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EMAGIN CORP
Form 10-K/A
May 06, 2003

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K/A

(Mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002.

OR

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

Commission File No. 000-24757

eMagin Corporation

(Exact name of registrant as specified in its charter)

Delaware 56-1764501

(State or other jurisdiction of incorporation or organization
and I.R.S. Employer Identification No.)

eMagin

2070 Route 52
Hopewell Junction, New York 12533

(Address of principal executive offices) (Zip Code)

(845) 892-1900

(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, \$0.001 par value

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 No

The aggregate market value of the voting stock held by non-affiliates of the Registrant as of April 28, 2003 was approximately \$19.1 million, based upon the closing sales price of the Registrant's common stock as quoted on the AMEX. The number of shares outstanding of the Registrant's common stock as of April 28, 2003 was 35,961,223.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the

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best of the Registrant's knowledge, in definitive proxy or information statements incorporated in Part III of this Form 10-K or any amendment to this Form 10-K. / /

PRELIMINARY NOTE:

This Amended Annual Report on Form 10-K/A is being filed to report (i) updates to the Security Ownership of Certain Beneficial Owners and Management reported in Item 12 of the Amended Annual Report on Form 10-K/A previously filed by the Company on May 2, 2003 resulting primarily from the recent financing completed by the Company, as well as from information subsequently provided to the Company from certain of its beneficial owners, and (ii) certain other information relating to the Company's improved financial situation resulting from such financing. In all other material respects, this Amended Annual Report on Form 10-K/A is unchanged from the 2002 Annual Report on Form 10-K previously filed by the Company on April 15, 2003, and the Amended Annual Report on Form 10-K/A previously filed by the Company on May 2, 2003.

FORM 10-K/A
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2002

INDEX

PART I

Item 1: Description of Business
Item 2: Description of Property
Item 3: Legal Proceedings
Item 4: Submission of Matters to a Vote of Security Holders

PART II

Item 5: Market for the Registrant's Common Equity and Related Shareholder Matters
Item 6: Selected Financial Data
Item 7: Management's Discussion and Analysis of Financial Conditions and Results of Operations
Item 7A: Quantitative and Qualitative Disclosures About Market Risk
Item 8: Financial Statements
Item 9: Changes in and Disagreements with Accountants on Accounting and Financial Disclosures

PART III

Item 10: Directors and Executive Officers of the Registrant
Item 11: Executive Compensation
Item 12: Security Ownership of Certain Beneficial Owners and Management
Item 13: Certain Relationships and Related Transactions

PART IV

Item 14: Controls and Procedures
Item 15: Exhibits, Financial Statement Schedules and Reports on Form 8-K

SIGNATURES

STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

4

PART I

ITEM 1: BUSINESS

Introduction

eMagin Corporation designs, develops, and markets OLED (organic light emitting diode)-on-silicon microdisplays and related information technology solutions. We integrate OLED technology with silicon chips to produce high-resolution microdisplays smaller than one-inch diagonally which, when viewed through a magnifier, create a virtual image that appears comparable to that of a computer monitor or a large-screen television. Our products enable our original equipment manufacturer (OEM) customers to develop and market improved or new electronic products. Our first commercial product, the SVGA+ (Super Video Graphics Array plus 52 added columns of data) OLED microdisplay was first offered for sampling in 2001, and our first SVGA-3D (Super Video Graphics Array plus built-in stereovision capability) OLED microdisplay was first shipped in February 2002. We are now accepting conditional purchase agreements for larger quantities of our first two commercial microdisplay products. These products are being applied or considered for near-eye and headset applications in products such as entertainment and gaming headsets, handheld Internet and telecommunication appliances, viewfinders, and wearable computers to be manufactured by OEM customers for military, medical, industrial, and consumer applications. We market our products in North American, Europe, and Asia.

Our OLED-on-silicon microdisplays offer a number of advantages over current

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liquid crystal microdisplays, including increased brightness, lower power requirements, less weight and wider viewing angles. Using our active matrix OLED technology, many computer and video electronic system functions can be built directly into the OLED-on-silicon microdisplay, resulting in compact systems with expected lower overall system costs relative to alternate microdisplay technologies. We license fundamental OLED technology from Eastman Kodak and we have developed our own technology to create high performance OLED-on-silicon microdisplays and related optical systems. iSuppli-Stanford Resources, an industry market research organization, has identified the emergence of OLED technology as a major advance, with OLED revenue expected to reach \$125 million in 2003 and rise to more than \$3.1 billion in 2009 for a compound annual growth rate of 56% from 2003 to 2009.

As the first to exploit OLED technology for microdisplays, and with our partners and intellectual property, we believe that we enjoy a significant advantage in the commercialization of this display technology. We are the only company to announce, publicly show and sell full-color OLED-on-silicon microdisplays.

Our wholly owned subsidiary, Virtual Vision, Inc., provides added value services to our customers by providing non-recurring engineering (NRE) support for virtual imaging subsystem design and prototyping, as well as by creating standardized optic and electronics interfaces to our displays to accelerate the time to market of our new potential customers.

Industry Overview

The overall flat panel display industry is predicted to grow to over \$69 billion in 2005, according to market research by DisplaySearch. Within the flat panel industry there are various sizes and applications of flat panel displays, ranging from wall size signage to calculator and viewfinder displays. Displays are sold as independent products (such as flat TVs) or as components of other systems (such as laptop computers). Our products target one segment of the flat panel industry - near-eye microdisplays.

Near-eye microdisplays are used in small optically magnified devices such as video headsets, camcorders, viewfinders and other portable devices. Microdisplays are typically of such high resolution that they are only practically viewed with magnifying optics. Although the displays are typically physically smaller than a postage stamp, they can provide a magnified viewing area similar to that of a full size computer screen. For example, when magnified through a lens, a high-resolution 0.5-inch to 0.75-inch diagonal display can appear comparable to a 19 to 21-inch diagonal computer screen at about 2 feet from the viewer or a 60-inch TV screen at about 6 feet. One version of our optics recreates the viewing and sound experience of sitting in the middle seat of a typical movie theater.

5

iSuppli-Stanford Resources, a market intelligence firm focusing on the global electronic display industry, forecasts that the world market for microdisplays as components will grow from \$669 million in 2001 to \$1.9 billion in 2007, for a compounded annual growth rate of 19%, with 244 million units projected to be shipped in 2007. Another leading industry market research organization, DisplaySearch, projects that the overall microdisplay market is expected to grow to \$3.1 billion by 2005.

We believe that the most significant driver of the microdisplay market is growing consumer demand for mobile access to larger volumes of information and entertainment in smaller packages. This desire for mobility has resulted in the development of microdisplay products in two categories: (i) near-eye microdisplays incorporated in products such as viewfinders, digital cameras,

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video cameras and personal viewers for cell phones and (ii) headset-application platforms which include mobile devices such as notebook and sub-notebook computers, wearable computers, portable DVD systems, games and other entertainment.

Until now, microdisplay technologies have not simultaneously met all of the requirements for high resolution, full color, low power consumption, brightness, lifetime, size and cost which are required for successful commercialization in OEM consumer products. We believe that our new OLED-on-silicon microdisplay product line meets these requirements better than alternate products and will help to enable virtual imaging to emerge as an important display industry segment.

Our Approach: OLED-on-Silicon Microdisplays and Optics

There are two basic classes of organic light emitting diode (OLED) technology, dubbed molecular and polymer. Our microdisplays are currently based upon active matrix molecular OLED technology, which we call OLED-on-silicon because we build the displays directly on silicon chips. Our OLED-on-silicon technology uniquely permits millions of individual low-voltage light sources to be built on low-cost, silicon computer chips to produce single color, white, or full-color display arrays. OLED-on-silicon microdisplays offer a number of advantages over current liquid crystal microdisplays, including increased brightness, lower power requirements, less weight and wider viewing angles. Using our OLED technology, many computer and video electronic system functions can be built directly into the silicon chip, under the OLED film, resulting in very compact, integrated systems with lowered overall system costs relative to alternate technologies.

We have developed our own proprietary technology to create high performance OLED-on-silicon microdisplays and related optical systems and we license fundamental OLED technology from Eastman Kodak. (See "Intellectual Property" and "Strategic Relationships") We expect that the integration of our OLED-on-silicon microdisplays into mobile electronic products will result in lower overall system costs to our original equipment manufacturer (OEM) customers.

We believe that our OLED-on-silicon microdisplays represent a new generation of microdisplay technology. Because our microdisplays generate and emit light, they have a wider viewing angle than competing liquid crystal microdisplays, and because they have the same high brightness at all forward viewing angles, our microdisplays permit a large field-of-view and superior optical image. The wider viewing angle of our display results in the following superior optical characteristics:

- o the user does not need to as accurately position the head-wearable display to the eye;
- o the image will change minimally with eye movement and appear more natural; and
- o the display can be placed further from the eye and not cut off part of the image.

In addition, our OLED-on-silicon microdisplays offer faster response times and use less power than competitive liquid crystal microdisplay systems. We expect that our integrated electronics and unique OLED characteristics, coupled with our lenses, will result in lower overall system costs for OEMs.

Our OLED microdisplay stores, until refreshed, all the color and luminance value information at each of the more than 1.5 million picture elements (pixels) in the display array, eliminating the flicker or color breakup seen by most other high-resolution microdisplay technologies. Even power efficient frame

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rates as low 30 Hz can usually be used effectively. Power consumption at the system level is expected to be the lowest of any full-color, full-video SVGA resolution range, large view microdisplay on the market. The OLED's ability to

6

emit light at wide angles allows customers to create large field of view (approx. 40 degrees), wide image capture range images from very compact, low-cost, one-piece optical systems. The display contains the majority of the electronics required for connection to the RGB (red, green, blue signal) port of a portable computer imbedded in its silicon chip backplane, thereby eliminating many other components required by other display technologies such as D-A converters, application-specific integrated circuits (ASICs), light sources, multiple optical elements, and other components. We believe that these features enable our new class of microdisplay to potentially be the most compact, highest image quality, and lowest cost solution for high resolution near-eye applications, once in full production.

We have commercialized two products, our SVGA+ resolution microdisplay (1.53 million picture elements) and our stereovision-capable SVGA-3D microdisplay (1.44 million picture elements). We are currently developing a military and industrial oriented ultra-high-luminance SXGA integrated circuit (3.9 million picture elements) that is due for completion in late 2003 or 2004. We sell our OLED-on-silicon microdisplays for use as components by customers who prefer to design and build their own lenses or coupled with our own optics. We also plan to offer OLED processing on our customers' integrated circuits to some OEMs who design their own integrated circuits. We provide Developer Kits, which include a color SVGA+ resolution microdisplay and associated electronics required for OEMs to build and test new products. This developer kit provides OEMs with the first opportunity for evaluation of an OLED-on-silicon microdisplay.

Our Products

We offer our products to Original Equipment Manufacturers (OEM) and other large volume buyers as both separate components and integrated bundles in a three-tiered platform:

- (1) OLED-on-silicon microdisplays for integration into OEM products for consumer, industrial, and military markets;
- (2) Microviewer(TM) modules that incorporate our OLED-on-silicon microdisplays with compact lenses and electronic interfaces for integration into OEM products for consumer, industrial, and military markets. These products have been prototyped and are planned;
- (3) Head-wearable display systems that will incorporate our Microviewers(TM) for consumer and industrial markets. These products have been prototyped and are planned.

We also plan to offer engineering support, enabling customers to quickly integrate our products into their own product development programs.

(1) OLED Microdisplay Products

We serve as a component manufacturer by supplying our OLED-on-silicon microdisplays for those customers who have their own lenses or integrated circuits. Our first commercial microdisplay products include:

0.62-inch Diagonal SVGA+ (Super Video Graphics Array plus 52 added columns of data) for Consumer OEMs. This display has a resolution of 852 x 3 x 600 pixels, and was dubbed "SVGA+" because it has 52 more display columns than a

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standard SVGA display. The design permits users to run either (1) standard SVGA (800 x 600 pixels) to interface to the analog output of many portable computers or (2) 852 x 480, using all the data available from a DVD player in a 16:9 wide screen entertainment format. The SVGA+ can be made as a full-color or monochrome microdisplay primarily for high-performance and large-view consumer OEM products such as games, video/data head-wearable displays, digital cameras, video cameras and other portable electronics applications. The display also has an internal NTSC monochrome video decoder for low power night vision systems. This product is designed to interface with most portable personal computers.

0.59-inch Diagonal SVGA-3D (Super Video Graphics Array plus built-in stereovision capability) for Consumer OEMs. This display has a resolution of 800 x 3 x 600 pixels. The SVGA-3D can be made as a full-color or monochrome microdisplay primarily for high-performance and large-view consumer OEM products such as personal computer games and video/data head-wearable displays, but is also designed to be applicable for digital cameras, video cameras and other

7

portable electronics applications since the 3D feature is optional. A built-in circuit provides compatibility with single channel frame sequential stereoscopic vision without additional external components. In high volumes, the SVGA-3D is priced lower than the SVGA+, so it is likely to be selected whenever the OEM customer does not need monochrome NTSC or the extra columns of resolution.

0.98-inch Diagonal SXGA (Super Extended Video Graphics Array) for Industrial, Medical and Military Applications. We are developing an introductory SXGA microdisplay product as a personal computer-compatible headset display for military, medical, high-end commercial, and industrial applications. This product will have 1280 x 1024 monochrome pixels and will be adaptable to color VGA resolution. The display will have a capability for very high luminance. We expect that this display will be able provide over 30,000 Cd/m² luminance. For reference, a typical notebook computer operates at 80 Cd/m² peak luminance. This digital video and data interface product is being designed to exhibit a wide dimming range and high luminance for special military applications. We anticipate that the performance features of the SXGA, such as high-speed digital video and 256 gray levels, have the potential to serve as a catalyst for the development of new applications.

(2) Microviewer(TM) Products Incorporating Lenses

By providing an integrated solution of a complete microdisplay and lens assembly to integrate into OEM customers' end product design, OEM customers can avoid incurring expensive optics design and tooling costs. Different lens and microdisplay specifications can be mixed and matched to be adapted to many end products.

We have developed advanced lens technology for several applications and hold key patents on low cost, high performance lens technology for microdisplay applications. Our lens technology permits our OLED-on-silicon microdisplays to provide large field of view images that can be viewed for extended periods with reduced eye-fatigue.

We intend to sell Microviewer(TM) modules to OEMs for integration with their branded products, or incorporated into eGlass(TM) Personal Viewer(TM) head-wearable displays to be supplied by our subsidiary, Virtual Vision, Inc. Some of our potential customers have stated a preference for Microviewers(TM) over microdisplays since Microviewers(TM) incorporate lenses which save OEMs a step in their manufacturing process and can save them the long time required to develop a high performance lens system.

(3) eGlass(TM) Personal Viewer(TM) Head-Wearable Systems

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Personal Viewer(TM) head-wearable systems, such as our eGlass(TM) Personal Viewer(TM), give users the ability to work with their hands while simultaneously viewing information or video on the display. Our head-wearable displays enable more versatile portable computing, capable of delivering an image that appears comparable to that of a 19-inch monitor at 22 to 24 inches from the eye using a 0.59-inch diagonal microdisplay (SVGA-3D). We believe that Personal Viewer head-wearable displays will fill the increasing demand for instant data accessibility in mobile workplaces. We expect to sell the head-wearable displays primarily to OEM systems and equipment customers through direct sales and our e-commerce website which is under development.

We believe that our strategy of offering our products both as separate components and as integrated bundles that include microdisplays and lenses will allow us to address the needs of the largest number of potential customers.

Prior Product and Technology Awards

o Dual Use Technology Achievement Award

March 2002. eMagin and the US Air Force Armstrong Laboratory received first place for the US Air Force and was recognized as one of the best dual use technologies in 2001 recognition across all branches of the Armed Services for the Second Annual Dual Use Science and Technology Achievement Award awarded by the Deputy Under Secretary for Defense, Charles J. Holland. The award recognizes

8

the best dual use programs and honors those responsible for developing and implementing technology beneficial to both military and commercial sectors.

o 2001 Product of the Year

January 17, 2001. eMagin received a 2001 Product-of-the-Year Award from Electronic Products Magazine, honoring eMagin for the development of its first-of-class high-resolution active matrix OLED-on-silicon microdisplay, based on significant advances in technology.

o 2001 U.S. Army Phase II Quality Award

August 21, 2001. eMagin received a 2001 US Army SBIR (Small Business Innovation Research) Phase II Quality Award for the development of high-resolution active matrix OLED microdisplays for incorporation into military head-mounted displays. The annual Quality Awards Program recognizes top quality Army Phase II projects for their technical achievement, contribution to the Army and potential for commercial use. Selected by a distinguished panel of Army and industry experts, eMagin's project was among only five selected to receive a 2001 U.S. Army SBIR Phase II Quality Award through the rigorous Quality Awards competition.

o Display of the Year 2000 Gold Award

June 6, 2001. eMagin was honored by The Information Display Magazine and Society Information Display with the Display of the Year Gold Award for its OLED-on-Silicon microdisplay. The Display of the Year Award was established in 1995 to recognize outstanding products chosen for their innovation and potential impact on current and future display markets. An international committee of distinguished display technologists and leading editors in a four-month process of nominations and voting made the selection.

Our Market Opportunity

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The growth potential of our selected target market segments have been investigated using information gathered from key industry market research firms, including Display Search, Frost and Sullivan, Fuji-Chimera, International Data Corporation, Nikkei, SEMI, Stanford Resources-iSuppli and others. Such data was obtained using published reports and data obtained at industry symposia. We have also relied substantially on market projections obtained privately from industry leaders, industry analysts, and potential customers.

We believe that the consumer oriented, virtual-imaging market is characterized by about 20 large OEMs that, collectively, dominate 90% of the market. The non-consumer market consists of niches - industrial, medical, military, arcade games, 3-D CAD/Virtual Reality, and wearable computers. Within each of these market sectors, we believe that our microdisplays, when combined with compact optic lenses, will become a key component for a number of mobile electronic products. We are targeting the following applications:

(1) Near-Eye Viewers for Digital Cameras, Camcorders and Hand-held Internet and Telecommunications Appliances

We believe that our microdisplays will enhance near-eye applications in the following groups of products:

- o Digital cameras and camcorders, which typically use direct view displays at low resolution, offer a small visual image, and are difficult to see on sunny days. According to Display Search, 41 million digital cameras and 13 million camcorders are expected to be sold in 2005. Some of these products may incorporate microdisplays as high-resolution viewfinders which would permit individuals to see enlarged, high-resolution proofs immediately upon taking the picture, giving them the opportunity to retake a poor shot.
- o Mobile phones and other hand-held Internet and telecommunications appliances which will enable users to access full web and fax pages, data lists and maps in a pocket-sized device. According to the Fuji Chimera Research Institute, an industry market research organization, by 2005 the cellular phone and handheld portable digital assistant markets will grow to 655 million units and 20 million units, respectively. Some of these products may eventually incorporate our microdisplays. In order for the high-resolution wireless telecommunications market to develop, Generation 3 (G3) high-speed data transmission must become widely available. The current cost and limited availability of broadband services has impeded the development of this market, but several telecommunication companies have prototype programs in progress which incorporate our microdisplay products.

9

For each of these applications, we anticipate that our microdisplays, combined with compact optic lenses, will offer higher resolution, lower power and system cost and achieve larger images than are currently available in the consumer market. As a result, we believe that we can obtain a sizeable share of the market for the display components of these mobile electronic products.

(2) Head-wearable Display Platforms

Head-wearable displays incorporate microdisplays mounted in or on eyeglasses, goggles, simple headbands, helmets, or hardhats, and are often referred to as HMDs or headsets. Head-wearable displays may block out surroundings for a fully immersive experience, or be designed as "see-through" or "see-around" to the user's surroundings. They may contain one (monocular) or two (binocular) displays. Some of the increased current interest is due to accelerating the timetable to adapt such systems to military applications such as night vision and fire and rescue applications. These have military,

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commercial, and consumer applications.

Military

Military demand for head-wearable displays is currently being met with microdisplay technologies that we believe to be inferior to our OLED-on-silicon products. The new generation of soldiers will be highly mobile, and will often need to carry highly computerized communications and surveillance equipment. To enable interaction with the digital battlespace, rugged, yet lightweight and energy efficient technology is required. Currently available microdisplay technologies do not meet the requirements for low power, hands-free, day and night-viewable displays. Our OLED microdisplays demonstrate performance characteristics important to military and other demanding commercial and industrial applications including high brightness and resolution, wide dimming range, wider temperature operating ranges, shock and vibration resistance and insensitivity to high G-forces. The image does not suffer from flicker or color breakup in vibrating environments, and the microdisplay's wide viewing angle allows ease of viewing for long periods of time. The OLED's very low power consumption reduces battery weight and increases allowed mission length. Properly implemented, we believe that head-mounted systems incorporating our microdisplays will increase effectiveness by allowing hands-free operation and increasing situational awareness with enough brightness to be used in daylight, yet controllable for nighttime light security. The OLED's wide temperature range is especially of interest for military applications because the display can turn on instantly at temperatures far below freezing and can operate at very high temperatures in desert conditions.

Our OLED microdisplays were selected for several aircraft vehicles and soldier applications, including the US Army Land Warrior 1.0 and 2.0 programs and the US Air Force Joint Strike Fighter, among others. Land Warrior, a core program in the Army's drive to digitize the battlefield, is an integrated digital system that incorporates computerized communication, navigation, targeting and protection systems for use by the twenty-first century infantry soldier. Kaiser Electro-Optics, a Rockwell Collins company and the principal contractor for the US Army's Land Warrior HMD system, and eMagin will apply their respective expertise in HMD and imaging technology to develop rugged, yet lightweight and energy efficient products meeting the requirements of tomorrow's soldier. The US Army expects to initially equip more than 40,000 soldiers with the Land Warrior system. The current overall redesign of the Land Warrior system has delayed increased volume use of displays in that program until 2004. Our display is also used in Kaiser Electro-Optics, Inc.'s commercially available ProView S035 Monocular HMD. The US Air Force has selected our OLED microdisplay technology for incorporation into the Strike Helmet 21 system that uses Integrated Panoramic Night Vision Goggles (IPNVG) in avionics helmets. The Strike Helmet 21 system is targeted for integration into F-15E aircraft in the 2003-2004 time period. Similar systems are of interest for other military applications as well as for related operations such as fire and rescue.

Commercial Industrial, and Medical

We believe that a wide variety of commercial and industrial markets offer significant opportunities due to increasing demand for instant data accessibility in mobile workplaces. Some examples of microdisplay applications include: immediate access to inventory (parts, tools and equipment availability); instant accessibility to maintenance or construction manuals; routine quality assurance inspection; and real-time viewing of images and data. Commercial products in these sectors include Sage Technologies, Ltd.'s Helmet Vue (TM) Thermal Imaging System and an upcoming accessory to Antelope Technologies' MCC Wearable Computing system, which incorporates IBM's wearable PC technology.

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Consumer

We believe that our head-wearable display products will enhance the following consumer products:

- o Entertainment and gaming video headset systems, which permit individuals to view television (including HDTV), video CDs, DVDs and video games on virtual large screens or stereovision in private without disturbing others. Even though entertainment and gaming headsets represent an emerging product class, we are seeing demand from OEMs. Headset game systems for portable computers with head tracking and/or stereovision appears to be our predominant high quantity near term market opportunity, with several customers indicating an interest in large production quantities of our displays. Our current SVGA-3D display was designed specifically for this market. We believe that these new headset game systems can provide a game or telepresence experience not otherwise practical using conventional direct view display technology. We expect low cost to be important for success in this field, and expect our product cost to decrease in high quantity production.
- o Notebook computers, which can use head-wearable devices to reduce power as well as expand the apparent screen size and increase privacy. Current notebook computers do not use microdisplays. Our products can apply not only to new models of notebook computers, but also as aftermarket attachments to older notebooks still in use. We expect to market our head-wearable displays to be used as plug-in peripherals to be compatible with most notebook computers. We believe that the SVGA-3D microdisplay is well suited for most portable PC headsets. Our microdisplays can be operated using the USB power source of most portable computers. This eliminates added power supplies, batteries, and rechargers and reduces system complexity and cost.
- o Handheld personal computers, whose small, direct view screens are often limitations, but which are now capable of running software applications that would benefit from a larger display. Microdisplays can be built into handheld computers to display more information content on virtual screens without forfeiting portability or adding the cost a larger direct view screen. Microdisplays are not currently used in this market. We believe that GPS viewers and other novel products are likely to develop as our displays become more available.
- o Highly compact wearable computers and personal digital assistants (PDAs) using video headsets as screens can be made possible by high-resolution microdisplays. A lightweight (under one pound) pocket size computer can potentially be created with a foldout keyboard, compact input device, or voice actuation and a headset that provides a near-desktop personal computer experience.

The combination of power efficiency, high resolution, low systems cost, brightness and compact size offered by our OLED-on-silicon microdisplays has not been made available to makers and integrators of existing entertainment and gaming video headset systems, notebook computers and handheld computers. We believe that our microdisplays will catalyze the growth of new products and applications such as lightweight wearable computer systems.

Selected Applications by Market Sector

| Sector | Representative Applications |
|--------|-----------------------------|
|--------|-----------------------------|

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| | | |
|---|---|---|
| Portable Computer Peripheral | X | Notebook and SuperSubnotebook computer headsets |
| | X | Miniature data viewers |
| Entertainment | X | Games |
| | X | Headset Television/DVDs |
| Industrial, Medical, & Administration | X | Surgery and Dentistry |
| | X | Industrial Control and Safety |
| | X | Emergency Services |
| | X | Inventory and Retail |
| 11 | | |
| | X | Institutional Control |
| | X | Maintenance (Industry & Consumer) |
| | X | Communications |
| | X | Finance |
| | X | Education and Training |
| Military | X | Communications |
| | X | Targeting and Enhanced Vision |
| | X | Handheld & Headmount Equipment |
| | X | Body worn displays |
| | X | Avionics (Helmet mount) |
| | X | Ground and Water Vehicles |
| | X | Maintenance & Training |
| | X | Special Applications |
| Telecommunications, Handheld, and Small Instruments | X | Cell Phones/Headset phones |
| | X | Handheld & Portable Internet Viewers |
| | X | Smart Appliances & Instruments |
| Advanced Computer Applications | X | CAD/CAM |
| | X | Virtual Reality and Simulations |
| | X | Ultra-High Resolution |

Our Strategy

Our strategy is to establish and maintain a leadership position as a worldwide supplier of microdisplays and virtual imaging technology solutions for applications in high growth segments of the electronics industry by capitalizing on our leadership in both OLED-on-silicon technology and microdisplay lens technology. We aim to provide microdisplay and complimentary accessories to enable OEM customers to develop and manufacture new and enhanced electronic products. Some key elements of our strategy to achieve these objectives include the following:

Leverage our superior technology to establish a leading market position. As the first to exploit OLED-on-silicon microdisplays, we believe that we enjoy a significant advantage in bringing this technology to market.

Develop products for large consumer markets via key relationships with OEMs. Our relationships with OEMs whose products use microdisplays have allowed us to identify initial microdisplay products to be produced for entertainment, industrial, and military headsets, to be followed by other applications such as digital cameras, camcorders and hand-held Internet and telecommunications appliances. We target markets which we believe to have long-term growth potential.

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Reduce production costs. We intend to reduce our production costs by lowering our fixed costs and improving our manufacturing yields.

Optimize manufacturing efficiencies by outsourcing while protecting proprietary processes. We intend to outsource certain capital-intensive portions of microdisplay production, such as chip fabrication, to minimize both our costs and time to market. We intend to retain the OLED application and OLED sealing processes in-house. We believe that these areas are where we have a core competency and manufacturing expertise. We also believe that by keeping these processes under tight control we can better protect our proprietary technology and process know-how. This strategy will also enhance our ability to continue to optimize and customize processes and devices to meet customer needs. By performing the processes in-house we can continue to directly make improvements in the processes which will improve device performance. We also retain the ability to customize certain aspects such as chromaticity (color balance), specialized boards or interfaces, and adjust other parameters at the customer's request. In the area of lenses and head-wearable displays, we intend to focus on design and development, while working with third parties for the manufacture and distribution of finished products. We intend to prototype new optical systems, provide customization of optical systems, and manufacture limited volumes at our subsidiary, Virtual Vision, but intend to outsource high volume manufacturing operations. There are numerous potential plastics, PC Board, and assembly service companies globally that provide these outsource services.

12

Build and maintain strong internal design capabilities. As more circuitry is added to OLED-on-silicon devices, the cost of the end product using the display can be decreased; therefore integrated circuit design capability will become increasingly important to us. To meet these requirements, we intend to develop in-house design capabilities. Building and maintaining this capacity will allow us to reduce engineering costs, accelerate the design process and enhance design accuracy to respond to our customers' needs as new markets develop. In addition, we intend to maintain a product design staff capable of rapidly developing prototype products for our customers and strategic partners. Contracting third party design support to meet demand and for specialized design skills will also remain a part of our overall long term strategy.

Our Strategic Relationships

Strategic relationships have been an important part of our research and development efforts to date and are an integral part of our plans for commercial product launch. We have forged strategic relationships with major OEMs and strategic suppliers. We believe that strategic relationships allow us to better determine the demands of the marketplace and, as a result, allow us to focus our future research and development activities to better meet our customer's requirements. Moreover, we expect to provide microdisplays and Microviewers(TM) to some of these partners, thereby taking advantage of established distribution channels for our products.

Eastman Kodak is a technology partner in OLED development, OLED materials, and a potential future customer for both specialty market display systems and consumer market microdisplays. We license Eastman Kodak's OLED and optics technology portfolio. We have a nonexclusive, perpetual, worldwide license to use Eastman Kodak patented OLED technology and associated intellectual property in the development, use, manufacture, import and sale of microdisplays. The license covers emissive active matrix microdisplays with a diagonal size of less than 2 inches for all OLED display technology previously developed by Kodak. An annual minimum royalty is paid at the beginning of each calendar year and is fully creditable against the royalties we are obligated to pay based on net sales throughout the year. Eastman Kodak and eMagin have engaged in numerous

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discussions regarding potential product applications for eMagin's microdisplays by Eastman Kodak.

We are working in cooperation with the US Air Force, Ball Aerospace, ITT, and Kaiser Electro-optics (a subsidiary of Rockwell Collins) to complete development and characterization of our high brightness SXGA microdisplay.

We have recently announced the execution of an agreement with a major manufacturing partner to develop two new products: an enhanced version of our SVGA-3D microdisplay with new imbedded features for consumer head-mounted displays and high resolution games, and a new QVGA and/or VGA viewfinder microdisplay for camcorder and digital cameras, web phones, and low end games.

We are a member of the United States Display Consortium, a cooperative agency of display and related technology manufacturers whose charter is to support continued progress of the display industry. We intend to continue to establish additional strategic relationships in the future.

Our Technology Platforms

OLED-on-Silicon Technology

Scientists working at Eastman Kodak invented OLEDs in the early 1980s. OLEDs are thin films of stable organic materials that emit light of various colors when a voltage is impressed across them. OLEDs are emissive devices, which means they create their own light, as opposed to liquid crystal displays, which require a separate light source. As a result, OLED devices use less power and can be capable of higher brightness and fuller color than liquid crystal microdisplays. Because the light they emit is Lambertian, which means that it appears equally bright from most forward directions, a moderate movement in the eye does not change the image brightness or color as it does in existing

13

technologies. OLED films may be coated on computer chips, permitting millions of individual low-voltage light sources to be built on silicon integrated circuits to produce single color, white, or full-color display arrays. Many computer and video electronic system functions can be built directly into a silicon integrated circuit as part of the OLED display, resulting in an ultra-compact system. We believe these features, together with the well-established silicon integrated circuit fabrication technology of the semiconductor industry, make our OLED-on-silicon microdisplays attractive for numerous applications.

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. Eastman Kodak provides OLED technology and we provide additional technology advancements that have enabled us to coat the silicon integrated circuits with OLEDs.

We have developed numerous and significant enhancements to OLED technology as well as key silicon circuit designs to effectively incorporate the OLED film on a silicon integrated circuit. For example, we have developed a unique, up-emitting structure for our OLED-on-silicon devices that enables OLED displays to be built on opaque silicon integrated circuits rather than only on glass. Our OLED devices can emit full visible spectrum light that can be isolated with color filters to create full color images. Our microdisplay prototypes have a brightness that can be greater than that of a typical notebook computer and can have a potential useful life of over 50,000 operating hours, in certain applications. New materials and device improvements in development offer future potential for even better performance for brightness, efficiency, and lifespan. Additionally, we have invested considerable work over several years to develop unique electronics control and drive designs for OLED-on-silicon microdisplays.

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In addition to our OLED-on-silicon technology, we have developed compact optic and lens enhancements which, when coupled with the microdisplay, provide the high quality large screen appearance that we believe a large proportion of the marketplace demands.

Advantages of OLED Technology

We believe that our OLED-on-silicon technology provides significant advantages over existing solutions in our targeted microdisplay markets. We believe these key advantages will include:

- o Low manufacturing cost;
- o Low cost system solutions;
- o Wide angle light emission resulting in large apparent screen size;
- o Low power consumption for improved battery life and longer system life;
- o High brightness for improved viewing;
- o High-speed performance resulting in clear video images;
- o Wide operating temperature range; and
- o Good environmental stability (vibration and humidity).

Low manufacturing cost. Many OLED-on-silicon microdisplays can be built on an 8-inch silicon wafer using existing automated OLED and color filter processing tools. The level of automation used lowers labor costs. Only a minute amount of OLED material is used in each OLED-on-silicon microdisplay so that material costs, other than the integrated circuit itself, are small. The number of displays per silicon wafer may be higher on OLEDs than on liquid crystal displays (LCDs) because OLEDs do not require a space-wasting perimeter seal band.

Low cost systems solutions. In general, an OEM using OLED-on-silicon microdisplays will not need to purchase and incorporate lighting assemblies, color converter related Applications Specific Integrated Circuits (ASICs), or beam splitter lenses as is the case in liquid crystal microdisplays, which also require illumination. Many important display-related system functions can be

14

incorporated into an OLED-on-silicon microdisplay, reducing the size and cost of the system. Non-polarized light from OLEDs permit lenses for many OLED-on-silicon applications that are made of a single piece of molded plastic, which reduces size, weight and assembly cost when compared to the multipiece lens systems used for liquid crystal microdisplays. System cost relative to liquid crystal and liquid crystal on silicon (LCOS) competitive products is thus reduced. Because our displays are power efficient, they typically require less power at the system level than other display technologies at a given display size and brightness.

Wide-angle light emission simplifies optics for large apparent screen size. OLEDs emit light at most forward directions from each pixel. This permits the display to be placed close to the lens in compact optical systems. It also provides the added benefit of less angular dependence on the image quality relative to pupil and eye position when showing a large field of view, unlike reflective LCOS microdisplays. This results in less eye fatigue and makes it relatively easy to Low power consumption for improved battery life and longer

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system life. OLEDs emit light rather than transmitting it, so no power-consuming backlight or frontlight, as required for liquid crystal displays, is required. OLEDs can be energy efficient because of their high efficiency light generation. Furthermore, OLEDs conserve power by powering only those pixels that are on while liquid crystal on silicon requires light at all pixels all the time. Most optical systems used for our OLEDs are highly efficient, permitting over 80% of the light to reach the eye, whereas reflective technologies such as liquid crystal on silicon require multiple beam splitters to get light to the display, and then into the optical system. This results in typically less than 25% light throughput efficiency in reflective microdisplay systems. Most important, we do not need a power-hungry video frame buffer, as required in liquid crystal frame-sequential color systems. Battery life can therefore be long.

High brightness for improved viewing. This feature can be of great value to military applications, where there is a need to see the computer image overlaid onto brightly lit real-life backgrounds such as desert sand, water reflections or sunlit clouds. The OLED can be operated over a large luminance range without loss of gray level control, permitting the displays to be used in a range of dark environments to very bright ambient applications. Since military simulation and situation awareness applications, including night vision, typically require large fields of view, the OLED's Lambertian optical characteristics make it an excellent choice.

High-speed performance resulting in clear video images. The OLEDs switch much more rapidly than liquid crystals or most cathode ray tubes (CRTs). This results in smear-free video rate imagery and provides improved image quality for DVD playback applications. This eliminates visible image smear and makes practicable three-dimensional stereo imaging using a split frame rate. This advantage of our OLED-on-silicon is very important for 3-D stereovision gaming applications.

Flicker-free; no color breakup. Because the OLED-on-silicon stores brightness and color information at each pixel, the display can be run with no noticeable flicker and no color sequential breakup, even at low refresh rates. A lower refresh rate not only helps reduce power, it also facilitates system integration. Color sequential breakup occurs in systems such as liquid crystal on silicon and some liquid crystal display microdisplays when red, green and blue frames are sequentially imaged in time for the eye to combine. Since the different color screens occur at different times, movement of the eye due to vibration or just fast pupil movement can create color bands at each dark-light edge, making the image unpleasant to view and making text difficult to read. For example, the liquid crystal on silicon display needs to run at least three times the "normal" frame rate or speed to produce color sequential images, which wastes power and makes for a difficult technological challenge as display resolutions increase.

Wide operating temperature range. Our OLEDs offer much less temperature sensitivity at both high and low temperatures than LCDs. LCDs are sluggish or non-operative much below freezing unless heaters are added and lose contrast above 50 (degree)C, while our OLEDs turn on instantly and can operate between -55 (degree)C and 130 (degree)C. We specify a smaller range on most products to accommodate low cost packaging. This is an important characteristic for many portable products that may be used outdoors in many varying environmental conditions. It is especially important for military customers. Insensitivity to vibration, shock, and pressure are also important environmental control attributes.

15

Complementary Lens and System Technology

We have developed a wide range of technologies which complement our core

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OLED and lens technologies and which will enhance our competitive position in the microdisplay and head-wearable display markets. These include:

Lens technology: We have developed advanced lens technology for microdisplays and head-wearable display systems and hold key patents in these areas. Our lens technology permits our OLED-on-silicon microdisplays to provide large field of view images that can be viewed for extended periods with reduced eye-fatigue. During 2003, we plan to outsource manufacturing of our lenses in order to provide them in larger quantities to our customers.

We believe that the key advantages of our lens technology include:

- o Can be very low cost, with minimal assembly. A one piece, molded plastic optic attached to the microdisplay can serve many consumer end-product markets. Since our process is plastic molding, our per unit production costs are low;
- o Allows a compact and lightweight lens system that can greatly magnify a microdisplay to produce a large field of view;
- o Can use single-piece molded microdisplay lenses to permit high light throughput making the display image brighter or permitting the use of less power for an acceptable brightness;
- o Can be designed to provide focusing to enable users with various eyesight qualities to view images clearly; and
- o Can optionally provide focal plane adjustment for simultaneous focusing of computer images and real world objects. For example, this characteristic is beneficial for word processing or spreadsheet applications where a person is typing data in from reference material. This feature can make it easier for people with moderately poor accommodation to use a head-wearable display as a portable computer-viewing accessory.

Head-wearable display technology. We have developed ergonomic technologies that make head-wearable displays easier to use in a wide variety of applications. For example, the use of our patented rotatable Eyeblocker(TM) provides a sharp image without requiring most users to squint. The Eyeblocker can also be moved to create an effective see-through appearance. To our knowledge, we have made the lightest weight, high-resolution head-wearable display with an over 35(Degree) diagonal field of view ever publicly demonstrated.

Wireless video technology. We have developed power efficient, miniature, video and stereo sound, radio frequency transmitter-receiver technology as part of a government program. This could allow consumers to watch wireless high quality video from most locations in their home using existing entertainment (e.g., DVD or cable/satellite systems) or data systems. If commercialized, we expect this capability to greatly increase the available market and demand for video and data head-wearable displays and we are considering this technology for use in low cost consumer applications. Commercialization of this technology will be considered in the future.

Sales and Marketing

Current Status

We are now shipping monochrome and full color versions of our first two commercial microdisplay products. Our SVGA+ resolution OLED microdisplay (1.53 million picture elements) was specifically designed to meet the needs of several military, industrial, and medical customers based on marketing information obtained prior to the design phase of the display and was first offered for

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sampling in April 2001. Our stereovision-capable SVGA-3D microdisplay (1.44 million picture elements) was designed with the input of multiple customers to

16

principally target the mobile personal computer (PC) and PC games markets, and was first shipped in February 2002. We are currently developing a military and industrial oriented ultra-high-luminance SXGA resolution integrated circuit (3.9 million picture elements) that is due for completion in 2003, and we have shipped limited quantities of prototypes of our eGlass headsets. (See "Our Products")

Near term sales efforts have been focused on our military, industrial, and medical customers. Our primary production orders and design wins to date have been for the SVGA+ display. To date, we have shipped products and evaluation kits to more than 70 OEM customers. OEM evaluation and product design cycles may take from 6 months to 24 months. Some of our initial customers have completed their initial evaluation cycle and we are now receiving follow-on orders and notification of product purchase decisions. Several customers have indicated their intent to incorporate potentially high volumes of our microdisplays into consumer products during 2002 through 2004. We have also received notification that our microdisplays will be used as components in versions 1.0 and 2.0 of the US Army Land Warrior program and in the US Air Force Joint Strike Fighter program, among other programs.

General Sales and Marketing Effort

We primarily provide display components and Microviewer(TM) display-optic modules for OEMs to incorporate into their branded products and sell through their well-established distribution channels. In addition, we market head-wearable displays directly to various vertical market channels, such as medical, industrial, and government customers. A typical buyer is a manufacturer of a product requiring a specific resolution of visual display or viewfinder for insertion into a product such as a portable DVD headset, a PC-gaming headset, or an instrument.

As a market-driven company, we assess customer needs both quantitatively and qualitatively, through market research and direct communications. Because our microdisplays are the main functional component that defines many of our customers' end products, we work closely with potential customers to define our products to optimize the final design, typically on a senior engineer-to-engineer basis.

We identify companies with end products and applications for which we believe that our products will provide a system level solution and for which our products can be a key differentiator. We target both market leaders and select early adopter companies; their acceptance validates our technology and approach in the market. We believe successful marketing will require relationships with recognized consumer brand companies.

OEMs develop designs to enable them to develop products for their own target markets. An OEM design cycle typically requires between 6 and 24 months, depending on the uniqueness of the market and the complexity of the end product. New product development may require several design iterations prior to commercialization.

Customers

The Company sells products to a large number of customers, which are primarily in the United States. The Company's customer base includes 2 customers who account for 32%, 6% and 0% of sales in fiscal 2002, 2001 and 2000, respectively. One customer represented 18%, 6% and 0% and the other customer

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represented 14%, 0% and 0% of sales in fiscal 2002, 2001 and 2000. Although the Company is directly affected by the well-being of these customers, management does not believe significant credit risk exists at December 31, 2002.

Backlog

As of December 31, 2002 we had a backlog of purchase agreements of approximately \$10 million and by March 31, 2003 the number had grown to approximately \$27 million. Our backlog consists of both purchase agreements for delivery over the next 24 months and short-term purchase orders for delivery within 3-6 months. Most orders are subject to cancellation by the customer with

17

no or limited penalties. Because of the possibility of customer changes in delivery schedules or cancellations and potential delays in product shipment, our backlog as of a particular date may not be indicative of net revenue for any specific succeeding period. Lack of working capital has delayed our ability to ship the full quantity of purchase agreements and purchase orders on hand, and has required negotiations with customers for delays in product launch schedules.

Research and Development

OLED technology is a relatively new technology that has considerable room for substantial improvements in luminance, life, power efficiency, voltage swing, design compactness, and many other parameters. We also anticipate that achieving reductions in manufacturing costs will require new technology developments. We anticipate that improving the performance, capability and cost of our products will provide an important competitive advantage in our fast moving, high technology marketplace. Past and current research activities include development of improved OLED and display device structures, developing and/or evaluating new materials (including the synthesis of new organic molecules), manufacturing equipment and process development, electronics design methodologies and new circuits and the development of new lenses and related systems. During 2002 we focused primarily on near-term product development projects related to our transition from research to manufacturing. For example we developed a glass cover plate to ruggedize our displays to facilitate easier handling by our OEM customers. We also developed a new high luminance, high efficiency yellow monochrome OLED and adapted to our SVGA+ display for see-through optic applications and began sampling the yellow monochrome product in early 2003. However, in order to improve customer satisfaction and simultaneously maximize our margins, as well as to maintain competitive technology advantages, we believe that it is important to continue to engage in long-term research and development. During the past four years, we have spent approximately \$32.8 million on research and development. In 2001, we spent approximately \$12.7 million, and in 2002 we spent approximately \$7.3 million on research and development. During the same four-year period, we received \$3.6 million in funding from US government under research and development cost sharing arrangements.

External relationships play an important role in our research and development efforts. Suppliers, equipment vendors, government organizations, contract research groups, external design companies, customer and corporate partners, consortia, and university relationships all enhance the overall research and development effort and bring us new ideas (See "Strategic Relationships").

Manufacturing Facilities

We are located at IBM's Microelectronics Division facility, known as the Hudson Valley Research Park, located about 70 miles north of New York City in Hopewell Junction, New York. We lease approximately 45,000 square feet of space

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housing our own equipment for OLED microdisplay fabrication, and for research and development plus additional space for assembly and administrative offices. We believe that our lease agreement with IBM for a 16,300 square foot class 10 clean room space, along with additional, lower level clean room space, and the associated acquisition of substantial amounts of advanced manufacturing equipment is at a favorable cost, represents a substantial asset and competitive advantage. On or about April 21, 2003, eMagin and IBM entered into a Stipulation in order to settle an eviction proceeding originally commenced by IBM against eMagin on or about April 9, 2003. Thereafter, in accordance with the Stipulation, on April 23, 2003 the Stipulation was presented to, and approved by, the court, and a Judgment was issued in favor of IBM. Pursuant to the Judgment and Stipulation, (i) eMagin paid IBM all rent due and owing to IBM, and (ii) IBM was awarded possession of the leased premises, was issued a warrant to remove eMagin from possession of the leased premises, and obtained a monetary judgment for rent arrears in the sum of Eight Hundred Thirteen Thousand Fifty Five and 65/100 (\$813,055.65) Dollars, which sum is to be paid in equal monthly installments during the period commencing May 1, 2003 and ending on March 1, 2004.

Such Judgment is being held in escrow by IBM's attorney and the warrant of eviction is being stayed, so long as the Company continues to timely pay make the installment payments during the next 12 months and any additional rent and/or other sums due under the Lease.

Facilities services provided by IBM include our cleanroom, pure gases, high purity de-ionized water, compressed air, chilled water systems, and waste disposal support. This infrastructure provided by our lease with IBM provides us with many of the resources of a larger corporation without the added overhead costs. It further allows us to focus our resources more efficiently on our product development and manufacturing goals. We believe that our facility is capable of producing over 50,000 SVGA+ or SVGA-3D displays per month once we are manufacturing around the clock (24 hour/7-days per week) with a fully loaded manufacturing line.

We lease additional non-cleanroom facilities for chemical mixing, cleaning, chemical systems, and glass/silicon cutting. OLED chemicals can be purified in our facility with our equipment, permitting the company to evaluate new chemicals in pilot production that are not yet available in suitable purity for OLED applications on the market.

Our display fabrication process starts with the silicon wafer, which is manufactured by a semiconductor foundry using conventional CMOS process. After a device is designed by a combination of internal and external designers with customer participation, we outsource wafer fabrication.

18

Our manufacturing process for OLED-on-silicon microdisplays has three main components: organic film deposition, organic film encapsulation (also known as sealing), and color filter processing. All steps are performed in semi-automated, hands-free environment suitable for high volume throughput. An automated cluster tool provides all OLED deposition steps in a highly controlled environment that is the centerpiece of our OLED fabrication. After wafer processing, each part is inspected using an automated inspection system, prior to shipment. We have electrical and optical instrumentation required to characterize the performance of our displays including photometric and color coordinate analysis. We are also equipped for integrated circuit and electronics design and display testing

Our system development effort at Virtual Vision operates out of a leased facility in Redmond, Washington. The facilities are well suited for designing and building limited volume prototypes and industrial or government products. We

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plan to outsource high volume head-wearable display production to low cost plastics, lenses, and assembly manufacturers, including manufacturers in Asia.

We believe that manufacturing efficiency is an important factor for success in the consumer markets. We believe that high yield and maximum utilization of our equipment set will be key for profitability. We believe that all of the main components for manufacturing success are in place, but we require additional capital to: (1) staff and train employees for round the clock operation, (2) build suitable inventory of integrated circuits and other raw materials, and (3) properly maintain and continue to upgrade the equipment set. The equipment required for initial profitable production is in place. Some equipment will be added when our production volume increases or as needed. We will ramp production primarily by adding multi-shift staff and increasing inventory.

We intend to outsource certain capital-intensive portions of microdisplay production to minimize both our costs and time to market. Joint ventures are being considered for higher quantity OLED production off shore. We currently outsource integrated circuit fabrication while retaining the OLED application and OLED sealing processes in-house.

Intellectual Property

We have developed a significant intellectual property portfolio of patents, trade secrets and know-how, supported by our license from Eastman Kodak and our current patent portfolio.

Our license from Eastman Kodak gives us the right to use in miniature displays a portfolio in organic light emitting diode and optics technology, some of which are fundamental. Our agreement with Eastman Kodak provides for perpetual access to the OLED technology for our OLED-on-silicon applications, provided we remain active in the field and meet our contractual requirements to Eastman Kodak. We also generate intellectual property as a result of our internal research and development activities.

Our patents and patent applications cover a wide range of materials, device structures, processes, and fabrication techniques, such as methods of fabricating full color OLEDs. We believe that our patent applications relating to up-emitting structures on opaque substrates such as silicon wafers, which are critical for OLED microdisplays, and applications relating to the hermetic sealing of such structures are particularly important.

Our patents are concentrated in the following areas:

- o OLED Materials, Structures, and Processes
- o Display Color Processing and Sealing
- o Active Matrix Circuit Methodologies and Designs
- o Field Emission and General Display Technologies
- o Lenses and Tracking (Eye and Head)
- o Ergonomics and Industrial Design
- o Wearable Computer Interface Methodology

We also rely on proprietary technology, trade secrets, and know-how, which are not patented. To protect our rights in these areas, we require all employees, and where appropriate, contractors, consultants, advisors and collaborators to enter into confidentiality and noncompetition agreements. There

can be no assurance, however, that these agreements will provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of such trade

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secrets, know-how or other proprietary information.

We believe that our intellectual property portfolio, coupled with our strategic relationships and accumulated experience in the OLED field gives us an advantage over potential competitors.

Competition

We may face competition in the OLED and microdisplay industry from a variety of companies and technologies. We believe that our key competition will come from liquid crystal on silicon microdisplays (LCOS), also known as reflective liquid crystal displays. While we believe that OLED-on-silicon provides comparatively lower optics cost, larger apparent image size, reduced electronics cost and complexity, enhanced color, and improved power efficiency advantages over liquid crystal on silicon microdisplays, there is no assurance that these benefits will be realized or that liquid crystal on silicon manufacturers will not suitably improve these parameters. Companies pursuing liquid crystal on silicon technology include Microdisplay Corporation and Three-Five Systems, among others, although most of the companies are primarily focusing on projection microdisplays, which do not compete directly with the company. In certain markets, we may also face competition from developers of transmissive liquid crystal displays, such as those developed by Kopin, or laser scanning systems, such as those developed by Microvision Corporation.

To our knowledge, the only other company that has publicly stated plans to develop OLED microdisplays for near-eye applications is MicroEmissive Displays (Britain). We may also compete with potential licensees of Universal Display Corporation, Cambridge Display Corporation, and Uniax Corporation, each of which license OLED technology portfolios. Even though we could potentially license technology from these developers, potential competitors could also obtain licenses and may do so at more favorable royalty rates. However, should they decide to embark on developing microdisplays on silicon, we believe that our progress to date in this area gives us a substantial head start.

Our microdisplays and head-wearable display systems may face competition on a price and performance basis from major manufacturers such as Sony and Seiko Epson. However, these companies use first generation liquid crystal on polysilicon technology and therefore, we believe that they may incorporate our technology into their products when it becomes available.

Employees

As of March 31, 2003, we had a total of 18 full time, part time, and temporary staff plus 4 employees at Virtual Vision. None of our employees are represented by a labor union. We have not experienced any work stoppages and consider our relations with our employees to be good.

ITEM 2: PROPERTIES

Our principal executive offices are located at: 2070 Route 52, Hopewell Junction, New York 12533. We lease approximately 45,000 square feet of space from IBM, all of which is located in the same industrial park. Approximately 30,000 square feet of space houses our own equipment for OLED microdisplay fabrication, and for research and development plus additional space for assembly operations and storage. There are space reductions planned as we look to improve efficiency and costs. Approximately 10,000 square feet of space is used for administrative offices.

On or about April 21, 2003, eMagin and IBM entered into a Stipulation in order to settle an eviction proceeding originally commenced by IBM against eMagin on or about April 9, 2003. Thereafter, in accordance with the

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Stipulation, on April 23, 2003 the Stipulation was presented to, and approved by, the court, and a Judgment was issued in favor of IBM. Pursuant to the Judgment and Stipulation, (i) eMagin paid IBM all rent due and owing to IBM, and (ii) IBM was awarded possession of the leased premises, was issued a warrant to remove eMagin from possession of the leased premises, and obtained a monetary judgment for rent arrears in the sum of Eight Hundred Thirteen Thousand Fifty Five and 65/100 (\$813,055.65) Dollars, which sum is to be paid in equal monthly installments during the period commencing May 1, 2003 and ending on March 1, 2004.

Such Judgment is being held in escrow by IBM's attorney and the warrant of eviction is being stayed, so long as the Company continues to timely pay make the installment payments during the next 12 months and any additional rent and/or other sums due under the Lease.

Our lenses and system development operation at Virtual Vision lease approximately 7,000 square feet of space in Redmond, Washington. The lease for this facility runs until December 2003.

eMagin Corporation's telephone number is (845) 892-1900. Our website address is www.eMagin.com.

20

ITEM 3: Legal Proceedings

None.

Potential Liabilities: We have liabilities for approximately \$14.6 million for unpaid bills, contracts, and other liabilities. We believe that some of these liabilities are valid and payable, and others may be negotiated. As a result of the recent financing described in "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations - Recent Financing," \$4.9 million of these liabilities were converted into common stock of eMagin. Furthermore, we have entered into debt restructuring agreements with the holders of a large portion of the balance of our liabilities, which agreements provide for partial payment, write-off and/or conversion of liability to equity and are expected to be completed between now and June 30, 2003. We intend to make any required partial payments from the additional funds to be received from our recent financing. Should any of these payments not be made in a timely manner or at all, we may be required to pay the balance of the liabilities.

ITEM 4: SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of the security holders during the fourth quarter of the Fiscal Year covered by this Report.

PART II

ITEM 5: MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock has been traded on the American Stock Exchange under the symbol "EMA" since March 17, 2000. From November 18, 1997 to March 16, 2000 our common stock had been quoted on the OTC Bulletin Board under our prior name "Fashion Dynamics Corp." under the symbol "FSHD." Prior to January 2000, there had been no public trading of FSHD. The table below sets forth, for the periods indicated, the high and low closing prices per share of the common stock as

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reported on the American Stock Exchange and the OTC Bulletin Board. With respect to OTC Bulletin Board quotes, these prices reflect inter-dealer prices, without retail mark-up, markdown or commissions and may not represent actual transactions.

 2003

First Quarter

2002

First Quarter

Second Quarter

Third Quarter

Fourth Quarter

As of December 31, 2002, there were 30,854,980 shares of common stock outstanding.

 2001

First Quarter

Second Quarter

Third Quarter

Fourth Quarter

As of December 31, 2001, there were 25,171,183 shares of common stock outstanding.

As of December 31, 2002 and December 31, 2001, there were approximately 445 and 425 stockholders of record of our common stock, respectively. This does not reflect those shares held beneficially or those shares held in "street" name.

We have not paid cash dividends in the past, nor do we expect to pay cash dividends for the foreseeable future. We anticipate that earnings, if any, will be retained for the development of our business.

Equity Compensation Plan Information

| Plan category | Number of securities to be issued upon exercise of outstanding options, | Weighted average exercise price of outstanding options, warrants and rights |
|---------------|--|--|
|---------------|--|--|

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warrants and rights

| | (a) | (b) |
|--|------------|------|
| Equity compensation plans approved by security holders | 5,811,681 | 0.73 |
| Equity compensation plans not approved by security holders | 6,940,504 | 0.42 |
| Total | 12,752,185 | 0.56 |

Recent Issuances of Unregistered Securities.

On January 14, 2002, we entered into additional agreements to facilitate: (i) an additional funding of \$1,000,000 to eMagin by a private investor under the Secured Note Purchase Agreement, (ii) the repayment (the "Repayment") in full using the proceeds of the additional funding of three secured convertible notes held by certain initial investors under the Secured Note Purchase Agreement with an aggregate principal amount of \$250,000 (such notes then in default pursuant to a monthly expenditure requirement contained therein), and (iii) a repricing of both the conversion rate of all of the outstanding Secured Convertible Notes issued under the Secured Note Purchase Agreement into our common stock and the exercise price of the warrants held by certain initial investors not subject to the Repayment (the "Continuing Investors") and the issuance of certain additional warrants to the Continuing Investors in return for their consent to certain amendments and waivers. In return for the additional funding of \$1,000,000, the private investor received two additional Secured Convertible Promissory Notes, with an aggregate principal amount of \$300,000 and \$700,000, respectively, and related warrants, each issued pursuant to the terms of the Secured Note Purchase Agreement. The full amount of the outstanding secured convertible notes issued under the Secured Note Purchase Agreement, after giving effect to the January 2002 transactions, had an aggregate principal amount of \$1,625,000, and were all secured by a general security interest in the assets of the Company. As described below, the Investor agreed, in connection with the financing that we completed as of April 25, 2003, to (a) amend the secured notes issued to them, (b) terminate the security agreement dated November 20, 2001 that was entered into in connection with the purchase of the original secured notes and allow the new investors to enter into a new security agreement with them on a pari passu basis in order for eMagin to continue its operations as a developer of virtual imaging technology, and (c) simultaneously participate in the new financing.

The outstanding Secured Convertible Promissory Notes are due June 30, 2003 and bear interest at 9% per annum (payable at maturity or on the effective date of an early termination). Pursuant to the January 2002 transactions, the conversion terms of the outstanding secured notes were adjusted so that the notes are convertible into our common stock at a rate of \$0.5264 per share. The conversion of the notes into eMagin common stock is mandatory upon certain conditions including the completion of a next round of financing by the Company of convertible debt securities or equity securities in a minimum amount of \$10 million. The holders of the notes may also convert, at their option, the notes and accrued interest into our common stock. Upon a change of control event, we may also call and purchase the notes at a purchase price equal to 250% of the principal amount plus accrued interest. If we do not exercise this call right, in the event of a change of control, the holders may put the notes to the Company at the 250% of the principal amount pricing. Pursuant to the terms of the January 2002 transactions, the exercise price of the outstanding three year warrants held by the Continuing Investors was adjusted to \$0.5469 per share. The

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Initial Investors whose secured convertible notes were cancelled pursuant to the Repayment retained the three-year warrants previously issued to them under the Purchase Agreement, which have an exercise price of \$1.67 per share. All of the outstanding warrants issued under the Secured Note Purchase Agreement, including those issued pursuant to the January 2002 transactions described above, are exercisable for an aggregate of up to 1,954,944 shares of our common stock. We relied on Section 4(2) of the Securities Act and on Rule 506 of Regulation D in issuing the securities without registering the offering under the Securities Act.

Pursuant to the issuance of the notes and warrants under the Secured Note Purchase Agreement, we also entered into a registration rights agreement providing for the registration of shares to be issued pursuant to a conversion of the Secured Convertible Promissory Notes and the shares to be issued pursuant

22

to the exercise of the warrants issued thereunder. The registration rights agreement required us to file a registration statement no later than 90 days after the issuance of the notes and warrants at the initial closing. We are currently in default of this filing requirement. However management has been advised that the holders of such rights are amenable to waiving and extending the time period for the filing of the registration statement. Pursuant to a failure by us to use our reasonable best efforts to cause the registration statement to be declared effective by the Commission within six months of the date of the issuance of the Secured Convertible Promissory Notes and warrants, the registration rights agreement provides for the payment of liquidated damages at a rate of one percent (1%) per month (calculated to the nearest calendar day) of the value of the registrable securities not so declared effective until such registrable securities shall be declared effective. Some of these securities have already been sold by investors under 144 rules.

We entered into a Securities Purchase Agreement dated as of February 27, 2002 providing for the issuance and sale to eight accredited investors of an aggregate of (i) 3,617,128 restricted shares of our common stock, and (ii) warrants exercisable for a period of three (3) years for an aggregate of 1,446,852 shares of our common stock. The warrants have an exercise price of \$0.7542. For the issuance of the shares and warrants, we received an aggregate gross proceeds of \$2,500,519., with each share purchased at a purchase price of \$.6913, equal to 110% of the daily volume weighted average closing price per share of our common stock on the American Stock Exchange for a prescribed five trading day period. In connection with the sale of the shares and warrants, we also entered into a registration rights agreement with the investors to register for resale the shares the investors bought in the transaction and the shares to be issued pursuant to an exercise of the warrants. We are currently in default of this agreement due to the fact that we have not register the shares. As a result we are required to pay to each investor an amount equal to one percent (1%) per month of (A) the purchase price paid by such investor for the purchased securities, and (B) the value of any outstanding warrants held by such investor until such registration default no longer exists. As of December 31, 2002 the Company has accrued \$392,000 in penalties under this agreement. The accrued penalties payable for a registration default under the registration rights agreement may be paid in our common shares provided such shares are registered under the Securities Act. The issuance of the shares and the warrants was exempt from the registration requirements of the Securities Act pursuant to Section 4(2) of such Securities Act and Regulation D promulgated thereunder.

On March 4, 2002, we entered into a common stock purchase agreement and related documents with Northwind Associates, Inc., a Cayman Islands corporation (the "Investor"), pursuant to which we had the right receive in periodic draw downs at our option and subject to the terms and conditions of the agreement, up to \$15,000,000 in equity financing (the "Equity Line") over a three year period.

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The aggregate amount of the Equity Line could have increased to \$20,000,000 provided certain additional conditions regarding our share price, trading volume and market capitalization were met. The initial closing of the agreement occurred on Friday, March 22, 2002. Our right to draw down on the Equity Line

23

was subject to our registering for resale (and the continuing effectiveness of such registration) with the Commission the shares of eMagin common stock issuable pursuant to the Equity Line and was also subject to certain other significant conditions, including limits as to the maximum and minimum draw down amounts as specified in the common stock purchase agreement. The maximum investment amount for any draw down was the lesser of (i) \$5,000,000, and (ii) 15% of the volume weighted average price for our common stock (as reported by the American Stock Exchange) for the 30 trading days immediately prior to the applicable commencement date for such draw down multiplied by the total aggregate trading volume in respect of our common stock for such period. Pursuant to a draw down, the Investor agreed to purchase our shares at a discount to the price of our common shares on the American Stock Exchange. More specifically, the discounted purchase price to be paid by the Investor under the Equity Line was generally equal to (i) 88% of the daily volume weighted average price of our common stock on the American Stock Exchange for a prescribed 10 trading day period provided that the such stock price was less than \$4.00 per share at the time of determination, (ii) 90% if such stock price at the time of determination exceeded \$4.00 per share, and (iii) 92% if such stock price at the time of determination exceeded \$6.00 per share. The discounted purchase price could have been reduced by an additional 3% pursuant to certain special conditions as set forth in the agreement. The amount of our shares issued pursuant to draw downs on the Equity Line was also limited to 19.9% of the issued and outstanding common stock (unless stockholder approval of any excess amount is received) and no draw down could have been made to the extent that it would have resulted in the Investor and its affiliates beneficially owning more than 9.9% of our outstanding common stock. The agreement also limited our ability to enter into any other equity line type of financing during the term of the agreement and provides to the Investor a right of first refusal for subsequent sales by the Company of its securities.

Additionally, in consideration for the Investor's purchase commitment under the Equity Line and certain costs associated therewith, we issued to the Investor 30,000 unregistered shares of eMagin's common stock and warrants to purchase up to 150,000 shares of our common stock at an exercise price equal to 115% of the daily volume weighted average price of the common stock for the fifteen trading days preceding the date of the delivery of the warrant by the Company or \$0.8731. Each warrant is exercisable for a period of three years commencing six months from the date of their delivery by the Company. The issuance of the shares and the warrants was exempt from the registration requirements of the Securities Act pursuant to Section 4(2) of such Securities Act and Regulation D promulgated thereunder.

In connection with the Equity Line, we also entered into a registration rights agreement dated as of March 4, 2002 with the Investor that required the Company to file, obtain and maintain the effectiveness of a registration statement on an appropriate form with the Commission in order to register the sale and public resale of shares of the common stock acquired by the Investor under the agreement and upon the exercise of the warrants. Under the terms of the registration rights agreement, the Company was required to file such registration statement within sixty days of the date of the agreement. This agreement was terminated in December 2002 whereby the Investor, retained it warrants and eMagin agreed to pay the sum of \$25,000 upon the completion of specific financing.

24

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On June 20, 2002, we entered into a secured note purchase agreement with an investor whereby the Investor agreed to lend eMagin \$200,000 in exchange for (i) \$200,000 11.00% per annum secured promissory note due on August 30, 2002, and (ii) warrants exercisable for a period of five (5) years to purchase 300,000 shares of common stock of eMagin. Such warrant may not be exercised by the holder so long as the holder is the beneficial owner, directly or indirectly, of more than ten percent (10%) of our common stock for purposes of Section 16 of the Securities Exchange Act of 1934. We received the proceeds from the secured note on June 28, 2002. As described below, the Investor agreed, in connection with the financing that we completed as of April 25, 2003, to (a) amend the secured note issued to them, (b) terminate the security agreements dated June 20, 2002 that was entered into in connection with the purchase of the secured note and allow the new investors to enter into a new security agreement with them on a pari passu basis in order for eMagin to continue its operations as a developer of virtual imaging technology, and (c) simultaneously participate in the new financing.

Interest was payable on the secured note at a rate of 11% per annum and was payable at maturity or on the effective date of an early termination. The full amount of the secured note was secured by (i) a first priority general security interest in the assets of Virtual Vision, Inc., our wholly owned subsidiary, pursuant to a security agreement dated June 20, 2002 by and between Virtual Vision, Inc., Alligator Holdings, Inc. and the Investor; and (ii) a second priority general security interest in our assets pursuant to a subordinated security agreement dated June 20, 2002, by and between eMagin Corporation, Alligator and the Investor. Upon a change in control event, we had the right to call the secured note and purchase all of the aggregate principal amount of the secured note at a price equal to 250% of the principal amount plus accrued and unpaid interest. If we did not call the secured note within thirty (30) days of the event of a change in control, the Investor had the right to put the secured note to us at a price equal to 250% of the aggregate principal amount for a period of thirty days following the call period.

In connection with the issuance of the warrants, we entered into a registration rights agreement dated June 20, 2002, with the Investor, providing the Investor with certain registration rights under the Securities Act of 1933, as amended, to register for resale the shares to be issued pursuant to an exercise of the warrants.

On April 25, 2003, we entered into a global restructuring and secured note purchase agreement with a group of several accredited institutional and individual investors whereby the Investors agreed to lend us \$6,000,000 in exchange for (i) the issuance of \$6,000,000 principal amount of 9.00% secured convertible promissory notes due on November 1, 2005 and (ii) warrants to purchase an aggregate of 7,749,921 shares of common stock of eMagin (subject to certain customary anti-dilution adjustments), which Warrants are exercisable for a period of three (3) years.

Interest is payable on the notes at a rate of 9% per annum and, at our option, may be paid through the delivery of shares of our common stock (registered pursuant to the registration rights agreement referred to below) in lieu of cash interest payments. Subject to certain limitations, the notes may be converted, at the option of the holder, in whole or in part, into common shares with a conversion price equal to 105% of the volume weighted average of the closing price of our common shares as reported on The American Stock Exchange by the Wall Street Journal, New York City edition, for the five (5) trading days immediately preceding the closing date.

The exercise price of the warrants on a per share basis is \$.8110, an

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amount equal to 110% of the volume weighted average of the closing price of our common shares as reported on The American Stock Exchange by the Wall Street Journal, New York City edition, for the five (5) trading days immediately preceding the closing date.

As part of the transactions, the existing the holders of an aggregate of \$1,625,000 principal amount of secured notes that were purchased pursuant to a secured note purchase agreement entered into as of November 27, 2001, and the holder of a \$200,000 principal amount secured note that was purchased pursuant to a secured note purchase agreement entered into as of June 20, 2002, agreed to (a) amend their respective notes issued to them, (b) terminate the respective security agreements dated November 20, 2001 and June 20, 2002 that were entered into in connection with the purchase of their notes and allow the new investors to enter into a new security agreement with them on a pari passu basis in order for eMagin to continue its operations as a developer of virtual imaging technology, and (c) simultaneously participate in this new round of financing (subject to the terms and conditions set forth in the secured note purchase agreement). The amendments to the notes included (i) amending the note issued on June 20, 2002 so as to provide that the note shall be convertible and will have the same conversion price as the notes issued pursuant to the secured note purchase agreement, (ii) extending the maturity dates of the notes from June 30, 2003 to November 1, 2005, and (iii) revising and clarifying certain of the other terms and conditions of the notes, including provisions relating to interest payments, conversions, default and assignments of the notes.

In connection with the completion of the transactions under the securities purchase agreement, we also entered into a security agreement with the Investors dated as of April 25, 2003, and a registration rights agreement dated as of April 25, 2003 providing the investors with certain registration rights under the Securities Act of 1933, as amended, with respect to our common stock issued or issuable in lieu of cash interest payments on the notes, upon conversion of the notes and/or exercise of the warrants.

In addition to the foregoing, as a condition to and simultaneously with the closing of the transaction pursuant to the secured note purchase agreement, certain holders of our convertible notes agreed to convert approximately \$4.9 million of notes and accrued interest into shares of our common stock, subject to a "lock up" arrangement allowing only limited sales through private transactions for their remaining shares through December 31, 2003. Specifically, The Travelers Insurance Company agreed to convert their \$1 million convertible

26

note plus related interest into our common stock at a conversion price of approximately \$0.53 per share, and SK Corporation has agreed to convert its \$3 million convertible note and accrued interest into our common stock at an approximate conversion price of approximately \$1.28 per share. As further conditions to the closing of the transaction pursuant to the secured note purchase agreement, we have also entered into settlement or restructuring agreements with certain of our other creditors to whom we owed approximately \$5.2 million of current payables, pursuant to which the creditors have agreed to accept shares of our common stock in full or partial satisfaction of the amount owed to them, or which allow us to either make discounted payments to them or to make payments under more favorable payment terms than previously were in place.

The issuance of the shares and the warrants was exempt from registration requirements of the Securities Act of 1933 pursuant to Section 4(2) of such Securities Act and Regulation D promulgated thereunder based upon the representations of each of the Investors that it was an "accredited investor" (as defined under Rule 501 of Regulation D) and that it was purchasing such securities without a present view toward a distribution of the securities. In addition, there was no general advertisement conducted in connection with the

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sale of the securities.

For information on eMagin's equity compensation plans see Note 9 to Item 8 (Financial Statements and Supplemental Data).

27

ITEM 6: SELECTED FINANCIAL DATA

You should read the following selected financial data together with Item 7 entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our financial statements including accompanying notes, and other financial information, all of which are included elsewhere in this report. The selected financial data for the fiscal years ended December 31, 1998, 1999, 2000, 2001 and 2002 are derived from our consolidated financial statements, which have been audited by Arthur Andersen LLP and Grant Thornton LLP, independent auditors. The historical results are not necessarily indicative of results to be expected for any future period.

Prior to the acquisition of FED Corporation, Fashion Dynamics Corporation had no active business operations. Management believes that the comparison of eMagin's financial results to that of the operating entity (FED Corporation) provides the most meaningful comparative information to the reader. Accordingly, the comparative information that follows reflects the operating results of FED Corporation for all periods prior to the merger and it should be read in conjunction with the consolidated financial statements and notes thereto of this Form 10-K.

| | 1998 | Fiscal Year Ended December 31, | | |
|---|---------|---------------------------------------|----------|---------|
| | | 1999 | 2000 (1) | 2001 |
| | ----- | ----- | ----- | ----- |
| Statement of Operations Data: | | (IN THOUSANDS, EXCEPT PER SHARE DATA) | | |
| Revenues: | | | | |
| Net Contract Revenues..... | \$6,154 | \$ 1,895 | \$ 3,126 | \$5,005 |
| Product Sales | | | | 842 |
| Total revenue..... | 6,154 | 1,895 | 3,126 | 5,847 |
| Costs and Expenses: | | | | |
| Research and Development (net of funding under cost sharing arrangements) | 10,250 | 10,171 | 11,815 | 12,724 |
| Non-cash expense for conversion of debt to common stock | -- | 1,917 | -- | -- |
| Non-cash stock-based compensation..... | -- | -- | 10,319 | 2,841 |
| Amortization of purchase intangibles..... | -- | -- | 20,932 | 17,887 |
| Write-down of goodwill and purchased intangibles | -- | -- | -- | 32,146 |
| Acquired in-process research and development | -- | -- | 12,820 | -- |
| General and Administrative..... | | | | |

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| | | | | | |
|---|------------|-------------|-------------|-------------|------------|
| | 3,514 | 5,203 | 6,145 | 7,385 | |
| | ----- | ----- | ----- | ----- | ----- |
| Loss from operations..... | (7,610) | (15,396) | (58,905) | (67,136) | (1,000) |
| Other income (expense)..... | (122) | (404) | (2,616) | (1,351) | (1,000) |
| Net loss..... | \$ (7,732) | \$ (15,800) | \$ (61,521) | \$ (68,487) | \$ (1,000) |
| | ----- | ----- | ----- | ----- | ----- |
| Basic and diluted net loss per share..... | \$ (1.42) | \$ (6.04) | \$ (2.78) | \$ (2.73) | \$ (2.73) |
| Weighted average shares outstanding used in basic and diluted per-share calculation | 5,450,293 | 2,614,743 | 22,144,904 | 25,100,211 | 29,400,000 |

28

(1) The summary financial data for the year ended December 31, 2000 represent a pro forma presentation of the results for this period, containing the operating results of eMagin Corporation for the year ended December 31, 2000, with the operating results of FED Corporation for the period from January 1, 2000 through March 15, 2000, in order to present operating results for the year period for comparative purposes.

| | 1998 | 1999 | As of December 31 2000 | 2001 |
|---|----------|------------|---------------------------|------------|
| | ----- | ----- | ----- | ----- |
| Balance Sheet Data: | | | (IN THOUSANDS) | |
| Working capital (deficit)..... | \$ 3,371 | \$ (3,295) | \$ 6,243 | \$ (5,490) |
| Total assets..... | 11,163 | 5,038 | 62,549 | 4,910 |
| Current maturities of long-term debt..... | 62 | 269 | 313 | 690 |
| Short-term debt..... | -- | 2,127 | -- | 1,870 |
| Total shareholders' equity (deficit)..... | \$ 4,693 | \$ 60 | \$59,184 | \$ (4,870) |

29

ITEM 7: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITIONS AND RESULTS OF OPERATIONS

The following discussion should be read together with our financial statements and the notes to those statements and other financial information appearing elsewhere in this report. Our fiscal year ends December 31.

Overview

eMagin Corporation designs, develops, and markets OLED (organic light emitting diode)-on-silicon microdisplays and related information technology solutions. We integrate OLED technology with silicon chips to produce high-resolution microdisplays smaller than one-inch diagonally which, when viewed through a magnifier, create a virtual image that appears comparable to that of a computer monitor or a large-screen television. We shipped initial samples of our first commercial microdisplay product in March 2001. We are now accepting orders and shipping larger quantities of our first two commercial

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microdisplay products. 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.

Company History

eMagin Corporation was originally incorporated as Fashion Dynamics Corporation on January 23, 1996 under the laws of the State of Nevada. For the three years prior its acquisition of FED Corporation, Fashion Dynamics Corporation had no active business operations, and sought to acquire an interest in a business with long-term growth potential. On March 16, 2000, Fashion Dynamics Corporation acquired FED Corporation (derived from field emissive device), subsequently changed its name to eMagin Corporation (derived from "electronic imaging") and listed its common stock on the American Stock Exchange under the "EMA" trading symbol.

Under the terms of the merger agreement that facilitated our acquisition of FED Corporation, Fashion Dynamics Corporation issued approximately 10.5 million shares of its common stock to FED Corporation shareholders and issued approximately 3.9 million options and warrants in exchange for existing FED options and warrants. The total purchase price of the transaction was approximately \$98.5 million, including \$73.4 million of value relating to the shares issued (at a fair value of \$7 per share, the value of a simultaneous private placement transaction of similar securities), \$20.9 million of value relating to the options and warrants exchanged and \$3.8 million of assumed liabilities. The transaction was accounted for using the purchase method of accounting. Under the purchase method of accounting, the assets and liabilities were recorded based upon their fair values at the date of acquisition as determined by an independent appraisal.

Since for the three-year period prior to the acquisition of FED Corporation, Fashion Dynamics Corporation had no active business operations, management believes that the comparison of eMagin's financial results to that of the operating entity (FED Corporation) provides the most meaningful comparative information to the reader. Accordingly, the following comparative information reflects the operating results of FED Corporation for all periods prior to the merger and it should be read in conjunction with the consolidated financial statements and notes thereto. The comparison of financial information below for the period ended December 31, 2000 reflects pro forma results of eMagin for the period January 1, 2000 through December 31, 2000 and its predecessor FED Corporation for the period January 1, 2000 to March 15, 2000, on a combined basis, such that the amounts presented and discussed reflect the full year of operations for each period. Reference is made to our consolidated financial statements included herein for further detail on the results of eMagin and FED Corporation for their respective periods of ownership.

At our annual meeting of stockholders held on July 16, 2001, the stockholders approved the reincorporation of eMagin Corporation as a Delaware corporation. The reincorporation became effective on July 16, 2001 by merging eMagin Corporation, a Nevada corporation ("eMagin-Nevada"), into its then wholly owned subsidiary, eMagin Corporation, a Delaware corporation (formerly known as FED Corporation as described above) ("eMagin-Delaware"). Upon completion of this merger, eMagin-Nevada ceased to exist as a corporate entity and eMagin-Delaware succeeded to the assets and liabilities of eMagin-Nevada. Under the merger agreement for the reincorporation, each outstanding share of eMagin-Nevada common stock was automatically converted into one share of eMagin-Delaware

common stock at the time the merger became effective. There has been no

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interruption in the trading of our common stock as a result of the reincorporation. The reincorporation also resulted in the implementation of a new certificate of incorporation and by-laws for the Company, as the existing certificate of incorporation and by-laws of eMagin-Delaware continues as the certificate of incorporation and by-laws of the Company and has replaced the articles of association and by-laws of eMagin-Nevada. No change in the corporate name, board members, business, management, fiscal year, assets, liabilities, employee benefit plans or location of principal facilities of eMagin occurred as a result of the reincorporation.

Our history has been as a developmental stage company. We are now transitioning to manufacturing and intend to significantly increase our marketing, sales, and research and development efforts, and expand our operating infrastructure. Most of our operating expenses are fixed in the near term. If we are unable to generate significant revenues, our net losses in any given period could be greater than expected.

CRITICAL ACCOUNTING POLICIES

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

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

Revenue Recognition

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

Research and development cost

Amounts incurred in connection with research and development activities are expensed as incurred.

STATEMENT OF OPERATIONS

The following are descriptions of the revenue and expense components of our statement of operations:

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Total revenues currently represent revenues mostly from contracts funded by U.S. government programs. We have historically earned revenues from certain of our research and development activities under both fixed-price contracts and cost-type contracts, including some cost-plus-fee contracts. Revenues relating to fixed-price contracts are generally recognized on the

31

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 profit based on the relationship of costs and the allocation of allowable indirect costs as defined by each contract. The amount of revenues earned is dependent upon the execution of new government contracts, which may not be predictable or consistent from period to period because of variations in government funds allocated to research and development in our field of technology.

Research and development expenses represent salaries, development materials, external contracts, equipment lease and depreciation expense, electronics, rent, utilities and costs associated with operating our manufacturing facility. These costs are expensed as incurred. We have received cost sharing awards from certain U.S. government agencies to fund certain research and development. Funding from this type of contract is recognized as a reduction in research and development operating expenses during the period in which the services are performed and related direct expenses are incurred. As of December 31, 2002, we have no remaining amounts in cost sharing contracts to either incur or bill.

Non-cash stock-based compensation expense represents expenses associated with stock option grants to our officers and employees at below fair market value as additional compensation for their services and to induce them to lock-up their options for a longer time than would normally be specified under the Company's standard option grant. Deferred compensation is amortized over the remaining vesting period of the underlying options. The expense also represents warrant grants with exercise prices below fair market value to security holders of eMagin for a reduced number of warrants to induce them to lock-up prior to the merger.

Amortization of purchased intangibles represents the cost of amortization of the value of other acquired intangible assets. The purchased intangibles are amortized over their expected useful lives of three years on a straight-line basis. In 2001, the Company adopted SFAS No 141 "Business Combinations" and SFAS No 142 "Goodwill and Other Intangible Assets. After an evaluation, the Company recorded an impairment write-down of its goodwill in 2001.

Selling, general and administrative expenses principally represent the cost of salaries and fees for professional services, legal fees incurred in connection with patent filings and related matters, depreciation and amortization, and other administrative expenses as well as expenses associated with marketing.

Basic and diluted net loss per common share is computed by using the weighted average number of shares of common stock outstanding during the period, restated for the effect of the merger upon the number of shares outstanding in the current year, and for the presentation of the net loss per share for the predecessor, a stock split effected during 1999. No common stock equivalents have been included in the computation of weighted average shares outstanding, as their effect would be anti-dilutive.

Results of Operations

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Comparison of our financial results for the years ended December 31, 2000, 2001 and 2002.

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

Revenues

Revenues decreased to \$2.1 million for the year ended December 31, 2002 from \$5.8 million for the year ended December 31, 2001, representing an decrease of 64%. This decrease was due primarily to the expiration of Government contracts and the concentration of the company on transitioning from research and development to product manufacturing and sales.

Research and Development Expenses

Gross research and development expenses decreased to \$7.3 million for the year ended December 31, 2002 from \$12.7 million for the year ended December 31, 2001, representing a 43% decrease. Of these amounts, we received \$0.3 million in cost sharing from the U.S. government for the year ended December 31, 2002, and

32

\$1.6 million for the year ended December 31, 2001. The \$5.4 million decrease in gross expenses for the year ended December 31, 2002 reflects reduction in staffing and reduction in expenditures related to the company's difficult cash position.

Amortization and Write-Down of Intangibles

Amortization and write down of goodwill and purchased intangibles expense decreased to \$1.3 million for the year ended December 31, 2002 from \$50 million for the year ended December 31, 2001. The \$48.7 million decrease is primarily the result of the goodwill impairment charge recorded in 2001.

Selling, General and Administrative Expenses

General and administrative expenses decreased to \$4.5 million for the year ended December 31, 2002 from \$7.4 million for the year ended December 31, 2001. The decrease of \$2.9 million in selling, general and administrative expenses was due primarily to changes in personnel costs, patent filings, and legal fees. We expect marketing, general and administrative expense to increase in future periods as we add to our sales staff and make additional investments in marketing activities. In addition, non-cash stock-based compensation expense was \$1.6 million for the year ended December 31, 2002 versus \$2.8 million for the year ended December 31, 2001. The activity, for the years ended December 31, 2002 and 2001, reflects the amortization of deferred compensation costs related to the issuance of stock options, warrants issued and re-priced warrants and options at below fair market values in the first quarter of 2000.

Other Income (Expense)

Other expenses increased to \$2.3 million for the year ended December 31, 2002 from \$1.4 million for the year ended December 31, 2001. The increase of \$0.9 million was due primarily to increased interest expense. Interest expense increase was primarily due to the beneficial conversion of debt totaling approximately \$888,000. Net Loss/Net Loss Per Common Share

The following provides a reconciliation of information used in calculating the per share amounts for the year ended December 31, 2002 2001 and 2000.

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| | 2002 | 2001 |
|--|-----------------|-----------------|
| Loss attributable to common shareholders | | |
| Net loss | \$ (14,912,711) | \$ (68,486,735) |
| Loss attributable to common shareholders | \$ (14,912,711) | \$ (68,486,735) |
| Weighted average shares outstanding | 29,416,838 | 25,100,211 |
| Basic and diluted loss per common share | \$ (0.51) | \$ (2.73) |

33

Year Ended December 31, 2001 Compared to Year Ended December 31, 2000

Revenues

Revenues increased to \$5.8 million for the year ended December 31, 2001 from \$3.1 million for the year ended December 31, 2000, representing an increase of 87%. This increase was due primarily to the recognition of revenue from certain government contracts relating to head-wearable displays.

Research and Development Expenses

Gross research and development expenses increased to \$14.3 million for the year ended December 31, 2001 from \$13.3 million for the year ended December 31, 2000, representing a 7.5% increase. Of these amounts, we received \$1.6 million in cost sharing from the U.S. government for the year ended December 31, 2001, and \$1.5 million for the year ended December 31, 2000. The \$1.0 million increase in gross expenses for the year ended December 31, 2001 reflects the additional costs associated with personnel costs, equipment leases, depreciation, and material costs resulting from increased research and development activities and equipment additions at our manufacturing facility.

Amortization and Write-Down of Goodwill and Purchased Intangibles

Amortization and write down of goodwill and purchased intangibles expense increased to \$50.0 million for the year ended December 31, 2001 from \$20.9 million for the year ended December 31, 2000. The \$29.1 million increase in amortization and impairment write-down of its goodwill is primarily the result of the impairment charge recorded in 2001.

Acquired In-Process Research and Development

In connection with the merger in March 2000, we allocated \$12.8 million of the purchase price to acquired in-process research and development expense. Accordingly, these costs were expensed during the year ended December 31, 2000 upon finalization of a third party appraisal. No costs were expensed during the year ended December 31, 2001.

Selling, General and Administrative Expenses

General and administrative expenses increased to \$7.4 million for the year ended December 31, 2001 from \$6.1 million for the year ended December 31, 2000, representing a 1.3% increase. The increase in selling, general and administrative expenses was due primarily to increases in marketing activity, personnel costs, travel and patent filings. In addition, non-cash stock-based compensation expense was \$2.8 million for the year ended December 31, 2001 versus \$10.3 million for the year ended December 31, 2000. The activity, for the years ended December 31, 2001 and 2000, reflects the amortization of deferred compensation costs related to the issuance of stock options, warrants issued and re-priced warrants and options at below fair market values in the first quarter of 2000.

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Other Income (Expense)

Other expenses increased to \$1.4 million for the year ended December 31, 2001 from \$(0.4) million in income for the year ended December 31, 2000. The increase of \$1.8 million was due primarily to the decrease in amortization of the debt discount from the beneficial conversion of a bridge loan entered into by the company.

Liquidity and Capital Resources

Our cash requirements depend on numerous factors, including completion of our product development activities, ability to commercialize our products, market acceptance of our products and other factors. We expect to devote substantial capital resources to continue our development programs directed at commercializing our products in our target markets, hire and train additional

34

staff, expand our research and development activities, develop and expand our manufacturing capacity and begin production activities. Through December 31, 2002 we have incurred accumulated losses of approximately \$131.6 million since our inception and we anticipate incurring significant losses as we fund our growth. Since inception we have financed our operations through private placements of equity securities, research and development contracts and borrowings. As of December 31, 2002, we had \$83,000 in cash and cash equivalents, and a working capital deficit of \$13.6 million.

Net cash used in operating activities was \$5.6 million for the year ended December 31, 2002. Cash used in operating activities resulted primarily from our net loss partially offset by non-cash charges. Cash used in operating activities for 2001 was \$10.8 million and \$12.0 million in 2000 resulting primarily from operating losses.

Net cash used by investing activities was \$84,000 for the year ended December 31, 2002. Net cash used by investing activities in 2001 was \$0.5 million used for capital expenditures. Net cash flows from investing activities in 2000 was \$0.4 million with \$1.2 million net proceeds from acquisition less \$0.8 million used for capital expenditures.

Net cash provided by financing activities was \$5.0 million for the year ended December 31, 2002, and consisted primarily of proceeds from the sales of common stock and issuance of debt. Net cash provided by financing activities was \$4.7 million for the year ended December 31, 2001, and consisted primarily of proceeds from the issuance of debt. Net cash provided by financing activities was \$18.9 million for the year ended December 31, 2000, and consisted primarily of proceeds from the sales of common stock and issuance of debt. We currently anticipate that we will continue to experience significant growth in our operating expenses for the foreseeable future and that our operating expenses will be a material use of our cash resources. eMagin's recurring losses from operations since inception raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are described in Note 1 to the Item 8 (Financial Statements and Supplementary Data).

Pursuant to a Registration Rights Agreement dated November 27, 2001 by and between the Company and investors named therein, we may be forced to pay certain liquidated cash damages in the near future if we fail to use our reasonable best efforts to cause the registration statement thereunder to be declared effective by the Commission by June 30, 2003.

We have liabilities for approximately \$14.6 million for unpaid bills, rent and operating leases that are in default, contracts, and other liabilities. As described in "Item I - Business - Manufacturing Facilities," entered into a

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Stipulation with IBM pursuant to which we may remain in possession of our leased premises so long as we continue to timely pay certain required the installment payments, as well as any additional rent and/or other sums due under the our lease. In addition, as a result of the recent financing described in "Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations - Recent Financing," \$4.9 million of these liabilities were converted into common stock of eMagin. Furthermore, we have entered into debt restructuring agreements with the holders of a large portion of the balance of our liabilities, which agreements provide for partial payment, write-off and/or conversion of liability to equity and are expected to be completed between now and June 30, 2003. We intend to make any required partial payments from the additional funds to be recived from our recent financing. Should any of these payments not be made in a timely manner or at all, we may be required to pay the balance of the liabilities.

There can be no assurance that additional equity or debt financing will be available on acceptable terms or at all. If we are unable to obtain additional capital, we may be required to reduce the scope of our planned product development, selling and marketing activities and expansion of our manufacturing facilities, which would have a material adverse effect on our business, financial condition and operating results and our ability to continue as a going concern. In the event that we raise additional equity financing, further dilution to investors could result. Section 7A below, under "Risks Related To Our Financial Results," provides a more detailed description.

eMagin has experienced a net loss applicable to common stockholders of \$14.9 million during the year ending December 31, 2002. eMagin had negative cash flows from operations for the year ending December 31, 2002 of \$5.6 million. eMagin is in default of its loan and equity agreements due to our failure to register shares. As of April 11, 2003 eMagin was unable to obtain replacement financing and was not in compliance with several financial covenants under the credit agreement.

Management has undertaken certain actions in an attempt to improve the Company's liquidity and return the company to profitability. These actions included significant overhead reductions instituted in 2002. Management is also in discussions with several other lenders and investors. We may not be able to secure a financing or any other replacement financing.

As a result of its liquidity restrictions, eMagin has been unable to meet certain of vendor payable obligations, and has been forced to extend the terms of such payments.

35

eMagin's ability to obtain both replacement and additional financing depends on many factors beyond its control, including the state of the capital markets, the market price of eMagin's common stock, its customers' willingness to substantially prepay for product, the prospects of the business. The necessary additional financing may not be available to eMagin or may be available only on terms that would result in further dilution to the current owners of eMagin's common stock. Failure to obtain commitments for interim and longer term financing would have a material adverse effect on the business, results of operations and financial condition, which may include ceasing eMagin's operations . If the financing eMagin requires to sustain its working capital needs is unavailable or insufficient, eMagin may be unable to continue as a going concern.

Contractual Obligations at December 31, 2002

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| Contractual Obligations | Less than 1 year | One-Three years | Four-Five years |
|-------------------------|---------------------|--------------------|--------------------|
| Long Term Debt | \$ - | \$ 243,478 | \$ - |
| Short Term Debt | 5,825,000 | | |
| Operating Leases | 1,457,061 | 1,069,390 | |
| Capital Leases | 251,249 | 101,046 | 27,558 |
| Royalty Commitment | 62,500 | 187,500 | 250,000 |
| Total per Period | \$ 7,595,810 | \$ 1,601,414 | \$ 277,558 |

Quarterly Results of Operations for the Years Ended December 31, 2002 and 2001

| | First Quarter | Second Quarter | Third Quarter |
|---|----------------|----------------|----------------|
| Revenues | \$ 158,027 | \$ 268,127 | \$ 497,851 |
| Net loss | \$ (6,489,514) | \$ (4,001,043) | \$ (2,754,638) |
| Net loss per share Basic and diluted | \$ (0.24) | \$ (0.13) | \$ (0.09) |

Year ended December 31, 2001

| | First Quarter | Second Quarter | Third Quarter |
|---|---------------|----------------|---------------|
| Revenues | \$2,030,201 | \$1,616,005 | \$1,176,628 |
| Net loss | (9,708,435) | (10,832,756) | (42,377,769) |
| Net loss per share Basic and diluted | \$ (0.39) | \$ (0.43) | \$ (1.69) |

36

Recent Accounting Pronouncements

In August 2001, the FASB, issued SFAS, No. 143, "Accounting for Obligations Associated with the Retirement of Long-Lived Assets." SFAS No. 143 addresses financial accounting and reporting for the retirement obligation of an asset. This statement provides that companies should recognize the asset retirement cost at its fair value as part of the cost of the asset and classify the accrued amount as a liability. The asset retirement liability is then accreted to the ultimate payout as interest expense. The initial measurement of the liability would be subsequently updated for revised estimates of the discounted cash outflows. The Statement will be effective for fiscal years beginning after June 30, 2002. eMagin has not yet determined the effect that SFAS No. 143 will have on its consolidated financial position, results of operations or cash flows.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements

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No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." This statement eliminates the requirement under SFAS 4 to aggregate and classify all gains and losses from extinguishment of debt as an extraordinary item, net of related income tax effect. This statement also amends SFAS 13 to require that certain lease modifications with economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. In addition, SFAS No. 145 requires reclassification of gains and losses in all prior periods presented in comparative financial statements related to debt extinguishment that do not meet the criteria for extraordinary item in Accounting Principles Board Opinion ("APB") 30. The statement is effective for fiscal years beginning after May 15, 2002 with early adoption encouraged. eMagin does not believe the standard will have a material effect on its financial statements.

On July 30, 2002, The FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. eMagin is currently evaluating the requirements and impact of this statement on our consolidated results of operations and financial position.

In November 2002, the FASB issued interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN No. 45 requires certain guarantees to be recorded at fair value, which is different from current practice, which is generally to record a liability only when a loss is probable and reasonably estimable. FIN No. 45 also requires a guarantor to make significant new disclosures, even when the likelihood of making any payments under the guarantee is remote. The disclosure provisions of FIN No. 45 are effective for financial statements of interim or annual periods after December 15, 2002. eMagin has adopted the recognition and measurement provisions of FIN No. 45 on a prospective basis with respect to guarantees issued or modified after December 31, 2002. eMagin has adopted the recognition and measurement provisions of FIN 45 on a prospective basis with respect to guarantees issued or modified after December 31, 2002. The adoption of the disclosure provisions has been reflected in the December 31, 2002 financial statements.

In November 2002, the Emerging Issues Task Force reached a consensus opinion on EITF 00-21, "Revenue Arrangements with Multiple Deliverables." The

37

consensus provides that revenue arrangements with multiple deliverables should be divided into separate units of accounting if certain criteria are met. The consideration for the arrangement should be allocated to the separate units of accounting based on their relative fair values, with different provisions if the fair value of all deliverables are not known or if the fair value is contingent on delivery of specified items or performance conditions. Applicable revenue recognition criteria should be considered separately for each separate unit of accounting. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. Entities may elect to report the change as a cumulative effect adjustment in accordance with APB Opinion 20, Accounting Changes. eMagin has not determined the effect of adoption of EITF 00-21 on its financial statements or the method of adoption it will use.

In November 2002 the Emerging Issues Task Force reached a consensus opinion on EITF 02-16, "Accounting by a Customer (including a reseller) for Certain

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Consideration Received from a Vendor." EITF 02-16 requires that cash payments, credits, or equity instruments received as consideration by a customer from a vendor should be presumed to be a reduction of cost of sales when recognized by the customer in the income statement. In certain situations, the presumption could be overcome and the consideration recognized either as revenue or a reduction of a specific cost incurred. The consensus should be applied prospectively to new or modified arrangements entered into after December 31, 2002. eMagin has not yet determined the effects of EITF 02-16 on its financial statements

On December 31, 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for an entity that voluntarily changes to the fair value method of accounting for stock-based employee compensation. In addition, it also amends the disclosure provisions of SFAS No. 123 to require prominent disclosure about the effects on reported net income, including per share amounts, of an entity's accounting policy decisions with respect to stock-based employee compensation in annual and interim financial statements. SFAS No. 148 does not amend SFAS No. 123 to require companies to account for their stock-based employee compensation using the fair value method. The disclosure provisions of SFAS No. 123 were effective immediately in 2002. SFAS 148 is effective for fiscal years ending after December 15, 2002. The transition provisions for a change to the fair value based method may be early adopted, provided that financial statements for the 2002 fiscal year have not been issued as of December 31, 2002. As of December 31, 2002, the eMagin does not have any immediate plans to change its method of accounting for stock-based employee compensation to the fair value method. Included in the 2002 financial statements are the required disclosures of SFAS 148.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities", an Interpretation of ARB No. 51 ("FIN 46"). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. eMagin does not expect this new interpretation to have a material effect on its future results of operations or cash flows.

ITEM 7A: QUALITATIVE AND QUANTITATIVE Disclosures About Market Risk

This Form 10-K report contains forward-looking statements within the meaning of the securities laws that are based on current expectations, estimates, forecasts and projections about the industries in which eMagin operates, management's beliefs, and assumptions made by management. In addition, other written or oral statements which constitute forward-looking statements may be made by or on behalf of eMagin. Words such as "expects", "anticipates", "intends", "plans", "believes", "could", "seeks", "estimates", variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements, whether as a result of new information, future events or otherwise. Factors that could cause or contribute to such differences in outcomes and results, include, but are not limited to, those discussed below.

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Interest Rate Risk

Substantially all of the Company's cash equivalents are at fixed interest rates, and as such, the fair market value of these instruments is affected by changes in market interest rates. As of December 31, 2002, all of the Company's cash equivalents mature within one year. Accordingly, we believe that the market risk arising from our holdings of these financial instruments is immaterial. However, in the future, we may invest in securities with maturities of more than one year, which may carry greater interest rate risk. The Company's outstanding debt requires a penalty interest rate pegged to the prime rate in the event of a default. A 1% change in interest rate would increase our interest expense on debt and penalties approximately \$73,000.

Foreign Currency Exchange Risk

Presently, 100% of the Company's customer and supplier payments are made in U. S. dollars and, consequently, we believe we have no direct foreign currency exchange rate risk. However, in the future, we may enter into contracts in foreign currencies, which may subject the Company to foreign exchange rate risk. We do not have any derivative instruments and do not presently engage in hedging transactions.

Risk Factors

In evaluating our business, prospective investors and shareholders should carefully consider the following risks in addition to the other information in this 10-K or in the documents referred to in this 10-K. Any of the following risks could have a material adverse impact on our business, operating results and financial condition and result in a complete loss of your investment.

Risks Related To Our Financial Results

If we cannot operate as a going concern, our stock price will decline and you may lose your entire investment. Our auditors have included an explanatory paragraph in their report on our financial statements for the year ended December 31, 2002 which states that, due to recurring losses from operations since inception of the Company, there is substantial doubt about our ability to continue as a going concern. Our financial statements for the year ended December 31, 2002 do not include any adjustments that might result from our inability to continue as a going concern. These adjustments could include additional liabilities and the impairment of certain assets. If we had adjusted our financial statements for these uncertainties, our operating results and financial condition would have been materially and adversely affected.

If we do not obtain additional cash to operate our business, we may not be able to execute our business plan and may not achieve profitability. In the event that cash flow from operations is less than anticipated, if the costs are higher than anticipated, or we are unable to secure additional funding or sufficient product or service prepayments, in order to preserve cash, we would be required to further reduce expenditures and effect further reductions in our corporate infrastructure, either of which could have a material adverse effect on our ability to continue our current level of operations. Even if we obtain additional working capital in the near future, to the extent that operating expenses increase or we need additional funds to make acquisitions, develop new technologies or acquire strategic assets, the need for additional funding may be accelerated and there can be no assurances that any such additional funding can be obtained on terms acceptable to us, if at all. If we are not able to generate sufficient capital, either from operations or through additional financing, to fund our current operations, we may not be able to continue as a going concern. If we are unable to continue as a going concern, we may be forced to

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significantly reduce or cease our current operations. This could significantly reduce the value of our securities, which could result in our de-listing from the American Stock Exchange and cause investment losses for our shareholders.

We may not maintain The American Stock Exchange (the "Exchange") listing requirements. To maintain the listing of our common stock on the Exchange, we are required to meet certain listing requirements, including, in the case of our common stock selling for a substantial period of time at a low price per share, effecting a reverse split of such shares within a reasonable time after being notified by the Exchange that such action is appropriate under all the circumstances. In its review of whether a share price is too low or whether a

39

reverse split is appropriate, the Exchange will consider all pertinent factors, including market conditions in general, the number of shares outstanding, plans which may have been formulated by management, applicable regulations of the state of incorporation or of any governmental agency having jurisdiction over eMagin, and the relationship to other Exchange policies regarding continued listing. If the Exchange were to determine that our share price is too low and that we should reverse split our shares but we were unable to comply for any reason, our common stock may be delisted from the Exchange. Other rules regarding timely filing of reports, payments of fees, and other criteria also could be at issue. For instance, eMagin did not hold an annual meeting in 2001, which could have been determined to be a listing issue. The 2001 and 2002 meetings are currently planned to be combined and held in 2003. Delisting of our common stock could materially adversely affect the market price, the market liquidity of our common stock and our ability to raise necessary capital. Moreover, it would likely be more difficult to trade in or to obtain accurate quotations as to the market price of our common stock.

We have a history of losses since our inception and expect to incur losses for the foreseeable future. Accumulated losses excluding non-cash transactions as of December 31, 2002, were \$28.4 million. Prior 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 operating and capital expenditures in areas such as establishment and expansion of markets, sales and marketing, operating equipment and research and development. We cannot assure investors that we will ever achieve or sustain profitability or that our operating losses will not increase in the future.

We have been dependent on U.S. government contracts. In past years, the majority of our revenues to date have been derived from direct research and development contracts with the U.S. federal government. As we transition from research and development, some of our key purchase orders relate to their own procurement or development contracts with the federal government. The government at its discretion may modify or terminate our or our customers' government contracts. Our customers and we plan to submit proposals for additional development contract and product procurement 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 our or our customers' existing contracts will continue, that we or our customers will be successful in obtaining new government contracts, or that programs through which our contracts are funded will continue to be funded beyond the current fiscal year. Our or our customers' inability to obtain revenues from government contracts could have a material adverse effect on our results of operations.

Risks Related To Our Intellectual Property

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We rely on our license agreement with Eastman Kodak for the development of certain aspects of our products, and the termination of this license, Eastman Kodak's licensing of its OLED technology to others for microdisplay applications, or the sublicensing by Eastman Kodak of our OLED technology to third parties, could have a material adverse impact on our business. Our principal products under development utilize OLED technology that we license from Eastman Kodak. We rely upon Eastman Kodak to protect and enforce key patents held by Eastman Kodak, relating to OLED display technology. Eastman Kodak's patents expire over a range of years from 2003 to 2020. 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,

40

rights granted under patents issued to us may not afford us any competitive advantage, others may independently develop similar technology or design around our patents, our technology may be available to licensees of Eastman Kodak, and protection of our intellectual property rights may be limited in certain foreign countries. We may be required to expend significant resources to monitor and police our intellectual property rights. Any future infringement or other claims or prosecutions related to our intellectual property could have a material adverse effect on our business. Any such claims, with or without merit, could be time consuming to defend, result in costly litigation, divert management's attention and resources, or require us to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us, if at all. Protection of intellectual property has historically been a large yearly expense for eMagin. We have not recently been in a financial position to file for patents on a worldwide basis and may not be in a position to do so for some time. We continue to make an effort to protect our intellectual property and trade secrets as is practical in the current difficult situation.

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. 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 who we must displace.

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

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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 go construct 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 high volume production 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. Color LCOS displays went into initial production several years ahead of eMagin's OLED display introduction, and may be in higher volume production sooner than our microdisplays, which could have a significant detrimental effect on our market opportunity.

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

41

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. The Company has been constrained for over 2 years by serious capital deficiencies, and could continue to be undercapitalized relative to its competitors even after a modest financing.

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

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achieving customer qualification and incorporation of our products could adversely affect our business.

Our products will likely experience rapidly declining unit prices. In several of 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 our silicon integrated circuits on which we incorporate the OLED or printed circuit boards. Instead, we expect to provide the design layouts to semiconductor contract manufacturers who will manufacture the integrated circuits on silicon wafers. We also expect to depend on suppliers of a variety of other components and services, including circuit boards, graphic integrated circuits, passive components, materials and chemicals, and equipment support. Our inability to obtain sufficient quantities of high quality silicon integrated circuits or other necessary components, materials or services on a timely basis could result in manufacturing delays, increased costs and ultimately in reduced or delayed sales or lost orders which could materially and adversely affect our operating results.

42

We have not manufactured OLED-on-silicon products in large commercial quantities and we do not know if our manufacturing yields or throughput will be commercially viable. In order for us to be successful as a product or component manufacturer, our products must be manufactured to meet high quality standards in commercial quantities at competitive prices. We are not staffed adequately to achieve our full available capacity for high quantity production. The manufacture of OLED-on-silicon is new and OLED microdisplays have not been produced in significant volumes. If we are unable to produce our products in sufficient quantity, we will be unable to attract or retain customers. In addition, we cannot assure you that once we commence higher volume production we will attain yields at high throughput that will result in profitable gross margins or that we will not experience manufacturing problems which could result in delays in delivery of orders or product introductions.

We are dependent on a single manufacturing line. We initially expect to manufacture our products on a single manufacturing line. If we experience any significant disruption in the operation of our manufacturing facility we may be unable to supply microdisplays to our customers. For this reason, some OEMs may also be reluctant to commit a broad line of products to our microdisplays without a second production facility in place. Interruptions in our manufacturing could be caused by manufacturing equipment problems, the introduction of new equipment into the manufacturing process or delays in the delivery of new manufacturing equipment. Lead-time for delivery of manufacturing equipment can be extensive. No assurance can be given that we will not lose potential sales or be unable to meet production orders due to production interruptions in our manufacturing line. In order to meet the requirements of certain OEMs for multiple manufacturing sites, we will have to expend capital to

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secure additional sites and may not be able to manage multiple sites successfully or outsource production to other manufacturers.

Risks Related To Our Business

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

Our 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.

Our microdisplay business may not be successful. The market for microdisplays may develop later than anticipated by us may therefore limit our sales potential for the foreseeable future. Customers may be slow to ramp their products using our products or pursue other interests

We generally do not have long term contracts with our customers. Our business has historically operated on the basis of short term purchase orders and we cannot guarantee that our long term purchase agreements will result in the desired sales since the penalties for cancellation are small or non-existent. 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.

43

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

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assurance that we will be able to continue to establish and maintain strategic relationships on commercially acceptable terms, or that the alliances we do enter in to will realize their objectives. Failure to do so would have a material adverse effect on our business.

We will need to obtain additional financing, which may not be available on suitable terms, and as a result our ability to grow or continue existing operations may be limited. Our future liquidity and capital requirements are difficult to predict because they depend on numerous factors, including our success in completing the development of our products, manufacturing and marketing our products and competing technological and market developments. We may not be able to generate sufficient cash from our operations to meet additional working capital requirements, support additional capital expenditures or take advantage of acquisition opportunities. In addition, substantial additional capital may be required in the future to fund product development and product launches. No assurance can be given that additional financing will be available or that, if available, such financing will be obtainable on terms favorable to our shareholders or us. To the extent we raise additional capital by issuing equity or securities convertible into equity, our current shareholders will suffer dilution in ownership. If needed capital is unavailable, our ability to continue to operate and grow our business could be adversely affected. Even if capital is available at acceptable cost, we might not be able to manage growth effectively.

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. In addition, many of the OEMs which 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 give expose us to various risks including management of a multi-national organization, the complexities of complying with foreign law and custom, political instability and the complexities of taxation in multiple jurisdictions.

Our business may expose us to product liability claims. Our business exposes us to potential product liability claims. Although no such claim has 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 maintain product liability insurance coverage, there can be no assurance that product liability claims will not exceed coverage limits, fall outside the scope of such coverage, or that such insurance will continue to be available at commercially reasonable rates, if at all.

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

Risks Related To Our Stock

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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 December 31, 2002, we have outstanding options to purchase 5,893,085 shares. There are also outstanding warrants to purchase

44

6,894,153 shares of common stock. Incentive options for 5,185,000 Common Shares at \$0.21 per share were approved by the eMagin Board of Directors on October 9, 2002 for issue to employees, directors, and officers. The options were not yet granted, pending the future availability of Common shares for the options under the company's qualified option plan. Upon availability, the company may issue these options at which time the strike price will remain \$0.21 and the difference between the strike price and the fair market value, if the strike price is under the fair market value at the date of issue, will be recognized as compensation expense. As of December 31, 2002, there were only approximately 100,000 shares available within the plan. The number of shares actually granted may be prorated to a much small number.

We do not intend to pay dividends; you will not receive funds without selling shares; and you may lose the entire amount of your investment. We have not paid any dividends on our common stock and we do not plan to pay cash dividends in the foreseeable future. We intend to retain our earnings, if any, for use in our business. We further cannot assure you that you will receive a return on your investment when you sell your shares or that you will not lose the entire amount of your investment.

We have a staggered Board of Directors and other anti-takeover provisions which could inhibit potential investors or delay or prevent a change of control that may favor you. Our Board of Directors is divided into three classes and our Board members are elected for terms that are staggered. This could discourage the efforts by others to obtain control of the company. Some of the provisions of our certificate of incorporation, our bylaws and Delaware law could, together or separately, discourage potential acquisition proposals or delay or prevent a change in control. In particular, our board of directors is authorized to issue up to 10,000,000 shares of preferred stock (less any outstanding shares of preferred stock) with rights and privileges that might be senior to our common stock, without the consent of the holders of the common stock.

We cannot forecast our future performance. We cannot accurately forecast our revenues because of our limited commercial operating history and because the OLED microdisplay market is only beginning to emerge. We may experience significant fluctuations in our quarterly operating results due to many factors which are outside our control. These factors include: fluctuation in demand and orders for our products; timing or cost of future supply or equipment deliveries; manufacturing capacity and yields; variations in product and process development costs; expenses or operational disruptions resulting from acquisitions; activities of our competitors; adequate working capital; and general economic conditions. Due to these factors, we cannot anticipate with any degree of certainty what our revenues, if any, will be in future periods. You have limited historical financial data and operating results with which to evaluate our business and our prospects. As a result, you should consider our prospects in light of the expense, difficulties and delays frequently encountered by early stage companies formed to pursue development of new technologies.

Our share price is likely to be highly volatile which may result in substantial losses for investors. Share price volatility may subject us to

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securities class action litigation. Prices and trading volume for technology related stock has been highly volatile. Accordingly, our stock prices are likely to also be highly volatile. Shareholders may experience a decrease in the value of their common stock regardless of our operating performance or prospects. In addition, the trading price of our common stock could be subject to wide fluctuations in response to: our perceived prospects; quarter to quarter variations in our operating results; changes in earnings estimates or recommendations by securities analysts and market perceptions of our operating results in relation to those estimates or recommendations; changes in market valuation of companies in the microdisplay systems industry; announcements of technological innovations or new products by us or our competitors; economic, political, and issues associated with our customers, suppliers, partners, accountants, governmental agencies in the USA and elsewhere, or other parties; sales of shares by other shareholders; and general conditions in the personal products industries or stock market conditions. In the past, securities class action litigation has often been instituted against companies following periods of volatility in their share price. Those companies, like us, that are involved in rapidly changing technology markets are particularly subject to this risk. This type of litigation, if instituted against us, could result in substantial costs and divert our management's attention and resources, which could cause serious harm to our business.

ITEM 8: FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

FINANCIAL STATEMENT INDEX

FINANCIAL STATEMENTS FOR eMAGIN CORPORATION

Report of Independent Certified Public Accountants.....
Report of Independent Public Accountants
Consolidated Balance Sheets as of December 31, 2002 and December 31, 2001
Consolidated Statements of Operations for the years ended December 31, 2002, 2001 and 2000 and fo
period from inception (January 23, 1996) through December 31, 2002
Consolidated Statements of Shareholders' Equity for the period from inception to December 31, 199
the six years ended December 31, 2002.....
Consolidated Statements of Cash Flows for the years ended December 31, 2002, 2001 and 2000 and fo
period from inception (January 23, 1996) through December 31, 2002
Notes to the Consolidated Financial Statements.....

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Shareholders of eMagin Corporation:

We have audited the accompanying balance sheet of eMagin Corporation (a Delaware corporation in the development stage; see Note 1) and subsidiaries as of December 31, 2002 and the related consolidated statements of operations,

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shareholders' equity (deficit) and cash flows for the year then ended and the 2002 amounts included in the cumulative period from inception (January 23, 1996) to December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of eMagin Corporation as of December 31, 2001 and for the year then ended and from inception to December 31, 2001 were audited by other auditors who have ceased operations and who's report dated March 13, 2002 included an explanatory paragraph that described uncertainties regarding the Company's ability to continue as a going concern.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of eMagin Corporation and subsidiaries as of December 31, 2002, and the results of their operations and their cash flows for the year then ended, and the 2002 amounts included in the cumulative period from inception (January 23, 1996) to December 31, 2002, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company's recurring losses from operations since inception and the working capital deficit raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ Grant Thornton LLP
New York, New York
April 11, 2003

47

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Shareholders of eMagin Corporation:

We have audited the accompanying consolidated balance sheets of eMagin Corporation (a Delaware corporation in the development stage; see Note 1) and subsidiaries as of December 31, 2001 and 2000, and the related consolidated statements of operations, shareholders' equity (deficit) and cash flows for the years then ended and the related consolidated statements of operations, shareholders' equity (deficit) and cash flows for the period from inception (January 23, 1996) to December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We have not audited

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the financial statements of the Company from inception to December 31, 1999. These financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the consolidated statements of operations, shareholders' equity (deficit) and cash flows for the period from inception to December 31, 1999, is based solely on the report of other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of eMagin Corporation and subsidiaries as of December 31, 2001 and 2000, and the results of their operations and their cash flows for the years then ended, and for the period from inception to December 31, 2001, in conformity with accounting principles generally accepted in the United States.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company's recurring losses from operations since inception and the working capital deficit raise substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Arthur Anderson LLP
New York, New York
March 13, 2002

Note: Reprinted above is a copy of the report previously expressed by such firm which has ceased operations. The reprinting of this report is not equivalent to a current re-issuance of such report as would be required if such firm was still operating. The consolidated operations, shareholders' equity (deficit) and cash flows for the two years then ended and the related consolidated statements of operations, shareholders' equity (deficit) and cash flows for the period from inception (January 23, 1996) to December 31, 2001 referred to in this report have been included in the accompanying financial statements. Because such firm has not consented to the inclusion of this report in this Form 10-K, the reader's ability to make a claim against such firm may be limited or prohibited.

eMAGIN CORPORATION (a development stage company)

CONSOLIDATED BALANCE SHEETS
DECEMBER 31,

ASSETS

2002

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CURRENT ASSETS:

| | | |
|---|----|-----------|
| Cash and cash equivalents | \$ | 82,951 |
| Contract receivables | | 240,136 |
| Unbilled costs and estimated profits on contracts in progress | | 125,359 |
| Inventory | | 250,998 |
| Prepaid expenses and other current assets | | 113,849 |
| | | ----- |
| Total current assets | | 813,293 |
| Equipment and leasehold improvements | | 634,532 |
| Patents | | 331,442 |
| Other long-term assets | | 55,117 |
| | | ----- |
| Total assets | \$ | 1,834,384 |
| | | ===== |

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES:

| | | |
|-----------------------------------|----|------------|
| Current portion of long-term debt | \$ | 49,275 |
| Other short term debt | | 5,690,889 |
| Accounts payable | | 6,381,036 |
| Accrued expenses | | 1,207,693 |
| Accrued payroll and benefits | | 1,031,958 |
| Deferred Revenue | | 30,400 |
| Other current liabilities | | 23,505 |
| | | ----- |
| Total current liabilities | | 14,414,756 |
| | | ----- |

LONG-TERM DEBT

227,742

SHAREHOLDERS' EQUITY (DEFICIT):

| | | |
|---|----|---------------|
| Common Stock, par value \$0.001 per share | | |
| Shares authorized - 100,000,000 | | |
| Shares issued and outstanding - 30,854,980 and 25,171,183 | | 30,855 |
| Additional paid-in capital | | 119,221,277 |
| Deferred compensation | | (462,983) |
| Deficit accumulated during the development stage | | (131,597,263) |
| | | ----- |
| Total shareholders' equity (deficit) | | (12,808,114) |
| | | ----- |
| Total liabilities and shareholders' equity (deficit) | \$ | 1,834,384 |
| | | ===== |

The accompanying notes are an integral part of these financial statements

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eMAGIN CORPORATION
(a development stage company)

CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2002, 2001, 2000
and for the period from inception (January 23, 1996) through December 31, 2002

| | 2002 | 2001 | 2000 | Peri J to |
|--|-----------------|-----------------|-----------------|-----------------|
| | | | | |
| CONTRACT REVENUE: | | | | |
| Contract revenue | \$ 840,658 | \$ 5,005,657 | \$ 2,557,587 | \$ |
| Product revenue | 1,287,002 | 841,713 | - | |
| Total revenue | 2,127,660 | 5,847,370 | 2,557,587 | |
| COSTS AND EXPENSES: | | | | |
| Research and development, net of funding under cost sharing arrangements of \$331,956, \$1,555,811, \$1,328,121, \$3,608,325 respectively | 7,254,996 | 12,724,161 | 9,634,948 | |
| Amortization of purchased intangibles | 1,325,796 | 17,886,838 | 20,932,320 | |
| Acquired In Process Research & Development | - | | 12,820,000 | |
| Writedown of Goodwill and purchased intangibles | - | 32,145,863 | - | |
| Selling, general and administrative | 6,153,238 | 10,226,710 | 7,689,341 | |
| Total costs and expenses, net | 14,734,030 | 72,983,572 | 51,076,609 | |
| OTHER INCOME (EXPENSE): | | | | |
| Interest expense | (2,329,452) | (1,411,668) | (210,542) | |
| Other income (expense), net | 23,111 | 61,135 | 562,747 | |
| Other income (expense) | (2,306,341) | (1,350,533) | 352,205 | |
| Loss before provision for income taxes | \$ (14,912,711) | \$ (68,486,735) | \$ (48,166,817) | \$ |
| PROVISION FOR INCOME TAXES | | | | |
| | - | | | |
| Net loss | \$ (14,912,711) | \$ (68,486,735) | \$ (48,166,817) | \$ |

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| | | | |
|---|------------|------------|------------|
| Basic and diluted loss per common share | (0.51) | (2.73) | (2.18) |
| Weighted average outstanding common stock | 29,416,838 | 25,100,211 | 22,144,904 |

The accompanying notes are an integral part of the financial statements.

50

eMAGIN CORPORATION (a development stage company)
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT)
FOR THE PERIOD FROM INCEPTION (JANUARY 23, 1996) through DECEMBER 31, 2002

| | Common Stock | | Deferral | Additional |
|--|--------------|---------|--------------|-----------------|
| | Shares | \$ | Compensation | Paid-In Capital |
| Balance, February 6, 1996 | 600,000 | \$ 600 | | \$ 5,400 |
| Net loss for period | | | | |
| Balance, December 31, 1996 | 600,000 | 600 | - | 5,400 |
| Issuance of common stock for cash | 500,000 | 500 | | 24,500 |
| Net loss for period | | | | |
| Balance, December 31, 1997 | 1,100,000 | 1,100 | - | 29,900 |
| Effect of stock split | 5,500,000 | 5,500 | | (5,500) |
| Net loss for period | | | | |
| Balance, December 31, 1998 | 6,600,000 | 6,600 | - | 24,400 |
| Effect of stock split | 13,556,400 | 13,556 | | (13,556) |
| Net loss for period | | | | |
| Balance, December 31, 1999 | 20,156,400 | 20,156 | - | 10,844 |
| Sale of common stock in private placement | 3,464,547 | 3,465 | | 23,246,535 |
| Common stock, options and warrants issued in connection with FED acquisition | 10,486,386 | 10,486 | | 92,354,461 |
| Cancellation of existing shareholders common stock | (9,356,018) | (9,356) | | 9,356 |
| Issuance of common stock related to exercise of warrant | 1,080 | 1 | | 1,835 |
| Issuance of common stock for services | 316,748 | 317 | | 2,216,919 |

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| | | | | |
|--|------------|-----------|-----------------|----------------|
| Deferred compensation | | | \$ (13,023,364) | |
| Amortization of deferred compensation | | | 2,539,828 | |
| To book forfeited stock options | | | 1,217,139 | (1,217,139) |
| Net loss for period | | | | |
| Balance, December 31, 2000 | 25,069,143 | 25,069 | (9,266,397) | 116,622,811 |
| Sale of warrants | 16,002 | 16 | | 27,507 |
| Issuance of common stock for services | 86,038 | 86 | | 116,151 |
| Issuance of common stock related to debt financing | | | | 408,068 |
| Beneficial conversion of debt financings | | | | 530,473 |
| OID for debt financings | | | | 501,577 |
| Amortization of deferred compensation | | | 2,841,003 | |
| To book forfeited stock options | | | 4,148,027 | (4,148,027) |
| Net loss for period | | | | |
| Balance, December 31, 2001 | 25,171,183 | \$ 25,171 | \$ (2,277,367) | \$ 114,058,560 |

51

eMAGIN CORPORATION
(a development stage company)
STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY

| | Common Stock | | Deferred | Additional |
|--|--------------|-----------|----------------|--------------------|
| | Shares | \$ | Compensation | paid-in Capital |
| Balance, December 31, 2001 | 25,171,183 | \$ 25,171 | \$ (2,277,367) | \$ 114,058,560 |
| Sale of common stock in private placement | 4,899,179 | 4,899 | | 3,475,619 |
| Issuance of warrants in debt financing | | | | 140,387 |
| Issuance of common stock related to debt financing | 80,000 | 80 | | 55,570 |
| Buyout of debt financing | 500,000 | 500 | | 89,632 |

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| | | | | |
|---|---------------|-----------|--------------|----------------|
| Value related to original issue discount features of debt financing | | | | 672,682 |
| