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 March 31, 2011
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 ¨ 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 £ 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 April 30, 2011 was 21,686,196.

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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 March 31, 2011, which was originally filed with the Securities and Exchange Commission on May 12, 2011 (the "Original 10-Q"). This Amendment is being filed mainly to include restated financial statements as described in Note 16, 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"). 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, if 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.

eMagin Corporation

Form 10-Q /A
For the Quarter ended March 31, 2011

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ITEM 1. Condensed Consolidated Financial Statements

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

	March 31, 2011 (Restated) See Note 16 (unaudited)	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,763	$ 7,796
Short-term investments – held to maturity	3,500	3,100
Accounts receivable, net	4,698	5,150
Inventory	2,149	1,905
Prepaid expenses and other current assets	704	777
Total current assets	18,814	18,728
Long-term investments – held to maturity	1,750	1,500
Equipment, furniture and leasehold improvements, net	3,538	3,287
Intangible assets, net	38	39
Other assets	92	92
Deferred tax asset	9,056	9,056
Total assets	$ 33,288	$ 32,702
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 1,324	$ 1,100
Accrued compensation	1,811	1,975
Other accrued expenses	1,488	1,781
Advance payments	239	101
Deferred revenue	24	26
Warrant liability	7,536	7,694
Other current liabilities	175	170
Total current liabilities	12,597	12,847
Warrant liability	5,966	5,158
Total liabilities	18,563	18,005
Commitments and contingencies (Note 12)		
Shareholders' equity:		
Preferred stock, $.001 par value: authorized 10,000,000 shares:		

Series B Convertible Preferred stock, (liquidation preference of $5,679,000) stated value $1,000 per share, $.001 par value: 10,000 shares designated and 5,679 issued and outstanding as of March 31, 2011 and December 31, 2010		—		—
Common stock, $.001 par value: authorized 200,000,000 shares, issued and outstanding, 21,616,708 shares as of March 31, 2011 and 21,210,445 as of December 31, 2010		22		21
Additional paid-in capital		209,664		206,298
Accumulated deficit		(194,961)		(191,622)
Total shareholders' equity		14,725		14,697
Total liabilities and shareholders' equity	$	33,288	$	32,702

See notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2011 (Restated) See Note 16	2010
Revenue:		
Product	$ 4,310	$ 4,486
Contract	1,131	1,441
Total revenue, net	5,441	5,927
Cost of goods sold:		
Product	2,609	1,845
Contract	586	764
Total cost of goods sold	3,195	2,609
Gross profit	2,246	3,318
Operating expenses:		
Research and development	532	734
Selling, general and administrative	2,141	1,682
Total operating expenses	2,673	2,416
(Loss) income from operations	(427)	902
Other income (expense):		
Interest expense, net	(29)	(28)
Other income, net	16	7
Change in fair value of warrant liability	(3,057)	(9,497)
Total other expense, net	(3,070)	(9,518)
Loss before (benefit from) provision for income taxes	(3,497)	(8,616)
(Benefit from) provision for income taxes	(158)	1
Net loss	$ (3,339)	$ (8,617)
Loss per common share, basic	$ (0.16)	$ (0.50)
Loss per common share, diluted	$ (0.16)	$ (0.50)
Weighted average number of common shares outstanding:		
Basic	21,522,716	17,109,706
Diluted	21,522,716	17,109,706

See notes to Condensed Consolidated Financial Statements.

eMAGIN CORPORATION

CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

(In thousands)

(unaudited)

	Preferred Stock		Common Stock				
	Shares	Amount	Shares	Amount	Additional Paid-in Capital (Restated) See Note 16	Accumulated Deficit (Restated) See Note 16	Total Shareholders' Equity (Restated) See Note 16
Balance, December 31, 2010	5,679	$ —	21,210,445	$ 21	$ 206,298	$ (191,622)	$ 14,697
Fair value of warrants reclassed from liability to equity upon exercise	—	—	—	—	2,407	—	2,407
Cashless exercise of common stock warrants	—	—	310,897	—	—	—	—
Exercise of common stock warrants	—	—	72,116	1	81	—	82
Exercise of common stock options	—	—	23,250	—	22	—	22
Stock-based compensation	—	—	—	—	856	—	856
Net loss	—	—	—	—	—	(3,339)	(3,339)
Balance, March 31, 2011	5,679	$ —	21,616,708	$ 22	$ 209,664	$ (194,961)	$ 14,725

See notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended March 31,	
	2011 (Restated) See Note 16	2010
	(unaudited)	
Cash flows from operating activities:		
Net loss	$ (3,339)	$ (8,617)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	34	16
Reduction of provision for sales returns and doubtful accounts	(204)	(161)
Deferred tax benefit	(150)	—
Stock-based compensation	856	433
Amortization of common stock issued for services	—	1
Change in fair value of warrant liability	3,057	9,497
Changes in operating assets and liabilities:		
Accounts receivable	656	303
Inventory	(244)	(14)
Prepaid expenses and other current assets	73	(53)
Deferred revenue	(2)	128
Accounts payable, accrued compensation, other accrued expenses, advance payments, and other current liabilities	60	(67)
Net cash provided by operating activities	797	1,466
Cash flows from investing activities:		
Purchase of equipment	(284)	(763)
Purchase of investments – held to maturity	(650)	—
Net cash used in investing activities	(934)	(763)
Cash flows from financing activities:		
Proceeds from exercise of stock options and warrants	104	—
Net cash provided by financing activities	104	—
Net (decrease) increase in cash and cash equivalents	(33)	703
Cash and cash equivalents, beginning of period	7,796	5,295
Cash and cash equivalents, end of period	$ 7,763	$ 5,998
Cash paid for interest	$ 15	$ 15
Cash paid for taxes	$ —	$ 115
Issuance of 310,897 and 334,608 shares of common stock for cashless exercise of 380,511 and 669,717 warrants in 2011 and 2010, respectively	$ —	$ —

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 and 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 have been condensed or omitted pursuant to instructions, rules and regulations prescribed by the Securities and Exchange Commission. The Company believes that the disclosures provided herein are adequate to make the information presented not misleading when these unaudited 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, 2010. The results of operations for the period ended March 31, 2011 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 months ended March 31, 2011 to correct errors in the accounting for certain warrants as discussed in Note 16, "Restatement".

