 2006, the Company submitted a plan advising the AMEX of actions that it would take, which may bring it into compliance with Sections 1003 (a)(ii) and 1003(a)(iii) of the Company Guide within a maximum of 18 months of receipt of the notice letter. On January 5, 2007, the Company received notice from the staff of the AMEX indicating that it intended to strike the Company’s common stock from listing on AMEX by filing a delisting application with the Securities and Exchange Commission as it had determined that the Company has failed to comply with the continued listing standards. The Company requested a verbal hearing which was held on February 27, 2007.

On March 1, 2007, the Company received notice from the AMEX indicating that the AMEX would initiate the delisting process with respect to the Company’s common stock. On March 12, 2007, in accordance with Part 12 of the Company Guide, the Company was suspended from trading on the AMEX. The Company’s common stock is trading on the Over-the-Counter Bulletin Board under the symbol, EMAN.

The delisting from the AMEX triggered a compliance condition on the notes payable. As a result the Company is required to pay the noteholders monthly interest at 1% rather than .5% on the outstanding principal of the notes payable. The Company received a waiver from the noteholders that allows the Company to accrue the interest and delay the interest payment until the earliest of the Company (i) completing $2 million of debt or equity financing or (ii) the occurrence of a Repurchase Event per the note.

Note 15: Subsequent Events

On March 28, 2007, the Company entered into a Note Purchase Agreement for the sale of $500 thousand of senior secured debentures (the “Note”) and warrants to purchase approximately 1.0 million shares of common stock, par value $.001 per share. The investor purchased the Note with a conversion price of $0.35 per share that may convert into approximately 1.4 million shares of common stock and warrants exercisable at $0.48 per share into approximately 1.0 million shares of common stock expiring in 4.2 years. If the Notes are not converted, 50% of the principal amount will be due on July 21, 2007 and the remaining 50% will be due on January 21, 2008. 6% interest is payable in quarterly installments on outstanding notes with the first installment to be paid June 1, 2007. On April 9, 2007, the Company closed the transaction and received approximately $460 thousand, net of offering costs of approximately $40 thousand which are amortized over the life of the Note.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Statement of Forward-Looking Information

In this quarterly report, references to "eMagin Corporation," "eMagin," "Virtual Vision," "the Company," "we," "us," and "our" refer to eMagin Corporation and its wholly owned subsidiary, Virtual Vision, Inc.

Except for the historical information contained herein, some of the statements in this Report contain forward-looking statements that involve risks and uncertainties. These statements are found in the sections entitled "Management's Discussion and Analysis or Plan Operations" and "Risk Factors." They include statements concerning: our business strategy; expectations of market and customer response; liquidity and capital expenditures; future sources of revenues; expansion of our proposed product line; and trends in industry activity generally. In some cases, you can identify forward-looking statements by words such as "may," "will," "should," "expect," "plan," "could," "anticipate," "intend," "believe," "estimate," "predict," "potential," "goal," or "continue" or similar terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including, but not limited to, the risks outlined under "Risk Factors," that may cause our or our industry's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by such forward-looking statements. For example, assumptions that could cause actual results to vary materially from future results include, but are not limited to: our ability to successfully develop and market our products to customers; our ability to generate customer demand for our products in our target markets; the development of our target markets and market opportunities; our ability to manufacture suitable products at competitive cost; market pricing for our products and for competing products; the extent of increasing competition; technological developments in our target markets and the development of alternate, competing technologies in them; and sales of shares by existing shareholders. Although we believe that the expectations reflected in the forward looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Unless we are required to do so under federal securities laws or other applicable laws, we do not intend to update or revise any forward-looking statements.

Overview

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 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. 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).

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 received a CES Design and Innovations Award for the electronic gaming category and also received the coveted Best of Innovation Awards for the entire display category. The product was also recognized as a Digital Living Class of

2005 Innovators.

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 we are the only company to sell full-color active matrix small molecule OLED-on-silicon microdisplays.

Company History

From inception through January 1, 2003, we were a developmental stage company. We have transitioned to manufacturing our products and intend to significantly increase our marketing, sales, and research and development efforts, and expand our operating infrastructure. Most of our operating expenses are fixed in the near term. If we are unable to generate significant revenues, our net losses in any given period could be greater than expected.

CRITICAL ACCOUNTING POLICIES

The Securities and Exchange Commission ("SEC") defines "critical accounting policies" as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Not all of the accounting policies require management to make difficult, subjective or complex judgments or estimates. However, the following policies could be deemed to be critical within the SEC definition.

Revenue Recognition

Revenue on product sales is recognized when persuasive evidence of an arrangement exists, such as when a purchase order or contract is received from the customer, the price is fixed, title 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

The Company's cash, cash equivalents, investments, accounts receivable and accounts payable are stated at cost which approximates fair value due to the short-term nature of these instruments.

Stock-based Compensation

We maintain several stock equity incentive plans. The 2005 Employee Stock Purchase Plan (the "ESPP") provides our employees with the opportunity to purchase common stock through payroll deductions. Employees purchase stock semi-annually at a price that is 85% of the fair market value at certain plan-defined dates. As of March 31, 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 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", 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 condensed 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.

NEW ACCOUNTING PRONOUNCEMENTS

See Note 2 of the Condensed Consolidated Financial Statements in Item 1 for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition.

RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2007 COMPARED TO THREE MONTHS ENDED MARCH 31, 2006

Revenues

Revenues for the three months ended March 31, 2007 were approximately $3.6 million as compared to approximately $1.6 million for the three months ended March 31, 2006, an increase of approximately 120%. Higher revenue for the three month period 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 March 31, 2007 was approximately $3.1 million as compared to approximately $3.0 million for the three months ended March 31, 2006, an increase of approximately $0.1 million. The gross margin for the three months ended March 31, 2007 was approximately $0.5 million as compared to a gross loss of approximately ($1.4) million for the three months ended March 31, 2006. This translates to a gross margin of 14% for the three months ended March 31, 2007 as compared to a gross loss of (85%) for the three months ended March 31, 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 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 months ended March 31, 2007 were approximately $0.9 million as compared to $1.2 million for the three months ended March 31, 2006, a decrease of approximately $0.3 million. The decrease was due to a reduction of research and development expenditures and personnel costs in the quarter as compared to the quarter ended March 31, 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 months ended March 31, 2007 were approximately $2.2 million as compared to approximately $2.6 million for the three months ended March 31, 2006. The decrease of approximately $0.4 million for the quarter ended March 31, 2007 was primarily related to a reduction of marketing, tradeshow and personnel costs in the quarter as compared to the quarter ended March 31, 2006.

Other Income, net. 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 three months ended March 31, 2007, interest income was approximately $16 thousand compared to approximately $54 thousand for the three months ended March 31, 2006. The decrease in interest income was primarily a result of lower cash balances available for investment. For the three months ended March 31, 2007, interest expense was $840 thousand as compared to $0 for the three months ended March 31, 2006. The increase in the interest expense was a result of interest associated with our notes payable of $133 thousand, the amortization of the deferred costs associated with the notes payable of $133 thousand, and the amortization of the debt discount of $574 thousand. The gain from the change in the derivative liability was $460 thousand and $0, respectively, for the quarters ended March 31, 2007 and 2006.

Liquidity and Capital Resources

As of March 31, 2007, we had approximately $0.4 million of cash and investments as compared to $1.6 million as of December 31, 2006. The decrease of approximately $1.2 million was due primarily to cash used for operating activities.

Cash flow used in operating activities during the three months of 2007 was approximately $1.2 million as compared to cash used of approximately $5.0 million during the three months of 2006. The decrease was attributable to a reduction in net losses of approximately $2.2 million, approximately $600,000 of stock rather than cash issued for services and an increase in accounts payable of approximately $500,000 rather than a reduction of $500,000 during the first quarter of 2006.

Cash used in investing activities during the three months ended March 31, 2007 was approximately $4 thousand as compared to approximately $56 thousand during the three months ended March 31, 2006. The reduction of cash used in investing activities was primarily due to lower purchases of equipment.

Cash used in financing activities during the three months ended March 31, 2007 was approximately $15 thousand as compared to approximately $9 thousand during the three months ended March 31, 2006. The funds were used to make payments on long-term debt and capital leases.

Our condensed consolidated financial statements as of March 31, 2007 have been prepared under the assumption that we will continue as a going concern for the year ending December 31, 2007. 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 in 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.

As we have reported, our business experienced significant revenue growth during the period ended March 31, 2007. This trend, if it continues, may result in higher accounts receivable levels and may require increased production and/or higher inventory levels both of which require working capital. In addition, in July 2007 and January 2008, we are responsible for repaying $3.1 million to the noteholders. If the funds are not available, we will negotiate with the noteholders to defer the payment but no assurances can be made that they will agree. We anticipate that our cash requirements to fund these requirements as well as other operating or investing cash requirements over the next twelve months will be greater than our current cash on hand.

