EMAGIN CORP
Form 10QSB/A
April 12, 2005

U.S. Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-QSB/A

(Mark One)

[X] Quarterly report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended September 30, 2004
[ ] Transition report pursuant section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ____________ to ________________

eMAGIN CORPORATION
(Exact name of small business issuer as specified in its charter)

Commission file number: 000-24757

DELAWARE	56-1764501
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

2070 Route 52
Hopewell Junction, New York 12533
(Address of principal executive offices)

(845) 838-7900
(Issuer's telephone number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 [X] No [ ]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:
Not applicable

APPLICABLE ONLY TO CORPORATE REGISTRANTS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: As of November 4, 2004 the Registrant had 79,332,589 shares of Common Stock outstanding.

TRANSITIONAL SMALL BUSINESS DISCLOSURE FORMAT (check one): Yes [ ] No [X]

PRELIMINARY NOTE:

This Amended Quarterly Report on Form 10-QSB/A is being filed to correct the previously reported Consolidated Balance Sheets, Statements of Operations, Consolidated Statements of Cash Flows, Statement of Changes in Shareholders' Equity and Management's Discussion and Analysis to reflect the elimination of $594,568 of interest expense in relation to the re-pricing of warrants issued for the non-participation of investors and to reflect the reclassification of approximately $1.67 million of unamortized debt discount and deferred financing costs from additional paid-in-capital to interest expense in relation to the

March 3, 2004 debt conversion of approximately $8.567 million in principal and accrued interest. In connection with the preparation of the Company's annual report on Form 10-KSB for the year ended December 31, 2004, on March 21, 2005 the Company was advised by its independent registered public accounting firm that the re-pricing of the original warrants should be classified as an equity transaction and therefore no expense should be recorded in connection with the re-pricing of these warrants. On March 28, 2005, the Company was advised by its independent registered public accounting firm that unamortized debt discount and the deferred financing costs should be recorded as interest expense. In all other material respects, this Amended Quarterly Report on Form 10-QSB/A is unchanged from the Quarterly Report on Form 10-QSB previously filed by the Company on November 12, 2004.

PART I. FINANCIAL INFORMATION

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CERTIFICATION

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

eMAGIN CORPORATION
CONSOLIDATED BALANCE SHEETS

ASSETS	September 30, 2004	December 3 2003
	(Unaudited)	
CURRENT ASSETS:		
Cash and cash equivalents	$ 4,051,286	$ 1,053,8
Trade receivables, net	869,622	768,5
Unbilled costs and estimated profits on contracts in progress .	--	75,3
Inventory	1,457,907	275,4
Prepaid expenses and other current assets	617,064	287,9
Total current assets	6,995,879	2,461,1
EQUIPMENT AND LEASEHOLD IMPROVEMENTS:	3,827,649	3,350,9
Less: Accumulated depreciation	(2,604,631)	(2,149,9
Equipment and leasehold improvements, net	1,223,018	1,200,9
INTANGIBLE ASSETS	53,819	--
Less: Accumulated amortization	(1,378)	--
Intangible assets, net	52,441	--
OTHER LONG-TERM ASSETS	36,258	86,9
Total assets	$ 8,307,596	$ 3,749,0
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 736,284	$ 234,8
Accrued payroll and benefits	541,827	952,8
Other accrued expenses	211,967	988,5
Advanced payments	41,903	122,3
Current portion of long term debt	13,588	38,1
Other current liabilities	34,762	18,0
Total current liabilities	1,580,331	2,354,8
Capitalized lease obligations	25,887	36,2
Notes payable and short-term debt subsequently converted to equity	--	6,124,4

Total liabilities	1,606,218	8,515,5
SHAREHOLDERS' EQUITY (CAPITAL DEFICIENCY)		
Common Stock, par value $0.001 per share		
Shares authorized - 200,000,000		
Shares issued and outstanding - 66,257,590 and 42,695,412	66,258	42,6
Additional paid-in capital	152,715,263	131,598,9
Deferred compensation	--	(87,5
Accumulated deficit	(146,080,143)	(136,320,5
Total shareholders' equity (capital deficiency)	6,701,378	(4,766,5
Total liabilities and shareholders' equity	$ 8,307,596	$ 3,749,0

See selected notes to financial statements.

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eMAGIN CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30, 2004	Three Months Ended September 30, 2003	Nine Months Ended September 30, 20
REVENUE:			
Contract revenue	$ 108,000	$ 275,504	$ 108,0
Product revenue, net of returns	980,928	472,983	2,967,1
Total revenue	1,088,928	748,487	3,075,1
COST OF GOODS SOLD:			
Direct cost of goods sold	615,890	393,660	1,632,3
Indirect cost of goods sold	992,102	945,779	2,875,8
Total cost of goods sold	1,607,992	1,339,439	4,508,1
Gross Loss	(519,064)	(590,952)	(1,433,0
COSTS AND EXPENSES:			
Research and development	359,453	571	443,3
Stock based compensation	-	1,896,011	87,5
Selling, general and administrative	902,389	732,438	2,753,5
Total costs and expenses, net	1,261,842	2,629,020	3,284,4
Interest income (expenses)	26,007	(441,749)	(5,042,0
Gain on payable forgiveness	-	2,752,570	
Other income (expenses), net	26,007	2,310,821	(5,042,0

Net loss	$ (1,754,899)	$ (909,151)	$ (9,759,5
Basic and diluted loss per common share	$ (0.03)	$ (0.02)	$ (0.
Weighted average common shares outstanding	65,260,205	38,360,090	60,277,5

See selected notes to financial statements.