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 related to, among others, allowance for doubtful accounts, warranty reserves, inventory reserves, stock-based compensation expense, deferred tax asset valuation allowances, litigation and other loss contingencies. 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. Product revenue is generally recognized when products are shipped to customers. 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 (contract revenues) under both firm fixed-price contracts and cost-type contracts. Revenues relating to firm fixed-price contracts and cost-type contracts are generally recognized on the percentage-of-completion method of accounting as costs are incurred (cost-to-cost basis). 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.

Product warranty

The Company offers a one-year product replacement warranty. In general, the standard policy is to repair or replace defective products. The Company accrues for estimated returns of defective products at the time revenue is recognized based on historical activity as well as for specific known product issues. The determination of these accruals requires the Company to make estimates of the frequency and extent of warranty activity and estimate future costs to replace the products under warranty. If the actual warranty activity and/or repair and replacement costs differ significantly from these estimates, adjustments to cost of revenue may be required in future periods.

Research and Development Costs

Research and development costs are expensed as incurred.

Cash and cash equivalents

All highly liquid instruments with an original maturity of three months or less at the date of purchase are considered to be cash equivalents.

Investments-held to maturity

Securities that the Company has the positive intent and ability to hold to maturity are classified as held-to-maturity and are carried at cost on the accompanying balance sheet.

Concentration of credit risk

eMagin's products are sold mainly throughout North America, Asia, and Europe. Sales to the Company's recurring customers are generally made on open account while sales to occasional customers are typically made on a prepaid basis. eMagin performs periodic credit evaluations on its recurring customers and generally does not require collateral. An allowance for doubtful accounts is maintained for credit losses.

Financial instruments which potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents and short-term and long-term investments. The Company's cash and cash equivalents are deposited with financial institutions which, at times, may exceed federally insured limits. The Company has Certificates of Deposits ("CDs"), classified as short and long-term investments – held to maturity, which are federally insured. To date, the Company has not experienced any loss associated with this risk.

Note 2: Recently Issued Accounting Pronouncements

During the three months ended March 31, 2011, there were no new accounting pronouncements that would have had a material effect on our unaudited condensed consolidated financial statements.

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 March 31, 2011 were as follows (in thousands):

	Fair Value as of March 31, 2011	Fair Value Measurement Using		
		Level 1	Level 2	Level 3
Warrant liability, current	$ 7,536	$ —	$ —	$ 7,536
Warrant liability, long-term	5,966	—	—	5,966
Total Warrant liability	$ 13,502	$ —	$ —	$ 13,502

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, 2011	$ 12,852
Change in fair value of warrants	3,057
Fair value of warrants exercised	(2,407)
Balance as of March 31, 2011	$ 13,502

For the three months ended March 31, 2011, the change in fair value of the warrant liability of $3.1 million was 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:

	March 31, 2011	December 31, 2010
Risk-free interest rate	0.09% - 1.29 %	0.19% - 1.02 %
Expected volatility	72.1% - 74.7 %	71.9% - 79.2 %
Expected life (in years)	0.25 – 2.75	0.50 – 3.0
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 an 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 allowance for doubtful accounts reflects an estimate of probable losses inherent in the accounts receivable balance. 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, deterioration in the customer's operating results or financial position, or deterioration in the customer’s credit history. 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, 2011 (unaudited)	December 31, 2010
Accounts receivable	$ 4,868	$ 5,524

Less allowance for doubtful accounts		(170)		(374)
Net receivables	$	4,698	$	5,150

Note 5: Net Loss per Common Share

Basic loss per share ("Basic EPS") is computed by dividing net loss by the weighted average number of common shares outstanding during the reporting period. Diluted loss per share ("Diluted EPS") is computed by dividing the net 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 March 31, 2011			Three Months Ended March 31, 2010		
Basic EPS	Income	Shares	Per Share Amount	Income	Shares	Per Share Amount
Net Loss	$ (3,339)			$ (8,617)		
Loss allocated to participating securities	$ —			$ —		
Loss allocated to common shares	$ (3,339)	21,522,716	$ (0.16)	$ (8,617)	17,109,706	$ (0.50)
Diluted EPS						
Diluted potential common shares		—			—	
Loss allocated to common shares	$ (3,339)	21,522,716	$ (0.16)	$ (8,617)	17,109,706	$ (0.50)

For the three months ended March 31, 2011 and 2010, the Company has excluded stock options, warrants and convertible preferred stock to acquire 14,195,375 and 19,463,750 shares, respectively , of our common stock from the computation of diluted loss per share because their effect would be antidilutive

Note 6: Inventory

Inventory is stated at the lower of cost or market. Cost is determined using the first-in first-out method. Cost includes materials, labor, and manufacturing overhead related to the purchase and production of inventories. The Company regularly reviews inventory quantities on hand, future purchase commitments with the Company's suppliers, and the estimated utility of the inventory. If the Company review indicates a reduction in utility below carrying value, the inventory is reduced to a new cost basis.

