EMAGIN CORP
Form 10-Q/A
October 11, 2011
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q/A

Amendment No. 1 to Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009
or

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

For the transition period from to

Commission file number 001-15751

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

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

3006 Northup Way, Suite 103, Bellevue, Washington 98004
(Address of principal executive offices)

(425) 284-5200
(Registrant’s telephone number, including area code)

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

(§232.405 of this chapter) during the preceding 12 months). Yes o No o

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

Large accelerated filer £ Accelerated filer £ Non-accelerated filer £ Smaller reporting company R

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

The number of shares of common stock outstanding as of October 31, 2009 was 16,961,902.

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

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EXPLANATORY NOTE

This Amendment No. 1 hereby amends our Quarterly Report on Form 10-Q ("Form 10-Q/A") for the period ended September 30, 2009, which was originally filed with the Securities and Exchange Commission on November 12, 2009 (the "Original 10-Q"). This Amendment is being filed mainly to include restated condensed consolidated financial statements as described in Note 14, Restatement, of the Notes to the Condensed Consolidated Financial Statements. The condensed consolidated financial statements are being restated to correct accounting errors as follows:

Adoption of certain provisions of Accounting Standards Codification ("ASC") 815 – "Derivatives and Hedging – Contracts in Entity's Own Equity" ("ASC 815") (formerly EITF 07-5, "Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock"). ASC 815 became effective January 1, 2009. The anti-dilution features in certain outstanding warrants ("Warrants") of the Company require these Warrants to be accounted for as liabilities and measured at fair value. The restated condensed consolidated financial statements reflect the reclassification of the Warrants from shareholders' equity to warrant liability, the cumulative effect adjustment to the opening balance of accumulated deficit and record changes in the fair value of the warrant liability in the condensed consolidated statements of operations.

Adoption of the two-class method for Earnings Per Share ("EPS") calculation under ASC 260, "Earnings Per Share" ("ASC 260"). The two-class method is an earnings allocation method under which EPS is calculated for each class of common stock and participating security. Under the two-class method, securities that participate in dividends, such as the Company's Series B Convertible Preferred stock, are considered 'participating securities." The restated financial statements reflect the restated basic and diluted earnings per share, as applicable and weighted average shares outstanding calculations.

The following sections of this Form 10-Q/A have been amended to reflect the restatement:

Part I – Item 1 – Financial Statements and Notes to the Condensed Consolidated Financial Statements
Part I – Item 2 – Management's Discussion and Analysis of Financial Condition and Result of Operations
Part I – Item 4 – Controls and Procedures

For the convenience of the reader, this Form 10-Q/A sets forth the Company's Original 10-Q in its entirety, as amended by, and to reflect the restatement as described above. Except as discussed above, the Company has not modified or updated disclosures presented in this Amendment. Accordingly, this Amendment does not reflect events occurring after the Original 10-Q or modify or update those disclosures affected by subsequent events, except as specifically referenced herein. Information not affected by the restatement is unchanged and reflects the disclosures made at the time of the Original Filing.

This Form 10-Q/A has been signed as of a current date and all certifications of the Company's Chief Executive Officer/Principal Executive Officer and Chief Financial Officer/Chief Accounting Officer and Principal Financial Officer are given as of a current date. Accordingly, this Form 10-Q/A should be read in conjunction with the Company's filings with the Securities and Exchange Commission subsequent to the filing of the Original 10-Q, including any amendments to those filings.

ITEM 1. Condensed Consolidated Financial Statements

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

	September 30, 2009 (Restated) See Note 14 (unaudited)	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,709	$ 2,404
Investments – held to maturity	97	97
Accounts receivable, net	4,111	3,643
Inventory	2,065	2,374
Prepaid expenses and other current assets	885	796
Total current assets	10,867	9,314
Equipment, furniture and leasehold improvements, net	811	381
Intangible assets, net	44	47
Other assets	92	—
Deferred financing costs, net	—	362
Total assets	$ 11,814	$ 10,104
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 728	$ 1,026
Accrued compensation	807	837
Other accrued expenses	985	804
Advance payments	116	694
Deferred revenue	220	164
Debt	—	1,691
Warrant liability	80	—
Other current liabilities	715	798
Total current liabilities	3,651	6,014
Warrant liability	6,644	—
Total liabilities	10,295	6,014
Commitments and contingencies		
Redeemable common stock: 522,500 redeemable shares as of December 31, 2008	—	429
Shareholders' equity:		

Preferred stock, $.001 par value: authorized 10,000,000 shares:		—		—
Series B Convertible Preferred stock, (liquidation preference of $5,739,000) stated value $1,000 per share, $.001 par value: 10,000 shares designated and 5,739 issued and outstanding at September 30, 2009 and December 31, 2008.		—		—
Common stock, $.001 par value: authorized 200,000,000 shares, issued and outstanding, 16,961,902 shares as of September 30, 2009 and 15,213,959 as of December 31, 2008, net of redeemable common stock		17		15
Additional paid-in capital		193,169		204,818
Accumulated deficit		(191,667)		(201,172)
Total shareholders' equity		1,519		3,661
Total liabilities and shareholders' equity	$	11,814	$	10,104

See notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009 (Restated) See Note 14	2008	2009 (Restated) See Note 14	2008
Revenue:				
Product	$ 5,260	$ 4,181	$ 14,560	$ 11,139
Contract	847	1,004	2,543	2,330
Total revenue, net	6,107	5,185	17,103	13,469
Cost of goods sold:				
Product	1,996	2,412	5,817	7,030
Contract	611	389	1,528	1,080
Total cost of goods sold	2,607	2,801	7,345	8,110
Gross profit	3,500	2,384	9,758	5,359
Operating expenses:				
Research and development	463	306	1,376	1,614
Selling, general and administrative	1,772	1,293	5,083	4,797
Total operating expenses	2,235	1,599	6,459	6,411
Income (loss) from operations	1,265	785	3,299	(1,052)
Other expense:				
Interest expense	(76)	(508)	(417)	(1,677)
Other income, net	1	84	41	294
Change in fair value of warrant liability	(3,315)	—	(6,379)	—
Total other expense	(3,390)	(424)	(6,755)	(1,383)
Net (loss) income	$ (2,125)	$ 361	$ (3,456)	$ (2,435)
(Loss) income per share, basic	$ (0.13)	$ 0.02	$ (0.21)	$ (0.18)
(Loss) income per share, diluted	$ (0.13)	$ 0.02	$ (0.21)	$ (0.18)

Weighted average number of shares outstanding:				
Basic	16,513,101	14,617,235	16,133,646	13,854,860
Diluted	16,513,101	23,430,416	16,133,646	13,854,860

See notes to Condensed Consolidated Financial Statements.

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

	Preferred Stock		Common Stock		Additional Paid-in Capital (Restated)	Accumulated Deficit (Restated)	Total Shareholders' Equity (Restated) See Note 14
	Shares	Amount	Shares	Amount	See Note 14	See Note 14	
Balance, December 31, 2008	6	$ —	15,214	$ 15	$ 204,818	$ (201,172)	$ 3,661
Cumulative effect of change in accounting principle	—	—	—	—	(15,091)	12,961	(2,130)
Fair value of warrants reclassified from liability to equity upon exercise	—	—	—	—	1,785		1,785
Issuance of common stock for services	—	—	499	—	304	—	304
Expiration of put options	—	—	522	1	428	—	429
Exercise of common stock warrants	—	—	727	1	(1)	—	—
Stock-based compensation	—	—	—	—	926	—	926
Net loss	—	—	—	—	—	(3,456)	(3,456)
Balance, September 30, 2009 (unaudited)	6	$ —	16,962	$ 17	$ 193,169	$ (191,667)	$ 1,519

See notes to Condensed Consolidated Financial Statements.