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eMAGIN CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months ended September 30, 2004	Nine Months ended September 30, 2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(9,759,565)	$(2,798,743)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	454,640	365,535
Amortization of intangibles	1,378	331,442
Amortization of financing fees	7,863	69,432
Bad debt expense	33,656	--
Non-cash charge for stock based compensation	87,565	2,095,407
Non-cash interest related charges	130,419	384,368
Non-cash charge for services received	8,400	443,252
Non-cash financing expense	4,955,186	103,899
Non-cash debt restructure	--	(4,637,993)
Changes in operating assets and liabilities:		
Trade receivables	(59,381)	(545,353)
Unbilled costs and estimated profits on contracts in progress	--	50,000
Inventory	(982,768)	(113,258)
Prepaid expenses and other current assets	(318,850)	(312,833)
Other long-term assets	(31,851)	61,960
Advanced payment on contracts to be completed	(80,459)	59,385
Deferred revenue	--	(29,900)
Accounts payable and accrued expenses	53,882	(560,665)
Other current liabilities	16,754	282,676
Net cash used in operating activities	(5,483,131)	(4,751,389)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of equipment	(476,175)	(880,572)
Net cash used in investing activities	(476,175)	(880,572)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from sales of common stock, net of issuance costs	3,916,536	--

Proceeds from exercise of stock options and warrants	5,078,423	986,054
Proceeds from long and short term debt	--	6,000,000
Payments for capital leases	(38,262)	--
Net cash provided by financing activities	8,956,697	6,927,676
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,997,391	1,295,715
CASH AND CASH EQUIVALENTS, beginning of period	1,053,895	82,951
CASH AND CASH EQUIVALENTS, end of period	$ 4,051,286	$ 1,378,666
Supplemental Cash Flow Disclosure:		
Conversion of debt to equity	$ 8,567,424	$ 4,845,537
Payments of A/P through issuance of stock	202,875	--
Stock issued for prepaid services	186,257	748,116
Cash payments of interest	5,172	--

See selected notes to financial statements.

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eMAGIN CORPORATION
STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (CAPITAL DEFICIENCY)

	Common Stock Shares	$	Deferred Compensation	Additional paid-in Capital
Balance, December 31, 2003	42,695,412	$ 42,694	$ (87,565)	$ 131,598,910
Conversion of debt to equity	11,394,621	11,395		8,556,029
Stock options exercised	5,221,052	5,221		1,379,263
Sale of equity	3,333,363	3,334		3,913,204
Issuance of warrants for debt conversion				3,180,000
Stock warrants exercised	3,358,691	3,359		3,690,581
Issuance of common stock for services	254,451	255		397,275
Amortization of deferred compensation			87,565	
Net loss for period				
Balance, September 30, 2004 (Unaudited)	66,257,590	$ 66,258	$ -	$ 152,715,263

See selected notes to financial statements.

eMAGIN CORPORATION
Selected Notes to Consolidated Financial Statements

Note 1 - ACCOUNTING POLICIES

Basis of Presentation

In the opinion of management, the accompanying unaudited interim financial information reflects all adjustments, consisting of normal recurring accruals, necessary for a fair presentation. Certain information and footnote disclosure normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles 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 interim condensed consolidated financial statements are read in conjunction with the audited consolidated financial statements contained in the company's Annual Report on Form 10-KSB for the year ended December 31, 2003. The results of operations for the period ended September 30, 2004 are not necessarily indicative of the results to be expected for the full year.

This Amended Quarterly Report on Form 10-QSB/A is being filed to reflect the elimination of $594,568 of interest expense in relation to the re-pricing of warrants issued for the non-participation of investors and to reflect the reclassification of approximately $1.67 million of unamortized debt discount and deferred financing costs from additional paid-in-capital to interest expense in relation to the March 3, 2004 debt conversion of approximately $8.567 million in principal and accrued interest.

Stock-Based Compensation Expense

The Company has elected to follow Accounting Principles Board Opinion No. 25 ("APB No. 25"), "Accounting for Stock Issued to Employees," and related interpretations in accounting for its employee stock options. Under APB No. 25, when the exercise price of employee stock options equals the market price of the underlying stock on the date of grant, no compensation expense is recorded. The Company discloses information relating to the fair value of stock-based compensation awards in accordance with Statements of Financial Accounting Standards No.123, "Accounting for Stock-Based Compensation" And No. 148 "Accounting for Stock-Based Compensation - Transition and Disclosure". The following table illustrates the effect on net loss and loss per share as if the Company had applied the fair value to all awards. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants in the third quarter of 2004 and 2003, respectively: (1) average expected volatility of 99% and 162%, (2) average risk-free interest rates of 3.79% and 3.74%, and (3) average expected lives of seven years.

The pro forma amounts that are disclosed reflect the portion of the fair value of awards that were earned for the three and nine months ended September 30, 2004 and 2003.

For the three and nine months ended September 30,	Three Months 2004	Three Months 2003	Nin

Net loss applicable to common stockholders, as reported	$ (1,754,899)	$ (909,151)	$ (9
Add: Stock based employee compensation expense included in reported net loss	-	-	
Deduct: Stock-based employee compensation expense determined under fair value method	(297,750)	(316)	(7
Pro forma net loss	$ (2,052,649)	$ (909,467)	$ (17
Net loss per share applicable to common stockholders:			
Basic and diluted, as reported	$ (0.03)	$ (0.02)	$
Basic and diluted, pro forma	$ (0.03)	$ (0.02)	$

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Note 2 - NATURE OF BUSINESS

We design and manufacture miniature display modules, which we refer to as OLED-on-silicon-microdisplays, primarily for incorporation into the products of other manufacturers. Microdisplays are typically smaller than a postage stamp, 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 them. Our technology permits OLEDs to be coated onto silicon chips to produce high resolution OLED-on-silicon microdisplays.

Note 3 - REVENUE AND COST RECOGNITION

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

The Company also earns revenues from certain of eMagin's 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. Amounts can typically be billed on a bi-monthly basis.

Note 4 - RECEIVABLES

The majority of our commercial accounts receivable are due from Original Equipment Manufacturers ("OEM"s). Credit is extended based on evaluation of a customers' 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 by considering a number of factors, including the length of time trade accounts receivable are past due, eMagin's previous loss history, the customer's current ability to pay its obligation, and the condition of the general economy and the industry as a whole. The Company writes off accounts receivable when they are deemed uncollectible.