To address these liquidity issues we have pursued asset based borrowing facilities and have received offers that would establish the $2.5 million revolving credit line allowed for in our notes payable agreement. We have not entered into a binding commitment for these funds and no assurance can be given that the final terms will be acceptable. We believe that these funds if available would be sufficient to fund our working capital requirements over the next 12 months, however they would not be sufficient to fund both working capital requirements and retirement of our notes payable. If we are unable to obtain sufficient funds we may be forced to reduce and/or curtail our production and operations, all of which could have a material adverse impact on our business prospects.

Off-Balance Sheet Arrangements

We do not have any off balance sheet arrangements that are reasonably likely to have a current or future effect on our financial condition, revenues, results of operations, liquidity or capital expenditures.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Market Rate Risk

We are exposed to market risk related to changes in interest rates and foreign currency exchanges rates.

Interest Rate Risk

We hold our assets in cash and cash equivalents. We do not hold derivative financial instruments or equity securities.

Foreign Currency Exchange Rate Risk

Our revenue and expenses are denominated in U.S. dollars. We have conducted some transactions in foreign currencies and expect to continue to do so; we do not anticipate that foreign exchange gains or losses will be significant. We have not engaged in foreign currency hedging to date.

Our international business is subject to risks typical of international activity, including, but not limited to, differing economic conditions; change in political climates; differing tax structures; and other regulations and restrictions. Accordingly, our future results could be impacted by changes in these or other factors.

ITEM 4. Controls and Procedures

a) *Evaluation of Disclosure Controls and Procedures.* Based on an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, as of March 31, 2007, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission’s rules and forms. Our Chief Executive Officer and Chief Financial Officer also concluded that, as of March 31, 2007, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure..

(b) *Changes in Internal Controls.* During the quarter ended March 31, 2007, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. Legal Proceedings

None

ITEM 1A. 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 $184 million as of March 31, 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 quarter ended March 31, 2007. We anticipate that our cash requirements to fund these requirements as well as other operating or investing cash requirements over the next twelve months will be greater than our current cash on hand. 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. We do not currently have any financing commitments and no assurance can be given that additional financing will be available, or if available, will be on acceptable terms. If we are unable to obtain sufficient funds during the next twelve months we will further reduce the size of our organization and may be forced to reduce and/or curtail our production and operations, all of which could have a material adverse impact on our business prospects.

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 condensed consolidated financial statements as of March 31, 2007 have been prepared under the assumption that we will continue as a going concern for the year ending December 31, 2007. 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 in 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.

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 $6.1 million backlog, 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 April 30, 2007, we have outstanding (i) options to purchase 815,735 shares and (ii) warrants to purchase 4,548,174 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.

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

None.

ITEM 3. Defaults Upon Senior Securities

On March 1, 2007, the Company received notice from the AMEX indicating that the AMEX would initiate the delisting process with respect to the Company’s common stock. On March 12, 2007, in accordance with Part 12 of the Company Guide, the Company was suspended from trading on the AMEX. The Company is currently trading the Company’s common stock on the Over-the-Counter Bulletin Board under the symbol, EMAN.

The delisting from the AMEX triggered a compliance condition on the notes payable. As a result the Company is required to pay the noteholders monthly interest at 1% rather than .5% on the outstanding principal of the notes payable. The Company received a waiver from the noteholders that allows the Company to accrue the interest and delay the interest payment until the earliest of the Company (i) completing $2 million of debt or equity financing or (ii) the occurrence of a Repurchase Event per the note.

On May 10, 2007, the requirement to maintain cash and cash equivalents balances of $200 thousand was extended through July 21, 2007 and any previous claim that may have otherwise been made regarding the potential breach by the Company of the minimum cash balance requirement was waived. Subsequent to July 21, 2007, the Company must maintain $600 thousand in cash and cash equivalent balances.

ITEM 4. Submission of Matters to a Vote of Security Holders

None.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

EXHIBIT NUMBER	DESCRIPTION
31.1	Certification by Chief Executive Officer pursuant to Sarbanes Oxley Section 302*
31.2	Certification by Chief Financial Officer pursuant to Sarbanes Oxley Section 302*
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350*
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350*

*Filed herewith.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 15th day of May 2007.

eMAGIN CORPORATION

By: /s/ K.C. Park

K.C. Park
Interim Chief Executive Officer
Principal Executive Officer

By: /s/ John Atherly

John Atherly
Chief Financial Officer
Principal Accounting and Financial Officer