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

	Nine Months Ended September 30,			
	2009 (Restated) See Note 14		2008	
	(unaudited)			
Cash flows from operating activities:				
Net loss	$	(3,456)	$	(2,435)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:				
Depreciation and amortization		65		183
Amortization of deferred financing and waiver fees		362		1,152
(Reduction of) increase in provision for sales returns and doubtful accounts		(423)		241
Stock-based compensation		926		845
Amortization of common stock issued for services		178		88
Amortization of discount on notes payable		—		25
Change in the fair value of warrant liability		6,379		—
Changes in operating assets and liabilities:				
Accounts receivable		(45)		(1,860)
Inventory		309		(163)
Prepaid expenses and other current assets		(54)		254
Deferred revenue		56		(54)
Accounts payable, accrued compensation, other accrued expenses, and advance payments		(725)		94
Other current liabilities		(121)		(277)
Net cash provided by (used in) operating activities		3,451		(1,908)
Cash flows from investing activities:				
Purchase of equipment		(492)		(236)
Net cash used in investing activities		(492)		(236)
Cash flows from financing activities:				
Proceeds from sale of common stock, net of issuance costs		—		1,580
Proceeds from debt		—		1,934
Payments related to deferred financing costs		—		(117)
Payments of debt and capital leases		(1,654)		(694)
Net cash (used in) provided by financing activities		(1,654)		2,703
Net increase in cash and cash equivalents		1,305		559
Cash and cash equivalents beginning of period		2,404		713
Cash and cash equivalents end of period	$	3,709	$	1,272
Cash paid for interest	$	67	$	524
Cash paid for taxes	$	46	$	31
Common stock issued for services charged to prepaid expenses	$	126	$	202

See notes to Condensed Consolidated Financial Statements.

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eMAGIN CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

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

The Business

eMagin Corporation (the “Company”) designs, develops, manufactures, and markets OLED (organic light emitting diode) on silicon microdisplays, virtual imaging products which utilize OLED microdisplays. The Company’s products are sold mainly in North America, Asia, and Europe.

Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements of eMagin Corporation and its subsidiary reflect all adjustments, including normal recurring accruals, necessary for a fair presentation. Certain information and footnote disclosure normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to instructions, rules and regulations prescribed by the Securities and Exchange Commission (“SEC”). The Company believes that the disclosures provided herein are adequate to make the information presented not misleading when these unaudited condensed consolidated financial statements are read in conjunction with the audited consolidated financial statements contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2008. The results of operations for the period ended September 30, 2009 are not necessarily indicative of the results to be expected for the full year.

In this Amended 10-Q, the Company restated its previously issued condensed consolidated financial statements as of and for the three and nine months ended September 30, 2009 to correct errors in the accounting for certain warrants as discussed in Note 14, “Restatement”.

Reclassifications

Certain operating expense amounts have been reclassified from Selling, General, and Administrative to Research and Development in order to conform with prior year’s presentation.

Use of Estimates

In accordance with accounting principles generally accepted in the United States of America, management utilizes certain estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments. Management bases its estimates and judgments on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

Revenue and Cost Recognition

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, selling price is fixed or determinable and collection is reasonably assured. The Company records a reserve for estimated sales returns,

which is reflected as a reduction of revenue at the time of revenue recognition. The Company defers revenue recognition on products sold directly to the consumer with a maximum thirty day right of return. Revenue is recognized upon the expiration of the right of return.

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

Research and Development Costs

Research and development costs are expensed as incurred.

Note 2: Recently Issued Accounting Pronouncement

In June 2009, the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("Codification" or "ASC") became the single source of authoritative nongovernmental U.S. generally accepted accounting principles ("GAAP") except for additional authoritative rules and interpretive releases issued by the SEC. The Codification did not create any new GAAP standards but incorporated existing accounting and reporting standards into a new topical structure with a new referencing system to identify authoritative accounting standards, replacing the prior references to Statement of Financial Accounting Standards ("SFAS"), Emerging Issues Task Force ("EITF"), FASB Staff Position ("FSP"), etc. Authoritative standards included in the Codification are designated by their ASC topical reference, and new standards will be designated as Accounting Standards Updates ("ASU"), with a year and assigned sequence number. Beginning with the interim report for this third quarter, the Company adopted the Codification and it had no effect on its financial position, results of operations, or cash flows.

Effective January 1, 2009, the Company adopted ASC 815, "Derivatives and Hedging – Contracts in Entity's Own Equity". As a result, warrants issued with anti-dilution provisions for the holder are no longer considered indexed to the Company's stock and must be accounted for as derivatives. Upon adoption of this accounting guidance, on January 1, 2009, the Company recorded a cumulative effect adjustment based on the grant date fair value of the outstanding warrants at January 1, 2009 and the change in fair value of the warrant liability from the issuance date through January 1, 2009. These warrants are reclassified as liabilities and recorded at estimated fair value at each reporting date using the Monte Carlo Simulation approach. Changes in the liability from period to period are recorded in the Condensed Consolidated Statements of Operations.

The Company has recorded the change in fair value of the warrant liability as a component of other income and expense on the Condensed Consolidated Statements of Operations as the Company believes the amounts recorded relate to financing activities and not as a result of its operations.

The Company recorded the following cumulative effect of change in accounting principle pursuant to its adoption of ASC 815 as of January 1, 2009 (in thousands):

	Additional Paid-In Capital	Warrant Liability	Accumulated Deficit
Grant date fair value of Warrants	$ (15,091)	$ 15,091	$
Change in fair value of Warrants outstanding through January 1, 2009		(12,961)	12,961
Cumulative effect of change in accounting principle	$ (15,091)	$ 2,130	$ 12,961

The Company recorded other expense of $3,315 thousand and $6,379 thousand, respectively, for the change in the fair value of the warrant liability during the three and nine months ended September 30, 2009.

Note 3: Fair Value Measurement

The Company measures fair value in accordance with ASC 820, "Fair Value Measurements and Disclosures" ("ASC 820"). ASC 820 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value and expands disclosures about fair value measurements. Fair value is the price that would be

received to sell an asset or paid to transfer a liability in an orderly transaction between participants at the measurement date. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1 – valued based on quoted prices at the measurement date for identical assets or liabilities trading in active markets.
Level 2 – quoted prices in active markets for similar assets and liabilities and inputs that are observable for the asset or liability.
Level 3 – valuations derived from valuation techniques in which one or more significant inputs are not readily observable.

Recurring Fair Value Estimates

The Company's recurring fair value measurements at September 30, 2009 were as follows (in thousands):

	Fair Value as of September 30, 2009	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
Warrant liability, current	$ 80	$ —	$ —	$ 80
Warrant liability, long-term	$ 6,644	$ —	$ —	$ 6,644
Total Warrant liability	$ 6,724	$ —	$ —	$ 6,724

Note: Classification is based on warrant expiration date.

Recurring Level 3 Activity, Reconciliation and Basis for Valuation

The table below provides a reconciliation of the beginning and ending balances for the liabilities measured at fair value using significant unobservable inputs (Level 3) (in thousands).