Receivables consist of the following:

	September 30, 2004	December 31, 2003
Trade receivables	$ 1,161,689	$ 899,174
Contract receivables	194,951	173,809
Unbilled receivables	-	75,359
Total	1,356,640	1,148,342
Less allowance for doubtful accounts	(487,018)	(304,446)
Net receivables	$ 869,622	$ 843,896

Note 5 - RESEARCH AND DEVELOPMENT COSTS

Research and development costs are expensed as incurred.

Note 6 - NET LOSS PER COMMON SHARE

In accordance with SFAS No. 128, net loss per common share amounts ("basic EPS") and ("diluted EPS") were computed by dividing the net loss by the weighted average number of common shares outstanding, excluding any potential dilution. Common equivalent shares totaling 11,366,619 and 32,828,735 have been excluded from the computation of diluted EPS for the three and nine months ended September 30, 2004 and 17,304,028 and 19,091,435 have been excluded from the computation of diluted EPS for the three and nine months ended September 30, 2003, respectively as their inclusion would be antidilutive.

Note 7 - INVENTORIES

Inventory is stated at the lower of cost or market. Cost is determined using the first-in first-out method. The Company reviews the value of its inventory and reduces the inventory value to its net realized value based upon current market prices and contracts for future sales.

The components of inventories are as follows:

	September 30, 2004	December 31, 2003
Raw materials	$ 1,138,370	$ 20,416
Work in process	131,827	43,750
Finished goods	187,710	211,251
Total Inventory	$ 1,457,907	$ 275,417

Note 8 - DEBT

The debt consisted of the following:

	September 30, 2004	December 31, 2003
a Current portion of long term debt	$ 13,588	$ 38,184
b Restructuring Agreement and Original Secured Notes	-	6,124,451
c Long-term capitalized lease obligations	25,887	36,257
Total debt	$ 39,475	$ 6,198,892

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a) This amount represents the amount due to Citicorp Leasing over the next 12 months in lease payments for equipment.

b) In February 2004, we entered into an agreement whereby the holders of our Secured Convertible Notes (the "Notes"), which were due in November 2005, agreed to an early conversion of all of the $7.825 million principal amount of the Notes, together with the $742,424 of accrued interest on the Notes, into 11,394,621 shares of common stock of eMagin. On the date of the conversion the Company recorded, $1,598,335 in non-cash interest expense related to the unamortized debt discount and beneficial conversion feature and $74,637 in non-cash interest expense related to the writeoff of deferred financing costs.

In consideration of the Noteholders agreeing to the early conversion of the Notes, eMagin issued the Noteholders warrants to purchase an aggregate of 2.5 million shares of common stock (the "Warrants"), which Warrants are exercisable at a price of $2.76 per share. 1.5 million of the Warrants, "D warrants", are exercisable until December 31, 2005. The remaining 1.0 million of the Warrants, "E warrants", are exercisable until June 10, 2008. Using the Black Scholes method of valuating warrants, an expense totaling $3.18 million was recorded in interest expense in the first quarter of 2004 to record an estimated value for these warrants. The fair value of the warrants was estimated using the Black-Scholes option-pricing model with the following assumptions for the two sets of warrants: (1) average expected volatility of 100%, (2) average risk-free interest rates of 3.52%, (3) Fair Market Value of $2.30, (4) dividends of 0%, and (5) Average Term (in days) of 670 for the D warrants and 1,460 for the E warrants.

c) This amount is due to Citicorp Leasing as long-term debt for lease payments for equipment with this balance to be paid in 2005.

Note 9 - SHAREHOLDERS' EQUITY

The authorized common stock of the Company consists of 200,000,000 shares with a par value of $0.001 per share.

For the three months ended September 30, 2004, the Company received $1,926,795 for the exercise of 2,123,694 warrants. For the nine months ended September 30, 2004, the Company received a total of $5,078,424 for the exercise of 5,221,052 options and 3,358,690 warrants.

In August 2004, the Company and certain of the holders of its outstanding Class A, B and C common stock purchase warrants entered into an agreement pursuant to which the Company and the holders of the warrants agreed to the $0.90 re-pricing and exercise of Class A, B and C common stock purchase warrants. As a condition to the transaction, the holders of the warrants agreed to limit the right of participation that they were granted in January 9, 2004. As a result of the transaction, the holders agreed to re-price and exercise 2,099,894 Class A, B and/or C common stock purchase warrants, for an aggregate of $1,889,900.

The Company issued 162,412 and 254,451 shares of common stock for the payment of $219,457 and $397,531, respectively, for the three and nine months ended September 30, 2004, for services rendered and to be rendered in the future. As such, the Company recorded the fair value of the services rendered in selling, general and administrative expenses, services to be rendered as prepaid expenses and reduction of accounts payable for services previously rendered in the accompanying unaudited consolidated statements of operations.

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Note 10 - STOCK COMPENSATION

As of September 30, 2004, the Company has outstanding options to purchase 12,233,306 shares. In 2000 the Company issued options below fair market value. The Company recorded $87,565 in expense for the nine months ended September 30, 2004 for the amortization of those options. The transaction was fully amortized in the second quarter of 2004, so no additional expense will be recorded. The amount was recorded in Selling, General & Administrative expenses.

Note 11 - COMMITMENTS AND CONTINGENCIES

[a] Royalty payments:

The Company, in accordance with a royalty agreement, is obligated to make minimum annual royalty payments. Under this agreement, the Company must pay a certain percentage of net sales of 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 may be credited against the amounts due based on the percentage of sales. The royalty agreement terminates upon the expiration of the last-to-expire issued patent.

In the three and nine months ended September 30, 2004, $60,434 and $155,293 was recorded in royalty expense.

[b] Contractual obligations:

We currently lease space from IBM for $78,045 per month that houses our principal executive offices, our equipment for OLED microdisplay fabrication and research and development, as well as our assembly operations and storage. We currently occupy such space on a month-to-month basis. We are currently in negotiations with IBM for a new lease. No assurance can be given that we will execute a new lease, or that such new lease will be on terms that are favorable to us. In the event that we are forced to locate new space, we may experience a disruption in our operations, which could have a material adverse affect on our results of operations.

NOTE 12 - RECLASSIFICATIONS

Certain amounts in the September 30, 2003 financial statements have been reclassified to conform to the September 30, 2004 classification.

NOTE 13 - SUBSEQUENT EVENTS

On October 21, 2004, we entered into a Securities Purchase Agreement, pursuant to which we sold and issued 10,259,524 shares of common stock, par value $0. 001 per share, and series F common stock purchase warrants to purchase our common stock to purchasers for an aggregate purchase price of $10,772,500. The Common

Shares were priced at $1.05. The Common Shares and the shares underlying the warrants were drawn-down off of a shelf registration statement which was filed by us on May 5, 2004, and declared effective by the Securities and Exchange Commission on June 10, 2004. Net proceeds received after deducting expenses was approximately $9.75 million.

The Series F Warrants are exercisable from April 25, 2005 until April 25, 2010 to purchase up to 5,129,762 shares of common stock at an exercise price of $1.21 per share, subject to adjustment upon the occurrence of specific events, including stock dividends, stock splits, combinations or reclassifications of

our common stock or distributions of cash or other assets. In addition, the Series F Warrants contain provisions protecting against dilution resulting from the sale of additional shares of our common stock for less than the exercise price of the Series F Warrants, or the market price of the common stock, on the date of such issuance or sale.

On October 28, 2004, we entered into a Securities Purchase Agreement, pursuant to which we sold and issued 2,740,476 shares of common stock, par value $0. 001 per share, and series F common stock purchase warrants to purchase our common stock to purchasers for an aggregate purchase price of $2,877,500. The Common Shares were priced at $1.05. The Common Shares and shares underlying the warrants were drawn-down off of a shelf registration statement which was filed by us on May 5, 2004, and declared effective by the Securities and Exchange Commission on June 10, 2004. Net proceeds received after deducting expenses was approximately $2.65 million.

The Series F Warrants are exercisable from April 25, 2005 until April 25, 2010 to purchase up to 1,370,238 shares of common stock at an exercise price of $1.21 per share, subject to adjustment upon the occurrence of specific events, including stock dividends, stock splits, combinations or reclassifications of our common stock or distributions of cash or other assets. In addition, the Series F Warrants contain provisions protecting against dilution resulting from the sale of additional shares of our common stock for less than the exercise price of the Series F Warrants, or the market price of the common stock, on the date of such issuance or sale.

We paid a Placement Agent a fee equal to 6% of the gross proceeds of these offerings and agreed to reimburse them for reasonable expenses up to $50,000, incurred in connection with the offerings.

In addition, we engaged Larkspur Capital Corporation to act as an adviser in connection with the sale of these securities. For such services, we paid Larkspur Capital Corporation a fee equal to 1% of the gross proceeds of these offerings (see Note - 14).

As a result of the above transaction, the outstanding Series A Common Stock Purchase Warrants that were issued to participants of the Securities Purchase Agreement dated January 9, 2004 were re-priced from $1.74 to $1.05.

Note 14 - RELATED PARTY TRANSACTIONS

Paul Cronson, a member of our board of directors, is a founder and shareholder of Larkspur Capital Corporation which was engaged as advisor in connection with the sale of the securities listed above.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

Statement of Forward-Looking Information

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential" or "continue," the negative of such terms, or other comparable terminology. These statements are only predictions. Actual events or results may differ materially from those in the forward-looking statements as a result of various important factors. Although we believe that the expectations reflected in the forward-looking statements are reasonable, such should not be regarded as a representation by the Company, or any other person, that such forward-looking statements will be achieved. The business and operations of the Company are subject to substantial risks, which increase the uncertainty inherent in the forward-looking statements contained in this release.

We undertake no duty to update any of the forward-looking statements, whether as a result of new information, future events or otherwise. Readers are cautioned not to place undue reliance on the forward-looking statements contained in this report.

Overview

We design and manufacture miniature display modules, which we refer to as OLED-on-silicon-microdisplays, primarily for incorporation into the products of other manufacturers. Microdisplays are typically smaller than a postage stamp, 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 them. Our technology permits OLEDs to be coated onto silicon chips to produce high resolution OLED-on-silicon microdisplays.

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

Since our inception in 1996, we derived substantially all of our revenues from fees paid to us under research and development contracts, primarily with the U.S. government. We have devoted significant resources to the development and commercial launch of our products. We commenced limited initial sales of our SVGA+ microdisplay in May 2001 and commenced shipping samples of our SVGA-3D microdisplay in February 2002. As of September 30, 2004, we have recognized approximately $7.3 million from sales of our products, and have a backlog of approximately $35 million in products ordered for delivery through 2007. These products are being applied or considered for near-eye and headset applications in products such as entertainment and gaming headsets, handheld Internet and telecommunication appliances, viewfinders, and wearable computers to be manufactured by original equipment manufacturer (OEM) customers. In addition to marketing OLED-on-silicon microdisplays as components, we also offer microdisplays in an integrated package, which we call Microviewer, which includes a compact lens for viewing the microdisplay and electronic interfaces to convert the signal from our customer's product into a viewable image on the microdisplay. Through our wholly owned subsidiary, Virtual Vision, Inc., we are also developing head-wearable displays that incorporate our Microviewer.

We license our core OLED technology from Eastman Kodak and we have developed our own technology to create high performance OLED-on-silicon microdisplays and related optical systems. We believe our technology licensing agreement with Eastman Kodak, coupled with our own intellectual property portfolio, gives us a leadership position in OLED and OLED-on-silicon microdisplay technology. We are the only company to demonstrate publicly and offer commercially full-color OLED-on-silicon microdisplays.

Company History

Our history has been as a developmental stage company. As of January 1, 2003, we are no longer a development stage Company. We have transitioned to manufacturing our product and intend to significantly increase our marketing, sales, and research and development efforts, and expand our operating infrastructure. If we are unable to generate significant revenues, our net losses in any given period could increase and we may be forced to reduce our expenses or operations.

CRITICAL ACCOUNTING POLICIES

The Securities and Exchange Commission ("SEC") defines "critical accounting policies" as those that require application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods.

Not all of the accounting policies require management to make difficult, subjective or complex judgments or estimates. However, the following policies could be deemed to be critical within the SEC definition.

Revenue Recognition

Revenue on product sales is recognized when persuasive evidence of an arrangement exists, such as when a purchase order or contract is received from the customer, the price is fixed, title 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. Revenue is recognized at shipment and we record a reserve for estimated sales returns, which is reflected as a reduction of revenue at the time of revenue recognition.

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. Amounts can be billed on a bi-monthly basis. Billing is based on subjective cost investment factors.

Results of Operations

THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2004 COMPARED TO THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2003

Revenues

Revenues for the three and nine months ended September 30, 2004 were $1.1 million and $3.1 million, respectively as compared to $0.7 million and $1.5

million for the three and nine months ended September 30, 2003, an increase of 45% and 102%, respectively. The increase in revenue resulted from increased unit volume to the Company's current customer base. Unit pricing was relatively unchanged in 2004 as compared to 2003. We currently have firm orders or letters of intent to purchase our products at significantly higher volume levels than we have experienced historically. In order to realize revenue from these orders, we will be required to increase unit production levels and the amount of capital committed to pre-payments of raw materials and finished goods. The critical raw materials in the manufacture of our products are silicon wafers used to create our OLED microdisplays and lenses used in assembly of our subsystems. Both of these items require significant cash pre-payments and can take up to six months for delivery once ordered. While we anticipate that our revenues will increase in the future, we can not reliably estimate when and by how much until predictable raw material delivery is established or increased levels of these materials are held in inventory.

Cost of Goods Sold. Cost of goods sold includes direct and indirect costs associated with production and inventory loss. Cost of goods sold for the three and nine months ended September 30, 2004 were $1.6 million and $4.5 million, respectively, as compared to $1.3 million and $3.5 million for the three and nine months ended September 30, 2003. The $0.3 million and $1.0 million increase, respectively, in costs was directly related to higher unit volumes in 2004 as compared to 2003. However, our gross loss percentage during the 2004 periods has been reduced significantly due to volume and operating efficiencies created as we increased production.

We currently record all expenses associated with manufacturing in cost of goods sold. The full facility overhead as well as the expense of indirect materials is matched against our units sold. While our production volume is low, the gross margin reflects the costs that will be absorbed when quantities increase.

Costs and Expenses

Research and Development. Research and development expenses included salaries, development materials and other costs specifically allocated to the development of new products. Research and development expenses were $359 thousand and $443 thousand for the three months and nine months ended September 30, 2004, respectively, as compared to $600 and $22,000 for the three and nine months ended September 30, 2003. The increase was a result of new OLED microdisplay and subsystem development initiatives. We currently anticipate that research and development expenses will increase over the coming quarters as these projects progress.

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, amortization, as well as other marketing and administrative expenses. Selling, general and administrative expenses were $0.9 million and $2.8 million for the three and nine months ended September 30, 2004, respectively, as compared to $0.7 million and $2.6 million for the three and nine months ended September 30, 2003. The increase of $0.2 million in the three months ended September 30, 2004 as compared to the three months ended September 30, 2003 is primarily due to relocation expenses associated with staff relocating to Washington State. The increase of $0.1 million in the nine months ended September 30, 2004 as compared to the nine months ended September 30, 2003 is primarily due to the same factors. We currently anticipate that selling, general and administrative expenses will increase over the coming quarters as we hire additional sales and support staff.

Other Income (Expense). Other income (expense) for the three and nine months ended September 30, 2004 were $26 thousand and ($5) million, respectively, as compared to $(0.4) million and $(0.7) million for the three and nine months ended September 30, 2003. The $0.4 million decrease in interest expense for the

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three months ended September 30, 2004 as compared to the three months ended September 30, 2003 was due to the elimination of approximately $7.825 million of Notes Payable during the first quarter of 2004 and the associated interest expense related to this debt that was no longer recorded in 2004. The increase in interest expense for the nine months ended September 30, 2004 was attributable to three factors; (1) $3.18 million of non-cash charges related to the value of the warrants issued to induce the holders of the $7.825 million in Notes to agree to an early conversion of the Notes into common stock, (2) $1,598,325 in non-cash charges related to the remaining unamortized debt discount and beneficial conversion feature associated with the aforementioned Notes, and (3) $74,637 in non-cash charges related to the write-off of the remaining unamortized deferred financing costs. Gain on Payable Forgiveness was a result of restructuring our debt in 2003.

Liquidity and Capital Resources

Current Financial Position

We have total liabilities and contractual obligations of $2,250,089 as of September 30, 2004. These contractual obligations, along with the dates on which such payments are due, are described below:

Contractual Obligations	Total	One Year or Less	More than One
Royalties	$ 531,250	$ 125,000	$ 406,250
Operating leases	110,892	110,892	-
Capital leases	47,461	18,372	29,089
Total contractual obligations	$ 689,603	$ 254,264	$ 435,339

As mentioned in Note 13 - Subsequent Events, in October and November of 2004 we completed direct equity placements of common stock and warrants that resulted in net proceeds after expenses of $12.4 million. These funds significantly strengthen our liquidity and capital resources and will be used in part to fund the working capital requirements discussed above.

Assuming we are able to increase our revenue, we anticipate that we will continue to experience growth in our operating expenses for the foreseeable future and that our operating expenses will be the principal use of our cash. In particular, we expect that salaries for employees engaged in production operations, purchase of inventory, funding of receivables and expenses of increased sales and marketing efforts would be the principle uses of cash. We expect that our cash requirements over the next 12 months will be met by a combination of cash on hand, which, as of September 30, 2004 was $4.1 million, additional financing, the exercise of outstanding options and warrants, and revenues generated by operations.

We have purchase agreements for approximately $35 million of our products to be delivered now through 2007. Management believes that the prospects for growth of product revenue remain high.

Scheduled deliveries against our purchase agreements and other customer requirements are subject to change depending on a number of factors including, our production capacity which is heavily dependant on predictable silicon wafer and lens delivery from our suppliers, our customers' production timing of related systems into which they are integrating our products and their other supplier schedules, changes in the expected procurement periods for military programs and the requirements of the individual agreements and contracts that we have with our customers. We currently anticipate the need to ramp our supplies and staffing quickly and efficiently to be prepared to meet the currently anticipated shipping schedules, which will require significant added effort and capital.

Our cash requirements depend on numerous factors, including new product development activities, ability to commercialize our products, timely market acceptance of our products and our customers' products, and other factors. We expect to carefully devote capital resources to continue our development programs directed at commercializing our products in our target markets, hire and train additional staff, expand our research and development activities, and develop and expand our manufacturing capacity.

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Any delays could change the cash requirements of the company. While we believe that we are in position to handle the anticipated production increase, there can be no assurance that we will not experience some issues relating to raw material availability, yield and throughput risk that could result in product shipment delays to customers.

Factors Which May Affect Future Results

In evaluating our business, prospective investors and shareholders should carefully consider the risks factors, any of which could have a material adverse impact on our business, operating results and financial condition and result in a complete loss of your investment.

We remain subject to the American Stock Exchange's review regarding our compliance with their continued listing requirements.

The AMEX staff notified us in June 2003 that we had fallen below Section 1003(a)(i) of the AMEX Company Guide for having shareholders' equity of less than $2,000,000 and losses from continuing operations and/or net losses in two out of the three most recent fiscal years. We were afforded the opportunity to submit a plan of compliance to the AMEX and presented a plan to the AMEX in July 2003. On September 9, 2003, we received notice from the staff of the AMEX that the AMEX had accepted our plan to regain compliance with AMEX's continued listing standards and granted us an extension until December 4, 2004 to regain compliance with those standards.

As a result of our financing activity throughout 2004 and the conversion of our outstanding promissory notes in March 2004, our balance sheet as of September 30, 2004 and our anticipated balance sheet at December 31, 2004 will meet AMEX's $2 million shareholder equity requirement.

While we anticipate that AMEX will notify us that we have regained compliance with their continued listing standards, we have not yet received such notification. Other unidentified issues may arise in the future that could adversely affect the financial or the potential listing status of the company.

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

Accumulated net losses as of September 30, 2004, were $(146) million, the majority of which was related to the March 2000 merger and the subsequent write-down of goodwill. The non-cash losses were dominated by the amortization and write-down of goodwill and purchased intangibles and write-down of acquired in-process research and development related to the March 2000 acquisition, and also included some non-cash stock-based compensation. We have not yet achieved profitability and we can give no assurances that we will achieve profitability within the foreseeable future as we fund our operations and capital expenditures in areas such as establishment and expansion of markets, sales and marketing, operating equipment and research and development. We cannot assure investors that we will ever achieve or sustain profitability or that our operating losses will not increase in the future.

We were previously primarily dependent on U.S. government contracts.

For many years the majority of our revenues were derived from research and development contracts with the U.S. government. We no longer rely on such contracts for revenue. We plan to submit proposals for additional development contract funding; however, funding is subject to legislative authorization and even if funds are appropriated such funds may be withdrawn based on changes in government priorities. No assurances can be given that we will be successful in obtaining new government contracts. Our inability to obtain revenues from government contracts could have a material adverse effect on our results of long-term operations, unless substantial product or non-government contract revenue offsets any lack of government contract revenue.

Risks related to our intellectual property

We rely on our license agreement with Eastman Kodak for the development of our products. Eastman Kodak's licensing of its OLED technology to others for microdisplay applications, or the sublicensing by Eastman Kodak of our OLED technology to third parties, could have a material adverse impact on our business.

Our principal products under development utilize OLED technology that we license from Eastman Kodak. We rely upon Eastman Kodak to protect and enforce key patents held by Eastman Kodak, relating to OLED display technology. Eastman Kodak's patents expire at various times in the future from near term in 2004 through long term patents that are just being issued in 2004. Our license with Eastman Kodak could terminate if we fail to perform any material term or covenant under the license agreement. Since our license from Eastman Kodak is non-exclusive, Eastman Kodak could also elect to become a competitor itself or to license OLED technology for microdisplay applications to others who have the potential to compete with us. The occurrence of any of these events could have a material adverse impact on our business.

We may not be successful in protecting our intellectual property and proprietary rights.

We rely on a combination of patents, trade secret protection, licensing agreements and other arrangements to establish and protect our proprietary technologies. If we fail to successfully enforce our intellectual property rights, our competitive position could suffer, which could harm our operating results. Patents may not be issued for our current patent applications, third parties may challenge, invalidate or circumvent any patent issued to us, unauthorized parties could obtain and use information that we regard as proprietary despite our efforts to protect our proprietary rights, rights granted under patents issued to us may not afford us any competitive advantage, others may independently develop similar technology or design around our patents, our technology may be available to licensees of Eastman Kodak, and protection of our intellectual property rights may be limited in certain foreign countries. We may be required to expend significant resources to monitor and police our intellectual property rights. Any future infringement or other claims or prosecutions related to our intellectual property could have a material adverse effect on our business. Any such claims, with or without merit, could be time consuming to defend, result in costly litigation, divert management's attention and resources, or require us to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us, if at all. Protection of intellectual property has historically been a large expense for eMagin. We have not been in a financial position to properly protect all of our intellectual property, and may not be in a position to properly protect our position or stay ahead of competition in new research and the protecting of the resulting intellectual property.

Risks related to the microdisplay industry

The commercial success of the microdisplay industry depends on the widespread market acceptance of microdisplay systems products.

The market for microdisplays is emerging. Our success will depend on consumer acceptance of microdisplays as well as the success of the commercialization of the microdisplay market. As an OEM supplier, our customer's products must also be well accepted. At present, it is difficult to assess or predict with any assurance the potential size, timing and viability of market opportunities for our technology in this market. The viewfinder microdisplay market sector is well established with entrenched competitors with whom we must compete.

The microdisplay systems business is intensely competitive.

We do business in intensely competitive markets that are characterized by rapid technological change, changes in market requirements and competition from both other suppliers and our potential OEM customers. Such markets are typically characterized by price erosion. This intense competition could result in pricing pressures, lower sales, reduced margins, and lower market share. Our ability to compete successfully will depend on a number of factors, both within and outside our control. We expect these factors to include the following:

- our success in designing, manufacturing and delivering expected new products, including those implementing new technologies on a timely basis;
- our ability to address the needs of our customers and the quality of our customer services;
- the quality, performance, reliability, features, ease of use and pricing of our products;
- successful expansion of our manufacturing capabilities;
- our efficiency of production, and ability to manufacture and ship products on time;

- the rate at which original equipment manufacturing customers incorporate our product solutions into their own products;
- the market acceptance of our customers' products; and
- product or technology introductions by our competitors.

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

The display industry is cyclical.

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

Competing products may get to market sooner than ours.

Our competitors are investing substantial resources in the development and manufacture of microdisplay systems using alternative technologies such as reflective liquid crystal displays (LCDs), LCD-on-Silicon ("LCOS") microdisplays, active matrix electroluminescence and scanning image systems, and transmissive active matrix LCDs. Some of these products have been introduced years ahead of our products and some are established in segments of the microdisplay and virtual imaging markets that we have yet to enter. Displacing entrenched competitors may be difficult, especially in long-term projects or products, even if our product proves itself to be better.

Our competitors have many advantages over us.

As the microdisplay market develops, we expect to experience intense competition from numerous domestic and foreign companies including well-established corporations possessing worldwide manufacturing and production facilities, greater name recognition, larger retail bases and significantly greater financial, technical, and marketing resources than us, as well as from emerging companies attempting to obtain a share of the various markets in which our microdisplay products have the potential to compete.

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Our products are subject to lengthy OEM development periods.

We plan to sell most of our microdisplays and related products to OEMs who will incorporate them into or with products they sell. OEMs determine during their product development phase whether they will incorporate our products. The time elapsed between initial sampling of our products by OEMs, the custom design of our products to meet specific OEM product requirements, and the ultimate incorporation of our products into OEM consumer products is significant. If our products fail to meet our OEM customers' cost, performance or technical requirements or if unexpected technical challenges arise in the integration of our products into OEM consumer products, our operating results could be significantly and adversely affected. Long delays in achieving customer qualification and incorporation of our products could adversely affect our business.

Our products will likely experience rapidly declining unit prices.

In the markets in which we expect to compete, prices of established products tend to decline significantly over time. In order to maintain our profit margins over the long term, we believe that we will need to continuously develop product enhancements and new technologies that will either slow price declines of our products or reduce the cost of producing and delivering our products. While we anticipate many opportunities to reduce production costs over time, there can be no assurance that these cost reduction plans will be successful. We may also attempt to offset the anticipated decrease in our average selling price by introducing new products, increasing our sales volumes or adjusting our product mix. If we fail to do so, our results of operations would be materially and adversely affected.

Risks related to manufacturing

We expect to depend on semiconductor contract manufacturers to supply our silicon integrated circuits and other suppliers of key components, materials and services.

We do not manufacture the silicon integrated circuits on which we incorporate our OLED technology. Instead, we provide the design layouts to semiconductor contract manufacturers who manufacture the integrated circuits on silicon wafers. We also depend on suppliers of a variety of other components and services, including circuit boards, graphic integrated circuits, passive components, materials and chemicals, and equipment support. Our inability to obtain sufficient quantities of high quality silicon integrated circuits or other necessary components, materials or services on a timely basis has resulted in delays and could result in future manufacturing delays, increased costs and ultimately in reduced or delayed sales or lost orders which could materially and adversely affect our operating results.

The manufacture of OLED-on-silicon is new and OLED microdisplays have not been produced in significant quantities.

If we are unable to produce our products in sufficient quantity, we will be unable to attract customers. In addition, we cannot assure you that once we commence volume production we will attain yields of throughput that will result in profitable gross margins or that we will not experience manufacturing problems which could result in delays in delivery of orders or product introductions.

We are dependent on a single manufacturing line.

We initially expect to manufacture our products on a single manufacturing line. If we experience any significant disruption in the operation at our manufacturing facility or a serious failure of a critical piece of equipment, we may be unable to supply microdisplays to our customers. For this reason, some OEMs may also be reluctant to commit a broad line of products with our microdisplays without a second production facility in place. Interruptions in our manufacturing could be caused by manufacturing equipment problems, the

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introduction of new equipment into the manufacturing process or delays in the delivery of new manufacturing equipment. Lead-time for delivery of manufacturing equipment can be long. No assurance can be given that we will not lose potential sales or be able to meet sales orders delivery requirements due to production interruptions in our manufacturing line. In order to meet the requirements of certain OEMs for multiple manufacturing sites, we will have to expend capital to secure additional sites and may not be able to manage multiple sites successfully.

We currently lease space from IBM on a month-to-month basis.

We currently lease space from IBM that houses our principal executive offices, our equipment for OLED microdisplay fabrication and research and development, as well as our assembly operations and storage. We currently occupy such space on a month-to-month basis. We are currently in negotiations with IBM for a new lease. No assurance can be given that we will execute a new lease, or that such new lease will be on terms that are favorable to us. In the event that we are forced to locate new space, we will experience a disruption in our operations, which could have a material adverse affect on our results of operations.

Risks related to our business

Our success depends on attracting and retaining highly skilled and qualified technical and consulting personnel.

We must hire highly skilled technical personnel as employees and as independent contractors in order to develop our products. The competition for skilled technical employees is intense and we may not be able to retain or recruit such personnel. We must compete with companies that possess greater financial and other resources than we do, and that may be more attractive to potential employees and contractors. To be competitive, we may have to increase the compensation, bonuses, stock options and other fringe benefits offered to employees in order to attract and retain such personnel. The costs of retaining or attracting new personnel may have a material adverse affect on our business and operating results. In addition, difficulties in hiring and retaining technical personnel could delay the implementation of our business plan.

Our success depends in a large part on the continuing service of key personnel.

Changes in management could have an adverse effect on our business. We are dependent upon the active participation of several key management personnel, including Gary W. Jones, our chief executive officer. This is especially an issue while the company staffing is small. We will also need to recruit additional management in order to expand according to our business plan. The failure to attract and retain additional management or personnel could have a material adverse effect on our operating results and financial performance.

Our business depends on new products and technologies.

The market for our products is characterized by rapid changes in product, design and manufacturing process technologies. Our success depends to a large extent on our ability to develop and manufacture new products and technologies to match the varying requirements of different customers in order to establish a competitive position and become profitable. Furthermore, we must adopt our products and processes to technological changes and emerging industry standards and practices on a cost-effective and timely basis. Our failure to accomplish any of the above could harm our business and operating results.

We generally do not have long-term contracts with our customers.

Our business is operated on the basis of short-term purchase orders and we cannot guarantee that we will be able to obtain long-term contracts for some time. Such purchase orders can be cancelled or revised without penalty, depending on the circumstances. In the absence of a backlog of orders that can only be canceled with penalty, we plan production on the basis of internally generated forecasts of demand, which makes it difficult to accurately forecast revenues. If we fail to accurately forecast operating results, our business may suffer and the value of your investment in the Company may decline. Large, long-term supply line commitments and large inventories of various types of displays and other products will be required to support our business and provide reasonable order turn around for customers. Potentially enabling rapid sales growth targets can greatly increase the cash requirement for these accounts. Such supplies and inventories are subject to potential obsolescence, long delays before sale, and potential damage or loss.

Our business strategy may fail if we cannot continue to form strategic relationships with companies that manufacture and use products that could incorporate our OLED-on-silicon technology.

Our prospects will be significantly affected by our ability to develop strategic alliances with OEMs for incorporation of our OLED-on-silicon technology into their products. While we intend to continue to establish strategic relationships with manufacturers of electronic consumer products, personal computers, chipmakers, lens makers, equipment makers, material suppliers and/or systems assemblers, there is no assurance that we will be able to continue to establish and maintain strategic relationships on commercially acceptable terms, or that the alliances we do enter into will realize their objectives. Failure to do so would have a material adverse effect on our business.

Our business depends to some extent on international transactions.

We purchase needed materials from companies located abroad and may be adversely affected by political and currency risk, as well as the additional costs of doing business with a foreign entity. Some customers in other countries have longer receivable periods. In addition, many of the OEMs that are the most likely long-term purchasers of our microdisplays are located abroad exposing us to additional political and currency risk. We may find it necessary to locate manufacturing facilities abroad to be closer to our customers which could expose us to various risks, including management of a multi-national organization, the complexities of complying with foreign laws and customs, political instability and the complexities of taxation in multiple jurisdictions.

Our business may expose us to product liability claims.

Our business may expose us to product liability claims. Although no such claims have been brought against us to date, and to our knowledge no such claim is threatened or likely, we may face liability to product users for damages resulting from the faulty design or manufacture of our products. While we plan to maintain product liability insurance coverage, there can be no assurance that product liability claims will not exceed coverage limits, fall outside the scope of such coverage, or that such insurance will continue to be available at commercially reasonable rates, if at all.

Our business is subject to environmental regulations and possible liability arising from governmental claims related to the disposal of hazardous substances and/or potential employee claims of exposure to harmful substances used in the development and manufacture of our products.

We are subject to various governmental regulations related to toxic, volatile, experimental and other hazardous chemicals used in, and disposed of in connection with, our design and manufacturing process. Our failure to comply with these regulations could result in the imposition of fines or in the suspension or cessation of our operations. Compliance with these regulations could require us to acquire costly equipment or to incur other significant expenses. We develop, evaluate and utilize new chemical compounds in the manufacture of our products. While we attempt to ensure that our employees are protected from exposure to hazardous materials, we cannot assure you that potentially harmful exposure will not occur or that we will not be liable to employees as a result.

Risks related to our stock

The substantial number of shares that are or will be eligible for sale could cause our common stock price to decline even if the company is successful.

Sales of significant amounts of common stock in the public market, or the perception that such sales may occur, could materially affect the market price of our common stock. These sales might also make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate. As of September 30, 2004, we had outstanding (i) options to purchase 12,233,306 shares; and (ii) warrants to purchase 15,602,078 shares of common stock.

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ITEM 3: Controls and Procedures

As of September 30, 2004, an evaluation was performed by our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2004. There have been no significant changes in our internal controls subsequent to September 30, 2004.

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PART II - OTHER INFORMATION

Item 1. Legal Proceedings

The company is party to certain legal proceedings arising in the ordinary course of business. In the opinion of management, the outcome of such legal matters will not have a material adverse effect on the company's results of operations or financial position.

Item 2. Changes in 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 and Reports on Form 8-K

(a) Exhibits List

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

(b) Reports on Form 8-K

The Company filed one report on form 8-K during the quarter ended September 30, 2004. Information regarding the items reported on is as follows:

DATE OF REPORT	ITEM REPORTED ON
August 9, 2004	eMagin Corporation ("eMagin"), and certain holders of its outstanding Class A, B, and C common stock purchase warrants entered into an agreement pursuant to which the company and the holders of the warrants agreed to the re-pricing and exercise of warrants.

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SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

eMAGIN CORPORATION

Dated: April 11, 2005

/s/ Gary W. Jones

Gary W. Jones
Chief Executive Officer

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