The components of inventories are as follows (in thousands):

	March 31, 2011 (unaudited)	December 31, 2010
Raw materials	$ 1,177	$ 748
Work in process	599	681
Finished goods	373	476
Total inventory	$ 2,149	$ 1,905

Note 7: Prepaid Expenses and Other Current Assets:

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

	March 31, 2011 (unaudited)	December 31, 2010
Vendor prepayments	$ 45	$ 83
Other prepaid expenses *	659	694

Total prepaid expenses and other current assets	$	704	$	777

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

Note 8: Debt

At March 31, 2011, the Company had available a credit facility with Access Business Finance, LLC ("Access") under which the Company may borrow up to a maximum of $3 million based on a borrowing base equivalent of 75% of eligible accounts receivable. The interest on the line of credit is equal to the Prime Rate plus 4.00% but may not be less than 7.25% with a minimum monthly interest payment of $5,000. The term of the agreement with Access is for one year and automatically renews 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 renewal date is September 1, 2011. The Company paid $30,000 in loan fees to Access which were charged to prepaid expense and will be amortized over the life of the Agreement. As of March 31, 2011, $17,500 has been amortized to interest expense. The Company's obligations under the agreement are secured by its assets. As of March 31, 2011, the Company had not borrowed on its line of credit.

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 our expense categories for the three month periods ended March 31, 2011 and 2010 (in thousands):

	Three Months Ended March 31,			
	2011		2010	
Cost of revenue	$	25	$	97
Research and development		19		102
Selling, general and administrative		812		234
Total stock compensation expense	$	856	$	433

At March 31, 2011, total unrecognized compensation costs related to stock options was approximately $4.3 million, net of estimated 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 2.8 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. There were no options granted to consultants in the three months ended March 31, 2011. In May 2009, there were 60,000 options granted to consultants, of which the unvested options were remeasured to the current fair market value at March 31, 2011. 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 – 0.64% to 1.70%; expected volatility – 68.4 % to 84.1%; and expected term – 3 years.

During the three month period ended March 31, 2011, there were 1,294,177 stock options granted to employees and directors. During the three month period ended March 31, 2010, there were 448,185 stock options granted to employees. The following key assumptions were used in the Black-Scholes option pricing model to determine the fair value of stock options granted:

	Three Months Ended March 31,	
	2011	2010
Dividend yield	0 %	0 %
Risk free interest rates	1.04 to 2.37 %	1.34 to 2.07 %
Expected volatility	67.1 to 85.7 %	80.6 to 86.9 %
Expected term (in years)	3.5 to 5.5	3.5 to 4.0

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 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 our stock-based awards are expected to be outstanding and was determined based on historical experience and vesting schedules of similar awards.

For the three months ended March 31, 2011, 200,000 options were granted to employees from the 2008 Plan with a fair value of approximately $0.8 million and 1,094,177 options were granted to employees and directors from the 2003 Plan with a fair value of approximately $4.3 million. The weighted average fair value per share for options granted in the first quarter of 2011 was $3.92.

A summary of the Company's stock option activity for the three months ended March 31, 2011 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 December 31, 2010	3,152,114	$ 1.71		
Options granted	1,294,177	7.51		
Options exercised	(23,250)	0.95		
Options forfeited	(130)	2.60		
Options cancelled	(4,537)	1.38		
Outstanding at March 31, 2011	4,418,374	$ 3.42	5.96	$17,182,953
Vested or expected to vest at March 31, 2011 (1)	4,332,600	$ 4.22	5.96	$16,151,976
Exercisable at March 31, 2011	2,988,823	$ 1.95	6.38	$15,694,652

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

	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	979,058	5.31	$ 0.81	968,098	$ 0.81
$ 1.00 - $1.51	1,085,798	6.18	1.21	932,224	1.23
$ 1.80 - $1.94	376,099	5.87	1.94	368,899	1.94
$ 2.60 - $3.92	581,242	6.98	3.13	492,602	3.10
$ 5.62 - $22.50	1,396,177	5.84	7.48	227,000	7.29
	4,418,374	5.96	$ 3.42	2,988,823	$ 1.95

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 3,447,796 options in-the-money at March 31, 2011. The Company's closing stock price was $7.15 as of March 31, 2011. The Company issues new shares of common stock upon exercise of stock options.

Note 10: Shareholders' Equity

Preferred Stock - Series B Convertible Preferred Stock ("the Preferred Stock – Series B")

The Company has designated 10,000 shares of the Company's preferred stock as Series B Convertible Preferred Stock ("the Preferred -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.

The Preferred Stock –Series B votes with holders of Common Stock upon the election of directors and upon any other matter submitted to a vote of shareholders, except those matters required by law to be submitted to a vote of holders of Preferred Stock of the Company or Series B Convertible Preferred Stock voting separately as a class or series, and except as provided in the Certificate of Designations of Series B Convertible Preferred Stock. Fractional votes shall not, however, be permitted. The holder of 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 March 31, 2011, there were 5,679 shares of Preferred Stock – Series B issued and outstanding.

Common Stock

For the three months ended March 31, 2011, the Company received approximately $22 thousand for 23,250 stock options exercised and for the three months ended March 31, 2010, there were no stock options exercised. For the three months ended March 31, 2011, there were 380,511 warrants exercised on a cashless basis resulting in 310,897 shares of common stock issued. For the three months ended March 31, 2010, there were 669,717 warrants exercised on a cashless basis resulting in 334,608 shares of common stock issued. In addition, the Company received proceeds of approximately $81 thousand from the exercise of warrants and issued 72,116 shares of common stock in the three months ended March 31, 2011 and no proceeds were received for warrant exercises in the three months ended March 31, 2010.