Balance as of January 1, 2009	$ 2,130
Increase in fair value of warrants	6,394
Less: value of warrants expired	(15)
Less: value of warrants exercised	(1,785)
Balance as of September 30, 2009	$ 6,724

Changes in fair value of the warrant liability are included in other expense in the accompanying unaudited condensed consolidated statements of operations.

The Company estimates the fair value of the warrant liability utilizing the Monte Carlo Simulation method. The use of this method assumes multiple probabilities. The following additional assumptions were used in the Monte Carlo Simulation model to determine the fair value of the warrant liability:

	September 30, 2009	January 1, 2009
Risk-free interest rate	0.18% - 2.31 %	0.11% - 1.55 %
Expected volatility	75.2% - 97.5 %	94.4 %
Expected life (in years)	0.50 – 4.25	0.02 - 5.0
Expected dividend yield	0 %	0 %

Note 4 : 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, historical experience, the customer's current ability to pay its obligations, and the condition of the general economy and the industry as a whole. The Company will record a specific reserve for individual accounts when the Company becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position. If circumstances related to customers change, the Company would further adjust estimates of the recoverability of receivables.

Receivables consisted of the following (in thousands):

	September 30, 2009 (unaudited)	December 31, 2008
Accounts receivable	$ 4,545	$ 4,500
Less allowance for doubtful accounts	(434)	(857)
Net receivables	$ 4,111	$ 3,643

Note 5 : Net (Loss) Income per Common Share - Restated

Basic earnings (loss) per share ("Basic EPS") is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the reporting period. Diluted earnings (loss) per share ("Diluted EPS") is computed by dividing the net income (loss) by the weighted average number of common shares outstanding during the reporting period while also giving effect to all potentially dilutive common shares that were outstanding during the reporting period.

In accordance with ASC 260, entities that have issued securities other than common stock that participate in dividends with the common stock ("participating securities") are required to apply the two-class method to compute basic EPS. The two-class method is an earnings allocation method under which EPS is calculated for each class of common stock and participating security as if all such earnings had been distributed during the period. On December 22, 2008, the Company issued Convertible Preferred Stock – Series B which participates in dividends with the Company's common stock and is therefore considered to be a participating security. However, the participating convertible preferred stock is not required to absorb any net loss. Thus, the Company calculates EPS using the two-class method. The Company does not intend to pay dividends on its common or preferred stock.

The Company uses the more dilutive method of calculating the diluted earnings per share, either the two class method or "if-converted" method. Under the "if-converted" method, the convertible preferred stock is assumed to have been converted into common shares at the beginning of the period.

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except share and per share data):

	Three Months Ended September 30, 2009			Three Months Ended September 30, 2008		
	Loss	Shares	Per Share Amount	Income	Shares	Per Share Amount
Basic EPS						
(Loss) income allocated to common shares	$ (2,125)	16,513,101	$ (0.13)	$ 361	14,617,235	$ 0.02
(Loss) income allocated to participating securities	$ —			$ —		
Net (loss) income	$ (2,125)			$ 361		
Diluted potential common shares		—			8,813,181	
Diluted EPS						
Adjustment for interest expense on convertible notes, net of taxes	—			121		
Net (loss) income	$ (2,125)	16,513,101	$ (0.13)	$ 482	23,430,416	$ 0.02

	Nine Months Ended September 30, 2009			Nine Months Ended September 30, 2008		
	Loss	Shares	Per Share Amount	Loss	Shares	Per Share Amount
Basic EPS						
	$ (3,456)	16,133,646	$ (0.21)	$ (2,435)	13,854,860	$ (0.18)0)

Loss allocated to common shares						
Loss allocated to participating securities	—			—		
Net loss	$ (3,456)			$ (2,435)		
Diluted potential common shares		—			—	
Diluted EPS						
Adjustment for interest expense on convertible notes, net of taxes	—			—		
Net loss	$ (3,456)	16,133,646	$ (0.21)	$ (2,435)	13,854,860	$ (0.18)

For the three and nine months ended September 30, 2009, the Company has excluded options, warrants and convertible preferred stock to acquire 19,742,737 of its common stock since their effect would be anti-dilutive. For the three and nine months ended September 30, 2008, there were stock options, warrants and convertible notes outstanding to acquire 10,901,343 and 20,376,584 shares, respectively, of the Company's common stock which were excluded from the computation of diluted loss per share because their effect would be anti-dilutive. For the three and nine months ended September 30, 2008, the Company also excluded 360,000 and 522,500 redeemable shares, respectively as their effect would be anti-dilutive. The convertible notes are included in the calculation of diluted earnings per share as all shares are assumed converted.

Note 6 : Inventory

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

	September 30, 2009 (unaudited)	December 31, 2008
Raw materials	$ 824	$ 1,109
Work in process	324	280
Finished goods	917	985
Total inventory	$ 2,065	$ 2,374

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Note 7 : Prepaid Expenses and Other Current Assets:

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

	September 30, 2009 (unaudited)	December 31, 2008
Vendor prepayments	$ 418	$ 180
Other prepaid expenses *	467	383
Other assets	—	233
Total prepaid expenses and other current assets	$ 885	$ 796

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

Note 8 : Debt

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

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

The Company's line of credit with Moriah Capital, L.P. ("Moriah") matured on August 7, 2009 and the Company repaid a total of approximately $232 thousand in principal due on the line of credit. The Company did not renew its loan agreement with Moriah.

The Company entered into an agreement effective as of September 1, 2009 (the "Agreement"), with Access Business Finance, LLC ("Access") pursuant to which it may borrow an amount not to exceed $3,000,000. The Agreement provides that from time to time the Company may request advances in an amount equal to the lesser of (i) Borrowing Base less the Availability Reserves and (ii) the Maximum Amount as defined in the Agreement. The interest on the line of credit is equal to the Prime Rate plus 4.00% but may not be less than 7.25%. The term of the Agreement is for one year and will automatically renew for successive one year terms unless, at least 60 days' prior to the end of the current term, the Company gives Access prior written notice of its intent not to renew or if Access, at least ten days prior to the end of the current term, gives the Company written notice of its intent not to renew. The Company's obligations under the Agreement are secured by its assets. As of September 30, 2009, the Company had not borrowed on its line of credit. The Company paid $25,000 in annual loan fees to Access which were charged to prepaid expense and will be amortized over the life of the Agreement. As of September 30, 2009, $2,000 had been amortized to interest expense.

In the three and nine months ended September 30, 2009, approximately $61 thousand and $362 thousand, respectively, of deferred debt issuance costs were amortized to interest expense. For the three and nine months ended September 30, 2009, interest expense includes interest paid or accrued of approximately $15 thousand and $55 thousand, respectively, on outstanding debt.

Note 9 : Stock-based Compensation

The Company uses the fair value method of accounting for share-based compensation arrangements. The fair value of stock options 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 the expense categories for the three and nine month periods ended September 30, 2009 and 2008 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
Cost of revenue	$ 25	$ 31	$ 111	$ 106
Research and development	39	58	165	192
Selling, general and administrative	317	149	650	547
Total stock compensation expense	$ 381	$ 238	$ 926	$ 845

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At September 30, 2009, total unrecognized non-cash compensation cost related to stock options was approximately $415 thousand, net of forfeitures. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures and is expected to be recognized over a weighted average period of approximately 1.2 years.

Options granted to non-employees are measured at the grant date using a fair value options pricing model and remeasured to the current fair market value at each reporting period as the underlying options vest and services are rendered. For the nine months ended September 30, 2009, there were 60,000 options granted to consultants. The following assumptions were used in the Black-Scholes option pricing model to determine the fair value of stock options granted: dividend yield – 0%; risk free interest rates – 1.44% to 1.64%; expected volatility – 71.4% to 84.1%; and expected term – 3 years.

There were 411,600 and 1,278,841 options granted to employees and directors during the three and nine months ended September 30, 2009 and 171,000 and 919,253 options granted to employees and directors during the three and nine months ended September 30, 2008. The following key assumptions were used in the Black-Scholes option pricing model to determine the fair value of stock options granted:

	For the Nine Months Ended September 30,	
	2009	2008
Dividend yield	0%	0%
Risk free interest rates	2.02 to 2.51%	2.46 to 3.37 %
Expected volatility	80.3 to 86.4%	88.4 to 92.3 %
Expected term (in years)	4.0 to 5.5	5

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

The 2008 Incentive Stock Plan ("the 2008 Plan") adopted and approved by the Board of Directors on November 5, 2008 provides for shares of common stock and options to purchase shares of common stock to employees, officers, directors and consultants. The 2008 Plan has an aggregate of 2,000,000 shares. As of September 30, 2009, 1,278,841 options were granted from this plan with a fair value of approximately $814 thousand and 498,533 shares were issued with a fair value of approximately $304 thousand. At September 30, 2009, there were 222,626 shares available for grant.

A summary of the Company's stock option activity for the nine months ended September 30, 2009 is presented in the following tables:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value

Outstanding at January 1, 2009	1,615,673	$	1.63		
Options granted	1,278,841		1.03		
Options exercised	—				
Options forfeited	(71,598)		2.60		
Options cancelled	—				
Outstanding at September 30, 2009	2,822,916	$	1.33	6.37	$ 1,549,944
Vested or expected to vest at September 30, 2009 (1)	2,740,781	$	1.29	6.37	$ 1,068,090
Exercisable at September 30, 2009	2,001,564	$	1.39	6.71	$ 1,068,090

The Company’s stock option activity for the nine months ended September 30, 2009 (continued):

	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life (In Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercisable Price
$ 0.34 - $0.98	1,226,793	6.56	$ 0.83	895,127	$ 0.81
$ 1.00 - $1.44	1,200,177	7.40	1.20	773,390	1.24
$ 2.60 - $2.70	358,746	2.75	2.62	298,847	2.61
$ 3.50 - $22.50	37,200	2.03	9.75	34,200	9.54
	2,822,916	6.37	$ 1.33	2,001,564	$ 1.39

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

The aggregate intrinsic value in the table above represents the difference between the exercise price of the underlying options and the quoted price of the Company’s common stock. There were 2,417,970 options in-the-money at September 30, 2009. The Company’s closing stock price was $1.65 as of September 30, 2009. The Company issues new shares of common stock upon exercise of stock options.

Note 10 : Shareholders’ Equity

Preferred Stock

The Company has designated 10,000 shares of the Company’s preferred stock as Preferred Stock – Series B at a stated value of $1,000 per share. The Preferred Stock – Series B is convertible into common stock at a conversion price of $0.75 per share. The Preferred Stock – Series B does not pay interest. The holders of the Preferred Stock – Series B are not entitled to receive dividends unless the Company’s Board of Directors declare a dividend for holders of the Company’s common stock and then the dividend shall be equal to the amount that such holder would have been entitled to receive if the holder converted its Preferred Stock – Series B into shares of the Company’s common stock. Each share of Preferred Stock – Series B has voting rights equal to (i) the number of shares of Common Stock issuable upon conversion of such shares of Preferred Stock – Series B at such time (determined without regard to the shares of Common Stock so issuable upon such conversion in respect of accrued and unpaid dividends on such share of Preferred Stock) when the Preferred Stock – Series B votes together with the Company’s Common Stock or any other class or series of stock of the Company and (ii) one vote per share of Preferred Stock when such vote is not covered by the immediately preceding clause. In the event of a liquidation, dissolution, or winding up of the Company, the Preferred Stock – Series B is entitled to receive liquidation preference before the Common Stock. The Company may at its option redeem the Preferred Stock – Series B by providing the required notice to the holders of the Preferred Stock – Series B and paying an amount equal to $1,000 multiplied by the number of shares for all of such holder’s shares of outstanding Preferred Stock – Series B to be redeemed. As of September 30, 2009, there were 5,739 shares of

Preferred Stock – Series B issued and outstanding.

Common Stock

For the three and nine months ended September 30, 2009 and 2008, there were no stock options exercised. For the three and nine months ended September 30, 2009, there were 2.9 million warrants exercised on a cashless basis resulting in 727 thousand shares of common stock issued. No warrants were exercised for the three and nine months ended September 30, 2008.

For the three and nine months ended September 30, 2009, the Company issued 42,857 and 498,533 shares of common stock, respectively, for payment of approximately $45 thousand and $304 thousand, respectively, for services rendered and to be rendered in the future. For the three and nine months ended September 30, 2008, the Company issued 629,400 and 811,400 shares of common stock, respectively, for payment of approximately $441 thousand and $643 thousand, respectively, for services rendered and to be rendered in the future. The Company recorded the fair value of the services rendered and to be rendered in the future in prepaid expenses and selling, general and administrative expenses in the accompanying unaudited condensed consolidated financial statements for the three and nine months ended September 30, 2009 and 2008.

At December 31, 2008, the 522,500 shares underlying the 2007 and 2008 put options (“put options”) granted to Moriah were presented on the balance sheet as redeemable common stock in the amount of $429,000 which represented the amount for which the shares may be redeemed at the option of Moriah. On August 7, 2009, the put options expired when Moriah elected not to exercise its put options. At September 30, 2009, the 522,500 shares were classified as permanent equity on the balance sheet.

Note 11 : Income Taxes

The Company accounts for income taxes under an asset and liability approach that requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. The effect on deferred tax assets and liabilities of changes in tax rates will be recognized as income or expense in the period that the change occurs. A valuation allowance for deferred tax assets is recorded when it is more likely than not that some or all of the benefit from the deferred tax asset will not be realized. Changes in circumstances, assumptions and clarification of uncertain tax regimes may require changes to any valuation allowances associated with the Company's deferred tax assets.

The tax years 2005-2008 remain open to examination by the major taxing jurisdictions to which the Company is subject. In the event that the Company is assessed interest or penalties at some point in the future, it will be classified in the financial statements as general and administrative expense.

Note 12 : Commitments and Contingencies

Royalty Payments

The Company, in accordance with a royalty agreement with Eastman Kodak, must pay to Eastman Kodak a certain percentage of net sales with respect to certain products, which percentages are defined in the agreement. The percentages are on a sliding scale depending on the amount of sales generated. Any minimum royalties paid will be credited against the amounts due based on the percentage of sales. The royalty agreement terminates upon the expiration of the issued patent which is the last to expire.

Effective May 30, 2007, Kodak and eMagin entered into an intellectual property agreement where eMagin has assigned Kodak the rights, title, and interest to a Company owned patent currently not being used by the Company and in consideration, Kodak waived the royalties due under the existing licensing agreements for the first six months of 2007, and reduced the royalty payments by 50% for the second half of 2007 and for the entire calendar year of 2008. In addition, the minimum royalty payment was delayed until December 1st for the years 2007 and 2008. The Company recorded approximately $142 thousand and $396 thousand for the three and nine months ended September 30, 2008, respectively, as income from the license of intangible assets and included this amount as other income in the condensed consolidated statements of operations. Royalty expense (including amounts imputed – see above) was approximately $284 thousand and $792 thousand, respectively, for the three and nine months ended September 30, 2008.

Effective January 1, 2009, the royalty payments are to be calculated at 100%. The minimum annual royalty payment of $125 thousand was paid in January 2009.

In late 2008, the Company began evaluating the status of its manufacturing process and the use of the IP associated with its license agreement. After this analysis and after making a few changes to its manufacturing process, the Company determined it was no longer using the IP covered under the license agreement. As such, future royalty payments will be limited to the minimum royalty payment amount of $125,000 plus any residual royalties on sales of product produced prior to the manufacturing process change if such amount exceeds the minimum royalty payment. The associated royalty liability has been reduced to royalties on inventory produced prior to the manufacturing process changes. The Company is in discussions with the licensor regarding its position on the license agreement and the final outcome of these discussions is yet to be determined. As of September 30, 2009, the Company's believes that the total royalty owed is $250 thousand which is based on applying the royalty formula to only the sold displays produced prior to the manufacturing process changes. Until a final outcome is reached, the Company will continue to

recognize the reduced royalty liability as stated above. For the nine months ended September 30, 2009, the Company estimated that the royalty would be approximately $1.0 million if the Company applied the royalty formula to all sold displays produced without consideration of the change in the manufacturing process. For the nine months ended September 30, 2009, the Company recorded $250 thousand as royalty expense in its consolidated statements of operations and the associated liability on its consolidated balance sheet as the Company believes that is the amount due under the agreement.

Contractual Obligations

The Company leases office facilities and office, lab and factory equipment under operating leases. Certain leases provide for payments of monthly operating expenses. The Company currently has lease commitments for space in Hopewell Junction, New York and Bellevue, Washington. In May 2009, the Company renewed its lease with IBM until May 31, 2014 with the option of extending the lease for five years. The Company's prior lease in Bellevue, Washington expired August 31, 2009. The Company signed a lease agreement for 5,100 square feet of office space effective September 1, 2009 through August 31, 2014 which will reduce the Company's monthly rent by approximately $26 thousand. Rent expense was approximately $336 thousand and $1.1 million, respectively, for the three and nine months ended September 30, 2009 and $332 thousand and $996 thousand, respectively, for the three and nine months ended September 30, 2008.

Note 13 : Subsequent Events

In preparing the Company's financial statements, the Company evaluated events and transactions for potential recognition or disclosure through November 12, 2009, the date on which this Quarterly Report on Form 10-Q was filed with the SEC.

Note 14: Restatement

In this Amended 10-Q, eMagin restated its previously issued condensed consolidated financial statements as of and for the three and nine months ended September 30, 2009 to correct errors in the accounting for certain warrants and the calculation of EPS. The Company determined that certain warrants ("Warrants") issued contain anti-dilution provisions which should have been accounted for as derivatives in accordance with the provisions of ASC 815. Authoritative guidance, effective January 1, 2009, provides an approach for companies to evaluate whether an equity-linked financial instrument or embedded feature in the instrument is indexed to its own stock for the purpose of evaluating the scope exception in ASC 815. Since the Company has issued Warrants which contain anti-dilution features for the holder, they are not considered indexed to the Company's own stock, and therefore, do not qualify for the scope exception in ASC 815 and must be accounted for as derivatives. Accordingly, beginning January 1, 2009, the Company should have reclassified the Warrants as liabilities and recorded the Warrants at estimated fair value at each reporting date, computed using the Monte Carlo Simulation approach. Thereafter, changes in the warrant liability from period to period should have been recorded in the condensed consolidated statements of operations. Effective January 1, 2009, the Company should have recorded a cumulative effect adjustment based on the grant date fair value of the outstanding Warrants and the change in fair value of the warrant liability from the issuance date through January 1, 2009.

The Company computed the fair value of the warrant liability using the Monte Carlo Simulation approach. The fair value as of the issuance date was $15.1 million and as of January 1, 2009 was $2.1 million. Accordingly, the Company recorded a warrant liability of $2.1 million, a reduction in additional paid-in capital of $15.1 million and a reduction in accumulated deficit of $13.0 million. As of September 30, 2009, the Company computed the fair value of the warrant liability as $6.7 million, an increase of $4.6 million. The change in the warrant liability of $4.6 million was comprised of the change in the fair value of the warrants of $6.4 million offset by the fair value of the expired warrants of $0.02 million and the fair value of the exercised warrants of $1.8 million. For the nine months ended September 30, 2009, the Company recorded other expense in the Condensed Consolidated Statements of Operations of $6.4 million, the change in fair value of the warrant liability net of the fair value of expired warrants. The Condensed Consolidated Statement of Changes in Shareholders' Equity, Condensed Consolidated Statements of Cash Flows, and Notes to the Condensed Consolidated Financial Statements have been restated where applicable to reflect the adjustments.

The accompanying quarterly financial statements have been restated to report the following Warrants as derivative liabilities measured at estimated fair value, calculated using the Monte Carlo Simulation approach:

Warrant Issuance Dates	Number of Warrants Outstanding as of September 30, 2009	Exercise Price	Warrant Expiration Dates	Fair Value of Warrants at Issue Date (in thousands)	Fair Value of Warrants at January 1, 2009 (in thousands)	Fair Value of Warrants at June 30, 2009 (in thousands)	Fair Value of Warrants at September 30, 2009 (in thousands)
January 9, 2004	—	$ 0.35	January 8, 2009	$ 3,091	$ 15	$ —	$ —
October 25, 2004	650,001	$ 2.50	April 25, 2010	4,738	19	70	80
July 23, 2007	2,490,712	$ 1.03	July 21, 2011	5,031	1,120	2,615	2,207
	1,000,000	$ 0.48		1,136	304	728	1,208

July 23, 2007			July 21, 2011				
April 2, 2008	793,273	$ 1.13	April 2, 2013	561	224	571	954
December 22, 2008	1,875,467	$ 1.03	December 22, 2013	534	448	1,210	2,275
			Total Fair Value	$ 15,091	$ 2,130	$ 5,194	$ 6,724

The table below is a reconciliation of the beginning and ending balances for the warrant liability:

	Number of Warrants	Warrant Issuance Dates	Fair Value of Warrants (in thousands)
Balance as of January 1, 2009			$ 2,130
Change in fair value of warrants			828
Fair value of warrants expired	107,052 shares	January 9, 2004	(15)
Balance as of March 31, 2009			$ 2,943
Change in fair value of warrants			2,251
Balance as of June 30, 2009			$ 5,194
Change in fair value of warrants			3,315
Fair value of warrants exercised	2,900,000 shares	July 23, 2007	(1,785)
Balance as of September 30, 2009			$ 6,724

Additionally, under ASC 260, “Earnings Per Share”, entities that have issued securities other than common stock that participate in dividends with the common stock (“participating securities”) are required to apply the two-class method to compute basic EPS. The two-class method is an earnings allocation method under which EPS is calculated for each class of common stock and participating security as if all such earnings had been distributed during the period. However, the participating convertible preferred stock is not required to absorb any net loss. The Company has Convertible Preferred Stock - Series B which participates in dividends with the Company’s common stock and therefore the Company should have calculated EPS using the two-class method. Certain unaudited condensed consolidated financial statements have been restated to reflect EPS calculated using the two-class method.

The following tables summarize the effects of the restatement on the specific items presented in the Company's historical condensed consolidated financial statements previously included in the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2009:

Condensed Consolidated Balance Sheet (in thousands)	September 30, 2009 (As previously reported)	September 30, 2009 (As restated)
Warrant liability	$ —	$ 80
Total current liabilities	3,571	3,651
Warrant liability	—	6,644
Total liabilities	$ 3,571	$ 10,295
Shareholders' equity:		
Additional paid-in capital	$ 206,475	$ 193,169
Accumulated deficit	(198,249)	(191,667)
Total shareholders' equity	$ 8,243	$ 1,519

Condensed Consolidated Statements of Operations (in thousands except share and per share data)	Three Months Ended September 30, 2009 (As previously reported)	Three Months Ended September 30, 2009 (As restated)	Nine Months Ended September 30, 2009 (As previously reported)	Nine Months Ended September 30, 2009 (As restated)
Change in fair value of warrant liability	$ —	$ (3,315)	$ —	$ (6,379)
Total other expense	$ (75)	$ (3,390)	$ (376)	$ (6,755)
Net income (loss)	$ 1,190	$ (2,125)	$ 2,923	$ (3,456)
Income (loss) per share, basic	$ 0.07	$ (0.13)	$ 0.18	$ (0.21)
Income (loss) per share, diluted	$ 0.04	$ (0.13)	$ 0.12	$ (0.21)
Weighted average number of shares outstanding:				
Basic	16,513,101	16,513,101	16,133,646	16,133,646
Diluted	26,592,267	16,513,101	24,471,486	16,133,646

Condensed Consolidated Statements of Cash Flows (in thousands)	Nine Months Ended September 30, 2009 (As previously reported)	Nine Months Ended September 30, 2009 (As restated)
Net income (loss)	$ 2,923	$ (3,456)
Change in fair value of warrant liability	—	6,379
Net cash provided by operating activities	$ 3,451	$ 3,451

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

Statement of Forward-Looking Information

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

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

Overview

We design and manufacture miniature displays, which we refer to as OLED-on-silicon-microdisplays, and microdisplay modules for virtual imaging, primarily for incorporation into the products of other manufacturers. Microdisplays are typically smaller than many postage stamps, but when viewed through a magnifier they can contain all of the information appearing on a high-resolution personal computer screen. Our microdisplays use organic light emitting diodes, or OLEDs, which emit light themselves when a current is passed through the device. Our technology permits OLEDs to be coated onto silicon chips to produce high resolution OLED-on-silicon microdisplays.

We believe that our OLED-on-silicon microdisplays offer a number of advantages in near to the eye applications over other current microdisplay technologies, including lower power requirements, less weight, fast video speed without flicker, and wider viewing angles. In addition, many computer and video electronic system functions can be built directly into the OLED-on-silicon microdisplay, resulting in compact systems with lower expected overall system costs relative to alternate microdisplay technologies.

We hold a license from Eastman Kodak for use of their OLED related technology and we have developed a strong portfolio of our own patents, manufacturing know-how and technology to create high performance OLED-on-silicon microdisplays and related optical systems. We believe our technology and intellectual property portfolio gives us a leadership position in OLED and OLED-on-silicon microdisplay technology. We believe that we are the only company to demonstrate publicly and market full-color small molecule OLED-on-silicon microdisplays.

Restatement of Previously Issued Condensed Consolidated Financial Statements

In this Amendment No. 1 we have restated our previously issued management's discussion and analysis of financial condition and results of operations, condensed consolidated financial statements and related disclosures for the quarter ended September 30, 2009 for the following:

To correct errors in the accounting for certain warrants. Specifically, we previously classified as equity instruments warrants that should have been classified as derivative liability instruments based on the terms of the warrants and the applicable accounting guidance.

To correct an error in the calculation of earnings per share ("EPS"). We issued Preferred Stock – Series B which participates in dividends with our common stock; as a result, we should have used the two-class method for calculating EPS.

Company History

As of January 1, 2003, we were no longer classified as a development stage company. We transitioned to manufacturing our product and have significantly increased our marketing, sales, and research and development efforts, and expanded our operating infrastructure. Currently, most of our operating expenses are labor related and semi-fixed. If we are unable to generate significant revenues, our net losses in any given period could be greater than expected.

CRITICAL ACCOUNTING POLICIES

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

Revenue and Cost Recognition

Revenue on product sales is recognized when persuasive evidence of an arrangement exists, such as when a purchase order or contract is received from the customer, the price is fixed, title and risk of loss to the goods has changed and there is a reasonable assurance of collection of the sales proceeds. We obtain written purchase authorizations from our customers for a specified amount of product at a specified price and consider delivery to have occurred at the time of shipment. We record a reserve for estimated sales returns, which is reflected as a reduction of revenue at the time of revenue recognition. Products sold directly to consumers have a thirty day right of return. Revenue on consumer products is deferred until the right of return has expired.

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

Use of Estimates

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

Fair Value of Financial Instruments - Restated

eMagin’s cash, cash equivalents, accounts receivable, short-term investments, accounts payable and debt are stated at cost which approximates fair value due to the short-term nature of these instruments. eMagin measures the fair value of our warrants based on the Monte Carlo Simulation approach.

Stock-based Compensation

eMagin maintains several stock equity incentive plans. The 2005 Employee Stock Purchase Plan (the “ESPP”) provides our employees with the opportunity to purchase common stock through payroll deductions. Employees purchase stock semi-annually at a price that is 85% of the fair market value at certain plan-defined dates. As of September 30, 2009, the number of shares of common stock available for issuance was 300,000. As of September 30, 2009, no shares have been issued from this plan.

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

The 2008 Incentive Stock Plan ("the 2008 Plan") adopted and approved by the Board of Directors on November 5, 2008 provides for the issuance of shares of common stock and options to purchase shares of common stock to employees, officers, directors and consultants. The 2008 Plan has an aggregate of 2,000,000 shares. For the three and nine months ended September 30, 2009, there were 42,857 and 498,533 shares of common stock, respectively, issued to consultants. In addition, there were 411,600 and 1,278,841 options granted from the plan for the three and nine months ended September 30, 2009.

We account for the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors by estimating the fair value of stock awards at the date of grant using the Black-Scholes option valuation model. Stock-based compensation expense is reduced for estimated forfeitures and is amortized over the vesting period using the straight-line method. See Note 9 of the Condensed Consolidated Financial Statements – Stock Compensation for a further discussion on stock-based compensation.

NEW ACCOUNTING PRONOUNCEMENTS

See Note 2 of the Condensed Consolidated Financial Statements in Item 1 for a description of recent accounting pronouncements.

RESULTS OF OPERATIONS

THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2009 COMPARED TO THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2008

Revenues

Revenues for the three and nine months ended September 30, 2009 were approximately $6.1 million and $17.1 million, respectively, as compared to approximately $5.2 million and $13.5 million for the three and nine months ended September 30, 2008, respectively, an increase of approximately 18% and 27%, respectively. Higher revenue for the three and nine month periods was due to increased customer demand and product availability.