For the three months ended March 31, 2011 and 2010, no shares of common stock were issued for payment for services rendered and to be rendered in the future.

Note 11: Income Taxes

For the three months ended March 31, 2011, the Company recorded a current income tax benefit of approximately $158 thousand based upon the projected effective income tax rate for the year, as the Company expects to have taxable income for the year ending December 31, 2011. For the three months ended March 31, 2010, the Company recorded income tax expense of approximately $1,000.

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.

Due to the Company's operating loss carryforwards, all tax years 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 tax expense.

Note 12: Commitments and Contingencies

Royalty Payments

The Company signed a license agreement on March 29, 1999 with Eastman Kodak ("Kodak'), under which it is obligated to make royalty payments. Under this agreement, the Company must pay to Kodak a minimum royalty plus 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. The Company was notified that Kodak sold substantially all rights and obligations under the Company's license agreement to Global OLED Technology, owned by LG Electronics, as of December 30, 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 stopped using the IP covered under the license agreement by year end 2008. The last royalty payment

under the license agreement was made in November 2009. The Company determined that it is no longer required to pay the minimum royalty payment of $125,000 and as such has not paid or accrued this amount in 2010 or to date in 2011.

In April 2011, the Company received a request for royalty payments from a representative of Global OLED Technology, LLC, the current owner of the old Kodak OLED patent portfolio. The Company has responded stating, that the licenses are no longer in force and that in any event, the request for royalties is untimely.

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, Bellevue, Washington, and Santa Clara, California.

The Company's manufacturing facilities are leased from IBM in Hopewell Junction, New York. eMagin leases approximately 37,000 square feet to house its equipment for OLED microdisplay fabrication and for research and development, an assembly area and administrative offices. The lease expires May 31, 2014 with the option of extending the lease for five years. The corporate headquarters are located in Bellevue, Washington where eMagin leases approximately 6,300 square feet. The lease expires on August 31, 2014. On April 14, 2011, the Company signed an eighteen month lease agreement for approximately 2,400 square feet of office space in Santa Clara, California effective May 1, 2011. The Company's monthly rent expense will increase by approximately $3.5 thousand. The California location will be a research and development facility.

For the three months ended March 31, 2011and 2010, rent expense was approximately $289 thousand and $283 thousand, respectively.

Note 13: Legal Proceedings

On March 17, 2010, Gary Jones, a former executive at the Company, filed a complaint for damages in the Superior Court of the State of Washington for King County (the "Complaint") against the Company and the Company's Chief Financial Officer. The Complaint alleges unspecified damages for failure to pay contractual payments and wages under Washington law ("the Washington Wage Claim") and includes, among other claims, breach of contract, breach of the duty of good faith and fair dealing, promissory estoppel and misrepresentation.

On May 21, 2010, the court granted eMagin's motion to dismiss regarding the claim for misrepresentation and the Washington Wage Claim. The Chief Financial Officer's motion to dismiss was also granted relating to the following claims against him: the Washington Wage Claims, breach of contract, breach of promises of specific treatment in specific circumstances, breach of the duty of good faith and fair dealing, and promissory estoppel.

On March 21, 2011, the Company executed a Settlement Agreement and Full and Complete Mutual Release (the "Settlement Agreement") among the Company, Mr. Jones and the Company's Chief Financial Officer, which had previously been executed by Mr. Jones and the Chief Financial Officer, and became effective on March 29, 2011 (the "Effective Date"). On April 5, 2011, pursuant to the Settlement Agreement, the Company made the following payments in the aggregate amount of $650 thousand: (i) payment to Mr. Jones in the gross amount of $478 thousand for payment amounts set forth in the Executive Separation and Consulting Agreement ("ECSA") and Expense Reimbursement and Compensation Schedule ("ERCS") entered into by Mr. Jones and the Company in January 2007; (ii) payment to Mr. Jones in the amount of approximately $27 thousand for a negotiated interest amount pursuant to the ECSA and ERCS; and (iii) approximately $145 thousand in attorney's fees paid to Mr. Jones' attorneys (collectively, the "Settlement Payments"). The settlement offer was recorded as a liability on the Company's Consolidated Balance Sheet and included in selling, general, and administrative expense on the Company's Consolidated Statements of Operations as of December 31, 2010. In addition to the Settlement Payments, the defendants agreed to provide a full and complete release to Mr. Jones.

The Settlement Agreement contains mutual releases among the Company, its Chief Financial Officer and Mr. Jones, and pursuant to the Settlement Agreement, Mr. Jones agreed to dismiss the Complaint against the Company and its Chief Financial Officer with prejudice. On April 7, 2011 the Complaint was dismissed with prejudice by the Superior Court of the State of Washington for King County.

Note 14: Employment Agreements

On January 19, 2011, the Company signed an executive employment agreement (the "Employment Agreement") with Susan R. Taylor to serve as the Company's Corporate Secretary, Senior Vice President and General Counsel effective February 1, 2011. Pursuant to the Employment Agreement, Ms. Taylor is paid a base salary of $175,000 and was granted 225,000 options which are exercisable at $6.82 per share, the market price on the date of the grant, of which one third will vest annually on the subsequent three anniversary dates. If Ms. Taylor voluntarily terminates her employment with the Company, other than for Good Reason as defined in the Employment Agreement, she shall cease to accrue salary, personal time off, benefits and other compensation on the date of voluntary termination. The Company may terminate Ms. Taylor's employment with or without cause. If the Company terminates without cause, Ms. Taylor will be entitled to, at the Company's sole discretion, either (i) monthly salary payments for twelve (12) months, based on her monthly rate of base salary at the date of such termination, or (ii) a lump-sum payment of her salary for such 12 month period, based on her monthly rate of base salary at the date of such termination. Ms. Taylor shall also be entitled to receive (i) payment for accrued and unpaid vacation pay and (ii) all bonuses that have accrued during the term of the Employment Agreement, but not been paid. All non-vested options shall vest immediately.

On March 15, 2011, the Company signed an executive employment agreement (the "Employment Agreement") with Jerry Carollo to serve as the Company's Senior Vice President Business Development effective March 21, 2011. Pursuant to the Employment Agreement, Mr. Carollo is paid a base salary of $270,000 and was granted 100,000 options which are exercisable at $6.89 per share, the market price on the date of the grant, of which one third will vest annually on the subsequent three anniversary dates. If Mr. Carollo voluntarily terminates his employment with the Company, other than for Good Reason as defined in the Employment Agreement, he shall cease to accrue salary, personal time off, benefits and other compensation on the date of voluntary termination. The Company may terminate Mr. Carollo's employment with or without cause. If the Company terminates without cause, Mr. Carollo will be entitled to the lesser of (i) the total amount of base salary that remains unpaid under the Employment Agreement which shall be paid monthly or (ii) monthly salary payments for twelve (12) months, based on his monthly rate of base salary at the date of such termination, or in lieu of the aforementioned monthly payments, the Company may in its sole discretion pay such payments in a lump- sum. Mr. Carollo shall also be entitled to receive (i) payment for accrued and unpaid vacation pay and (ii) all bonuses that have accrued during the term of the Employment Agreement, but not been paid. All non-vested options shall vest immediately.

Note 15: Concentrations

For the three months ended March 31, 2011, approximately 74% of the company's net revenues were derived from customers in the United States and approximately 26% of the Company's net revenues were derived from international customers. For the three months ended March 31, 2010, approximately 62% of the company's net revenues were derived from customers in the United States and approximately 38% of the Company's net revenues were derived from international customers.

The following is a schedule of revenue by geographic location (in thousands):

	Three Months Ended March 31,	
	2011	2010
North America	$ 4,095	$ 3,716
Europe	532	1,490
Asia	814	721
Total	$ 5,441	$ 5,927

The Company purchases principally all of its silicon wafers from a single supplier located in Taiwan.

Note 16: Restatement

In this Amended 10-Q, eMagin restated its previously issued condensed consolidated financial statements as of and for the three months ended March 31, 2011 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 as of January 1, 2009, the Company recorded a warrant liability of $2.1 million, reduction in additional paid-in capital of $15.1 million and a reduction in accumulated deficit of $13.0 million. As of March 31, 2011, the Company computed the fair value of the warrant liability as $13.5 million, an increase of $0.7 million. The change in the warrant liability of $0.7 million was comprised of the change in the fair value of the warrants of $3.1 million offset by the fair value of the exercised warrants of $2.4 million. The change in the fair value from January 1, 2011 through March 31, 2011 of $3.1 million was recorded as other expense in the Condensed Consolidated Statements of Operations for the three months ended March 31, 2011. 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 March 31, 2011	Exercise Price	Warrant Expiration Dates	Fair Value of Warrants at January 1, 2011 (in thousands)	Fair Value of Warrants at March 31, 2011 (in thousands)
July 23, 2007	201,384	$ 1.03	July 21, 2011	$ 2,560	$ 1,205
July 23, 2007	1,000,000	$ 0.48	July 21, 2011	5,135	6,331
April 2, 2008	—	$ 1.13	April 2, 2013	347	—
December 22, 2008	1,000,000	$ 1.03	December 22, 2013	4,810	5,966
			Total Fair Value	$ 12,852	$ 13,502

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, 2011			$ 12,852
Change in fair value of warrants			3,057
Fair value of warrants exercised	326,665	July 23, 2007	(1,975)
Fair value of warrants exercised	72,116	April 2, 2008	(432)
Balance as of March 31, 2011			$ 13,502

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 March 31, 2011:

Condensed Consolidated Balance Sheet (in thousands)	March 31, 2011 (As previously reported)	March 31, 2011 (As restated)
Warrant liability	$ —	$ 7,536

Total current liabilities	5,211	12,597
Warrant liability	—	5,966
Total liabilities	$ 5,211	$ 18,563
Shareholders’ equity:		
Additional paid-in capital	$ 210,550	$ 209,664
Accumulated deficit	(182,345)	(194,961)
Total shareholders’ equity	$ 28,227	$ 14,725

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Condensed Consolidated Statements of Operations	Three Months Ended March 31, 2011	
(in thousands except share and per share data)	(As previously reported)	(As restated)
Change in fair value of warrant liability	$ —	$ (3,057)
Total other expense	$ (13)	$ (3,070)
Net loss	$ (282)	$ (3,339)
Loss per share, basic	$ (0.01)	$ (0.16)
Loss per share, diluted	$ (0.01)	$ (0.16)
Weighted average number of shares outstanding:		
Basic	21,522,716	21,522,716
Diluted	21,522,716	21,522,716

Condensed Consolidated Statements of Cash Flows	Three Months Ended March 31, 2011	
(in thousands)	(As previously reported)	(As restated)
Net loss	$ (282)	$ (3,339)
Loss from change in fair value of warrant liability	—	3,057
Net cash provided by operating activities	$ 797	$ 797

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.