For the three and nine months ended September 30, 2009, product revenue increased approximately $1.1 million and $3.4 million, respectively, as compared to the three and nine months ended September 30, 2008. The increase was due to higher customer demand and increased product availability for our OLED displays in the first nine months of 2009 as compared to the first nine months of 2008. For the three months ended September 30, 2009, contract revenue decreased approximately $0.2 million as compared to the three months ended September 30, 2008 and for the nine months ended September 30, 2009 increased approximately $0.2 million as compared to the nine months ended September 30, 2008. The change in revenue is a result of fluctuations in contract activity.

Cost of Goods Sold

Cost of goods sold includes direct and indirect costs associated with production. Cost of goods sold for the three and nine months ended September 30, 2009 were approximately $2.6 million and $7.3 million as compared to approximately $2.8 million and $8.1 million for the three and nine months ended September 30, 2008, a decrease of approximately $0.2 million and $0.8 million, respectively. Cost of goods sold as a percentage of revenues improved from 54% for the three months ended September 30, 2008 to 43% for the three months ended September 30, 2009. Cost of goods sold as a percentage of revenues improved from 60% for the nine months ended September 30, 2008 to 43% for the nine months ended September 30, 2009. Cost of goods is comprised primarily of material and labor cost. The labor portion of cost of goods is mostly fixed. Improved manufacturing yield, lower royalty expense and lower warranty expense resulted in a lower cost of goods sold percentage.

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

	Three months ended September 30,	Nine months ended September 30,

	2009	2008	2009	2008
	(unaudited)		(unaudited)	
Product revenue gross profit	$ 3,264	$ 1,769	$ 8,743	$ 4,109
Product revenue gross margin	62%	42%	60 %	37%
Contract revenue gross profit	$ 236	$ 615	$ 1,015	$ 1,250
Contract revenue gross margin	28%	61%	40%	54%
Total gross profit	$ 3,500	$ 2,384	$ 9,758	$ 5,359
Total gross margin	57%	46%	57%	40%

The gross profit for the three and nine months ended September 30, 2009 was approximately $3.5 million and $9.8 million as compared to approximately $2.4 million and $5.4 million for the three and nine months ended September 30, 2008, an increase of $1.1 million and $4.4 million, respectively. Gross margin was 57% for the three months ended September 30, 2009 up from 46% for the three months ended September 30, 2008. Gross margin was 57% for the nine months ended September 30, 2009 up from 40% for the nine months ended September 30, 2008. The increase was mainly attributed to the fuller utilization of our fixed production overhead due to improved yields and a reduction in royalty and warranty expenses. See Note 12 of the Condensed Consolidated Financial Statements - Commitments and Contingencies for further discussion on the royalty payments.

The product gross profit for the three and nine months ended September 30, 2009 was approximately $3.3 million and $8.7 million as compared to approximately $1.8 million and $4.1 million for the three and nine months ended September 30, 2008, an increase of $1.5 million and $4.6 million, respectively. Product gross margin was 62% for the three months ended September 30, 2009 up from 42% for the three months ended September 30, 2008. Product gross margin was 60% for the nine months ended September 30, 2009 up from 37% for the nine months ended September 30, 2008. The increase was attributed to the fuller utilization of our fixed production overhead due to improved yields and a reduction in royalty and warranty expenses. See Note 12 of the Condensed Consolidated Financial Statements - Commitments and Contingencies for further discussion on the royalty payments.

The contract gross profit for the three and nine months ended September 30, 2009 was approximately $0.2 million and $1.0 million as compared to approximately $0.6 million and $1.3 million for the three and nine months ended September 30, 2008, a decrease of $0.4 million and $0.3 million, respectively. Contract gross margin was 28% for the three months ended September 30, 2009 down from 61% for the three months ended September 30, 2008. Contract gross margin was 40% for the nine months ended September 30, 2009 down from 54% for the nine months ended September 30, 2008. The contract gross margin is dependent upon the mix of costs, internal versus external third party costs, with the external third party costs causing a lower gross margin and reducing the contract gross profit.

Operating Expenses

Research and Development. Research and development expenses include salaries, development materials and other costs specifically allocated to the development of new microdisplay products, OLED materials and subsystems. Research and development expenses for the three and nine months ended September 30, 2009 were approximately $0.5 million and $1.4 million, respectively, as compared to $0.3 million and $1.6 million for the three and nine months ended September 30, 2008, an increase of approximately $0.2 million and a decrease of approximately $0.2 million, respectively. The increase of $0.2 million was primarily due to the lower allocation of research and development resources and expenses related to contracts to cost of goods sold offset by the reduction in expense due to the streamlining of the research and development effort in the subsystems area. The decrease of $0.2 million was primarily related to the reduction in expense due to the streamlining of the research and development effort in the subsystems area.

Selling, General and Administrative. Selling, general and administrative expenses consist principally of salaries, fees for professional services including legal fees, as well as other marketing and administrative expenses. Selling, general and administrative expenses for the three and nine months ended September 30, 2009 were approximately $1.8 million and $5.1 million, respectively, as compared to approximately $1.3 million and $4.8 million for the three and nine months ended September 30, 2008, an increase of approximately $0.5 million and $0.3 million, respectively. The increase of $0.5 million for the three months is primarily related to an increase of personnel costs, non-cash compensation, and professional services. The increase of $0.3 million for the nine months is primarily related to an increase in personnel costs, non-cash compensation, and tradeshow costs, offset by a decrease in reserve for allowance for bad debts.

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

For the three and nine months ended September 30, 2009, interest expense was approximately $76 thousand and $417 thousand, respectively, as compared to $508 thousand and $1.7 million, respectively, for the three and nine months ended September 30, 2008. For the three and nine months ended September 30, 2009, the interest expense associated with debt was $7 thousand and $48, respectively, loan fees associated with the new line of credit was $7 thousand, and the amortization of the deferred costs associated with the debt was $62 thousand and $362 thousand,

respectively. The breakdown of the interest expense for the three and nine month period in 2008 was as follows: interest expense associated with debt of approximately $177 thousand and $501 thousand, respectively; the amortization of the deferred costs and waiver fees associated with the debt of approximately $331 thousand and $1.2 million, respectively; and the amortization of the debt discount associated with the debt of approximately $0 and $25 thousand, respectively. The decrease in interest expense for the three and nine months ended September 30, 2009 as compared to the three and nine months ended September 30, 2008 was primarily a result of carrying a lower balance on our line of credit, the repayment and conversion of the 8% Senior Secured Convertible Notes in December 2008, and lower deferred debt issuance costs.

Other income for the three and nine months ended September 30, 2009 was approximately $1 thousand and $41 thousand, respectively, as compared to $84 thousand and $294 thousand, respectively, for the three and nine months ended September 30, 2008. The other income for the three and nine months ended September 30, 2009 was interest income of approximately $1 thousand and $3 thousand, respectively, and for a settlement of a liability, $0 and $38 thousand, respectively. Other income for the three and nine months ended September 30, 2008 was interest income of approximately $2 thousand and $6 thousand, respectively; $142 thousand and $396 thousand, respectively, was income from a gain on the license of intangible assets; $0 and $18 thousand, respectively, of income from equipment salvage; and is offset by approximately $60 thousand and $126 thousand, respectively, of expense from registration payment arrangements. See Note 11: Commitments and Contingencies – Royalty Payments for additional information.

Change in Fair Value of Warrant Liability. In accordance with ASC 815, adopted January 1, 2009, certain warrants previously classified within equity are reclassified as liabilities. As a result of this reclassification, the accounting guidance requires revaluation of this liability every reporting period. The fair value of the liability at September 30, 2009 was measured by using the Monte Carlo Simulation model. The revaluation resulted in a charge of $3.3 million and $6.4 million, respectively, for the three and nine months ended September 30, 2009. This revaluation is a non-cash item and had no impact on our cash balances, operations, or operating income.

Liquidity and Capital Resources

As of September 30, 2009, we had approximately $3.7 million of cash and cash equivalents as compared to $2.4 million as of December 31, 2008. The change in cash and investments was primarily due to cash provided by operations of approximately $3.5 million offset by cash used for financing and investing activities of approximately $2.2 million.

Cash flow provided by operating activities during the nine months ended September 30, 2009 was approximately $3.5 million, attributable to our net loss of approximately $ 3.5 million, change in operating assets and liabilities of $0.6 million offset by non-cash expenses of $ 7.6 million. Cash flow used in operating activities during the nine months ended September 30, 2008 was approximately $1.9 million primarily attributable to our net loss of $2.4 million and an increase in accounts receivable of $1.9 million offset by non-cash expenses of $2.5 million.

Cash used in investing activities during the nine months ended September 30, 2009 and 2008 was approximately $492 thousand and $236 thousand, respectively, used for equipment purchases.

Cash used in financing activities during the nine months ended September 30, 2009 was approximately $1.7 million to pay down the line of credit. Cash provided by financing activities during the nine months ended September 30, 2008 was approximately $2.7 million and was comprised of approximately $1.6 million from the sale of common stock, $1.8 million from the line of credit, and offset by payments on debt of $0.7 million.

As we have reported, our business continues to experience revenue growth. This trend, if it continues, may result in higher accounts receivable levels and may require increased production and/or higher inventory levels. We anticipate that our cash needs to fund these requirements as well as other operating or investing cash requirements over the next twelve months will be less than our current cash on hand and the cash we anticipate generating from operations. We anticipate that we will not require additional funds over the next twelve months other than perhaps for discretionary capital spending. If unanticipated events arise during the next twelve months, we believe we can raise sufficient funds. However, if we are unable to obtain sufficient funds, we may further reduce the size of our organization and/or be forced to reduce and/or curtail our production and operations, all of which could have a material adverse impact on our business prospects.

Off-Balance Sheet Arrangements

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

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

ITEM 4T. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures. Based on an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, as of the end of the period covered by this Report, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Our Chief Executive Officer and Chief Financial Officer also concluded that, as of the end of the period covered by this Report, there were material weaknesses in both the design and effectiveness of our internal control over financial reporting. Management has assessed these deficiencies and has determined that there were two general categories of material weaknesses (described below) in eMagin's internal control over financial reporting. As a result of our assessment that material weaknesses in our internal control over financial reporting existed as of September 30, 2009, management has concluded that our internal control over financial reporting was not effective as of September 30, 2009. A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis. Management recognizes that any disclosure controls and procedures, no matter how well designed and operated, can only provide reasonable assurance of achieving their objectives.

The material weaknesses we have identified in our Form 10-K for the year ended December 31, 2008 include:

Deficiencies pertaining to the lack of controls or ineffectively designed controls. Our control design analysis and process walk-throughs disclosed a number of instances where review approvals were undocumented, where established policies and procedures were not defined, and controls were not in place.

Deficiencies related to information technology control design and operating effectiveness weaknesses. This material weakness resulted from the absence of key formalized information technology policies and procedures and could result in (1) unauthorized system access, (2) application changes being implemented without adequate reliability testing, (3) inconsistent investigation of system errors and the absence of timely or properly considered remedial actions, and (4) over reliance on spreadsheet applications without quality control assurances. These factors could lead to material errors and misstatements to financial statements occurring without timely detection.

There has been an ongoing focus on the remediation activities to address the material weakness in disclosure and financial reporting controls. We have formalized and documented our review process, have better defined policies and procedures, and established additional controls where necessary. During our third quarter, we tested our controls that were in place through June 30, 2009 and we had made significant improvement with fewer deficiencies. As part of the assessment, we are and will continue to conduct testing and evaluation of the controls implemented as part of the remediation plan to ascertain that they operate effectively. We anticipate that these remediation actions and resulting improvement in controls will generally strengthen our disclosure controls and procedures and represent ongoing improvement measures. While we have taken steps to remediate the material weaknesses, these steps may not be adequate to fully do so, and additional measures may be required.

Restatement of Condensed Consolidated Financial Statements

On August 10, 2011, the Audit Committee of the Board of Directors (“Audit Committee”) in consultation with the Company’s management concluded that the financial statements included in the Company’s Annual Reports issued on Form 10-K for the years ended December 31, 2009 and 2010 and quarterly reports issued on Form 10-Q for the quarters ended March 31, June 30, and September 30, 2009; March 31, June 30, and September 30, 2010; and March 31, 2011 did not use the proper method to calculate earnings per share and as a result, should not be relied upon. On August 15, 2011, after consulting with the Audit Committee on August 10, 2011 and with the Company’s auditors and former auditors, management concluded that the Company did not properly account for certain common stock warrants as liabilities and as a result, the financial statements, as mentioned above, should not be relied upon. The Audit Committee authorized and directed Company’s management to restate its consolidated financial statements for the above mentioned periods. As a result of a deficiency in our internal control over financial reporting relating to the accounting for common stock warrants, as of the end of the period covered by this report our management has reassessed the effectiveness of our disclosure controls and procedures and has determined that our disclosure controls and procedures were not effective.

Remediation Plan

Since the determination regarding this deficiency, we have devoted significant effort and resources to remediation and improvement of our internal control over financial reporting. While we had processes in place to identify and apply developments in accounting standards, we enhanced these processes to better evaluate our research of the nuances of complex accounting standards. Our enhancements included retaining a third party consultant, who is a technical accounting professional, to assist us in the interpretation and application of new and complex accounting guidance. Additionally, we have improved training of accounting personnel and communication among our internal staff, our legal team and our consultant. Management will continue to review and make necessary changes to the overall design of our internal control environment.

(b) Changes in Internal Controls. During the quarter ended September 30, 2009, other than the remediation activities noted above, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 1. Legal Proceedings

None.

ITEM 1A. Risk Factors

In addition to other information set forth in this Report, you should carefully consider the risk factors previously disclosed in "Item 1A to Part 1" of our Annual Report on Form 10-K for the year ended December 31, 2008. There were no material changes from the risk factors during the three and nine months ended September 30, 2009.

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

None.

ITEM 3. Defaults Upon Senior Securities

None.

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

None.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

EXHIBIT NUMBER	DESCRIPTION
31.1	Certification by Principal Executive Officer pursuant to Sarbanes Oxley Section 302 (1)
31.2	Certification by Principal Financial Officer pursuant to Sarbanes Oxley Section 302 (1)
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350 (1)
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350 (1)

(1) Filed herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on this 7th day of October 2011 .

eMAGIN CORPORATION

By: /s/ Andrew G. Sculley
Andrew G. Sculley
Chief Executive Officer
(Principal Executive Officer)

By: /s/ Paul Campbell
Paul Campbell
Chief Financial Officer
(Chief Accounting Officer and
Principal Financial Officer)