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 March 31, 2011 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.

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 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, market, and produce in significant quantities full-color small molecule OLED-on-silicon microdisplays.

At March 31, 2011, we had a total of 81 full-time and part-time employees, an increase of 21% from December 31, 2010. The majority of the increase in headcount was due to the personnel needed for the additional production shifts. In April, we hired a design team, located in California, with experience working on OLED microdisplay designs to work internally on our research and development projects. Having an in-house design team reduces our dependence on third party design providers and will strengthen our ability to more cost-effectively develop new microdisplays.

A detailed discussion of our business may be found in Part I, “Business,” of our 2010 Annual Report on Form 10-K for the year ended December 31, 2010.

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. 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). 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.

Product Warranty

We offer a one-year product replacement warranty. In general, our standard policy is to repair or replace the defective products. We accrue for estimated returns of defective products at the time revenue is recognized based on historical activity as well as for specific known product issues. The determination of these accruals requires us to make estimates of the frequency and extent of warranty activity and estimate future costs to replace the products under warranty. If the actual warranty activity and/or repair and replacement costs differ significantly from these estimates, adjustments to cost of revenue may be required in future periods.

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 related to, among others, allowance for doubtful accounts, warranty reserves, inventory reserves, stock-based compensation expense, deferred tax asset valuation allowances, litigation and other loss contingencies. 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.

Fair Value of Financial Instruments

eMagin’s cash, cash equivalents, accounts receivable, short-term investments, and accounts payable are stated at cost which approximates fair value due to the short-term nature of these instruments. In addition, the long-term investments are stated at cost which approximates fair value.

Stock-based Compensation

eMagin maintains several stock equity incentive plans. The 2005 Employee Stock Purchase Plan (the “ESPP”) would, once implemented, provide our employees with the opportunity to purchase common stock through payroll deductions. Employees could then purchase stock semi-annually at a price that is 85% of the fair market value at certain plan-defined dates. As of March 31, 2011, the number of shares of common stock available for issuance was 300,000. As of March 31, 2011, the plan had not been implemented.

The 2003 Stock Option Plan (the"2003 Plan") provides for grants of shares of common stock and options to purchase shares of common stock to employees, officers, directors and consultants. Under the 2003 plan, an incentive stock option ("ISO") 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. For the three months ended March 31, 2011, there were 1,094,177 options granted from the 2003 plan.

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 months ended March 31, 2011, there were 200,000 options granted from the 2008 plan.

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.

Income Taxes

For the three months ended March 31, 2011, we recorded an income tax benefit of approximately $158 thousand as compared with an income tax expense of approximately $1 thousand for the three months ended March 31, 2010. The effective tax rate for 2011 is projected to be 36% as compared to an effective tax rate of 2% for 2010. The increase in the effective tax rate is due to the valuation allowance which had been carried against our net deferred tax asset in 2010.

In preparing our consolidated financial statements, we are required to estimate income taxes in each of the jurisdictions in which we operate. The process involves estimating our current tax expense together with assessing temporary differences resulting from the differing treatment of items for accounting and tax purposes. These differences result in deferred tax assets and liabilities. Operating losses and tax credits, to the extent not already utilized to offset taxable income also represent deferred tax assets. We must assess the likelihood that any deferred tax assets will be recovered from future taxable income, and to the extent we believe that recovery is not likely, we must establish a valuation allowance. Significant judgment is required in determining our provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against our deferred tax assets.

In determining future taxable income, assumptions are made to forecast operating income, the reversal of temporary timing differences and the implementation of tax planning strategies. Management uses significant judgment in the assumptions it uses to forecast future taxable income which are consistent with the forecasts used to manage the business. Realization of the deferred tax asset is dependent upon future earnings which there is uncertainty as to the timing. We will continue to monitor the realizability of the deferred tax asset.

At December 31, 2010, a partial valuation allowance against the net deferred tax assets was $32.4 million. There was no change to the valuation allowance as of March 31, 2011. The partial valuation allowance will be maintained until further sufficient positive evidence exists to support an additional reduction in the valuation allowance.

NEW ACCOUNTING PRONOUNCEMENTS

During the three months ended March 31, 2011, there were no new accounting pronouncements that would have had a material effect on our unaudited condensed consolidated financial statements.

RESULTS OF OPERATIONS

THREE MONTHS ENDED MARCH 31, 2011 COMPARED TO THREE MONTHS ENDED MARCH 31, 2010

Revenues

Revenues for the three months ended March 31, 2011 were approximately $5.4 million, as compared to approximately $5.9 million for the three months ended March 31, 2010, a decrease of approximately 8%. Lower revenue for the three month period was due primarily to production issues which caused R&D engineering resources to be allocated to production issues causing a shortfall in work on R&D contracts, and a lower average sales price due to product mix sold.

Product revenue is comprised of sales of displays, Z800 systems, and other hardware. For the three months ended March 31, 2011, product revenue decreased approximately $176 thousand or 4% as compared to the three months ended March 31, 2010. The decrease was driven by the product mix sold. We had an increase in sales volume

however the average sales price per display was lower than the first quarter of 2010. In addition, we had unfilled orders during the three months ended March 31, 2011 due to production issues.

Contract revenue is comprised of revenue from research and development or non-recurring engineering ("NRE") contracts. For the three months ended March 31, 2011, contract revenue decreased approximately $310 thousand or 22% as compared to the first quarter of 2010. We had more active contracts in the first quarter of 2011 however we allocated R&D engineering resources to our production issues which impacted contract revenue.

Cost of Goods Sold

Cost of goods sold is comprised of costs of product revenue and contract revenue. Cost of product revenue includes materials, labor and manufacturing overhead related to our products. Cost of contract revenue includes direct and allocated indirect costs associated with performance of contracts. Cost of goods sold for the three months ended March 31, 2011 was approximately $3.2 million as compared to approximately $2.6 million for the three months ended March 31, 2010, an increase of approximately $0.6 million. Cost of goods sold as a percentage of revenues was 59% for the three months ended March 31, 2011 as compared to 44% for the three months ended March 31, 2010. The increase in cost was due primarily to lower yield and increased labor costs due to additional production shifts. The lower yield was a result of production issues in Q1 2011. Subsequently, we have addressed the production issues and the yield has improved.

The following table outlines product, contract and total gross profit and related gross margins for the three months ended March 31, 2011 and 2010 (dollars in thousands):

	Three months ended March 31,	
	2011	2010
	(unaudited)	
Product revenue gross profit	$ 1,701	$ 2,641
Product revenue gross margin	39%	59%
Contract revenue gross profit	$ 545	$ 677
Contract revenue gross margin	48%	47%
Total gross profit	$ 2,246	$ 3,318
Total gross margin	41%	56%

The gross profit for the three months ended March 31, 2011 was approximately $2.2 million as compared to approximately $3.3 million for the three months ended March 31, 2010, a decrease of $1.1 million. Gross margin was 41% for the three months ended March 31, 2011 down from 56% for the three months ended March 31, 2010.

The product gross profit for the three months ended March 31, 2011 was approximately $1.7 million as compared to approximately $2.6 million for the three months ended March 31, 2010, a decrease of $0.9 million. Product gross margin was 39% for the three months ended March 31, 2011 down from 59% for the three months ended March 31, 2010. The gross margin was unfavorably impacted by an increase in costs due to production issues being spread over a lower revenue base and a lower effective average selling price per display due to product mix changes.

The contract gross profit for the three months ended March 31, 2011 was approximately $0.5 million as compared to approximately $0.7 million for the three months ended March 31, 2010, a decrease of $0.2 million. Contract gross margin was 48% for the three months ended March 31, 2011 up slightly from 47% for the three months ended March 31, 2010. The contract gross margin is dependent upon the mix of costs, internal versus external third party costs, with 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 months ended March 31, 2011 were approximately $0.5 million as compared to $0.7 million for the three months ended March 31, 2010, a decrease of approximately $0.2 million related to a decrease in internal research and development of new products.

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, 2011 were approximately $2.1 million as compared to approximately $1.7 million for the three months ended March 31, 2010. The increase of approximately $0.4 million for the three months ended March 31, 2011 was primarily related to an increase in personnel costs of $0.5 million including approximately $0.6 million related to non-cash compensation, recruiting fees of approximately $0.1 million offset by a reduction of bonus expense of approximately $0.2 million, and an increase in director and shareholder related expenses of approximately $0.1

million offset by a decrease in allowance for bad debts of approximately $0.1 and professional fees of $0.1 million.

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 the fair value of the warrant liability.

For the three months ended March 31, 2011, interest expense was approximately $29 thousand as compared to $28 thousand for the three months ended March 31, 2010. For the three months ended March 31, 2011, the interest expense associated with debt was $22 thousand and the accrued interest on liquidated damages was $7 thousand. Interest expense for the three months ended March 31, 2010, the interest expense associated with debt was $21 thousand and the accrued interest on liquidated damages was $7 thousand.

Other income for the three months ended March 31, 2011 was approximately $16 thousand as compared to $7 thousand for the three months ended March 31, 2010. The other income for the three months ended March 31, 2011 was interest income of approximately $4 thousand and $12 thousand from equipment salvage. The other income for the three months ended March 31, 2010 was interest income of approximately $1 thousand and $6 thousand from equipment salvage.

Change in Fair Value of Warrant Liability. In accordance with ASC 815, adopted January 1, 2009, certain warrants previously classified within equity were 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 March 31, 2011 and 2010 was measured by using the Monte Carlo Simulation model. The revaluation resulted in a charge of approximately $3.1 million for the three months ended March 31, 2011 as compared to a charge of approximately $9.5 million for the three months ended March 31, 2010. This revaluation resulted in non-cash changes to other income (expense) and had no impact on our cash balances, operations, or operating income.

Liquidity and Capital Resources

As of March 31, 2011, we had approximately $13.0 million of cash, cash equivalents, and investments in certificates of deposit ("CDs") as compared to $12.4 million at December 31, 2010. Of the $13.0 million in cash, approximately $5.3 million was invested in CDs.

Cash flow provided by operating activities during the three months ended March 31, 2011 was approximately $0.8 million, approximately $0.5 million was from the change in operating assets and liabilities and net non-cash expenses of approximately $3.6 million offset by the net loss of approximately $3.3 million. Cash flow provided by operating activities during the three months ended March 31, 2010 was approximately $1.5 million, approximately $0.3 million was from the change in operating assets and liabilities and net non-cash expenses of $9.8 million offset by the net loss of $8.6 million .

Cash used in investing activities during the three months ended March 31, 2011 was approximately $0.9 million of which $0.6 million purchased CDs and approximately $0.3 million for equipment purchases primarily for upgrading our production line. Cash used in investing activities during the three months ended March 31, 2010 was approximately $0.8 million to purchase equipment for the Company's production line.

Cash provided by financing activities during the three months ended March 31, 2011 was approximately was $0.1 million, representing proceeds from the exercise of stock options and warrants. There was no cash provided by or used by financing activities during the three months ended March 31, 2010.

Credit Facility

At March 31, 2011, we had a credit facility with Access Business Finance, LLC ("Access") that provides for up to a maximum amount of $3 million based on a borrowing base equivalent of 75% of eligible accounts receivable. The interest on the credit facility is equal to the Prime Rate plus 4% but may not be less than 7.25% with a minimum monthly interest payment of $5 thousand. The credit facility will automatically renew on September 1, 2011 for a one year term unless written notice is provided. We did not draw on our credit facility during the quarter ended March 31, 2011.

The credit facility contains the customary representations and warranties as well as affirmative and negative covenants. We were in compliance with all debt covenants as of March 31, 2011.

We expect our business to experience revenue growth which 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, investments 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 have to 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.

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ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

ITEM 4T. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934 (the "Exchange Act")) as of the end of the period covered by this Quarterly Report on Form 10-Q. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

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.

Changes in Internal Controls.

Except as stated above, there were no changes in our internal controls over financial reporting during the fiscal quarter ended March 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. Legal Proceedings

On March 17, 2010, Gary Jones, a former executive at the Company, filed a complaint for damages in the Superior Court of the State of Washington for King County (the "Complaint") against the Company and the Company's Chief Financial Officer. The Complaint alleges unspecified damages for failure to pay contractual payments and wages under Washington law ("the Washington Wage Claim") and includes, among other claims, breach of contract, breach of the duty of good faith and fair dealing, promissory estoppel and misrepresentation.

On May 21, 2010, the court granted eMagin's motion to dismiss regarding the claim for misrepresentation and the Washington Wage Claim. The Chief Financial Officer's motion to dismiss was also granted relating to the following claims against him: the Washington Wage Claims, breach of contract, breach of promises of specific treatment in specific circumstances, breach of the duty of good faith and fair dealing, and promissory estoppel.

On March 21, 2011, the Company executed a Settlement Agreement and Full and Complete Mutual Release (the "Settlement Agreement") among the Company, Mr. Jones and the Company's Chief Financial Officer, which had previously been executed by Mr. Jones and the Chief Financial Officer, and became effective on March 29, 2011 (the "Effective Date"). On April 5, 2011, pursuant to the Settlement Agreement, the Company made the following payments in the aggregate amount of $650 thousand: (i) payment to Mr. Jones in the gross amount of $478 thousand for payment amounts set forth in the Executive Separation and Consulting Agreement ("ECSA") and Expense Reimbursement and Compensation Schedule ("ERCS") entered into by Mr. Jones and the Company in January 2007; (ii) payment to Mr. Jones in the amount of approximately $27 thousand for a negotiated interest amount pursuant to the ECSA and ERCS; and (iii) approximately $145 thousand in attorney's fees paid to Mr. Jones' attorneys (collectively, the "Settlement Payments"). The settlement offer was recorded as a liability on the Company's Consolidated Balance Sheet and included in selling, general, and administrative expense on the Company's Consolidated Statements of Operations as of December 31, 2010. In addition to the Settlement Payments, the defendants agreed to provide a full and complete release to Mr. Jones.

The Settlement Agreement contains mutual releases among the Company, its Chief Financial Officer and Mr. Jones, and pursuant to the Settlement Agreement, Mr. Jones agreed to dismiss the Complaint against the Company and its Chief Financial Officer with prejudice. On April 7, 2011 the Complaint was dismissed with prejudice by the Superior Court of the State of Washington for King County.

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 /A for the year ended December 31, 2010. There were no material changes from the risk factors during the three months ended March 31, 2011.

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

Pursuant to various cashless warrant exercises, the Company issued 310,897 shares of common stock in the three months ended March 31, 2011. In addition, the Company received proceeds of approximately $81 thousand from the exercise of warrants and issued 72,116 shares of common stock in the three months ended March 31, 2011. In connection with the foregoing, the Company relied upon the exemption from securities registration afforded by Rule 506 of Regulation D as promulgated by the SEC under the Securities Act of 1933, as amended (the "Securities Act")

and/or Section 4(2) of the Securities Act. No advertising or general solicitation was employed in offering the securities.

ITEM 3. Defaults Upon Senior Securities

None.

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

None.

ITEM 5. Other Information

eMagin Corporation (the “Company”) has tentatively scheduled its 2011annual general meeting of shareholders (the “Annual Meeting”) to be held in September 2011.

On May 11, 2011, the Company set a record date of August 10, 2011 for the Annual Meeting.

The Annual Meeting is being held more than 30 days before the anniversary of the Company's prior annual meeting of shareholders for fiscal 2010 held on November 18, 2010. As a result of this change in the timing of the Company's annual meeting date, a notice deadline provided in the Company's Proxy Statement, dated October 26, 2010, under the heading "Stockholder Proposals for the 2011Annual Meeting" has changed.

If a shareholder intends to present any proposal for inclusion in the Company's proxy statement for the Annual Meeting in accordance with Rule 14a-8 promulgated under the Securities Exchange Act of 1934, as amended, for consideration at the Annual Meeting, the proposal must be received by the Secretary of the Company by no later than June 30, 2011. Such proposal must also meet the other requirements of the rules of the United States Securities and Exchange Commission relating to shareholders' proposals.

Notices should be addressed in writing to: Secretary, eMagin Corporation, 3006 Northup Way, Suite 103, Bellevue, WA 98004.

ITEM 6. Exhibits

31.1	Certification by Chief Executive Officer pursuant to Sarbanes Oxley Section 302 (1)
31.2	Certification by Chief 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)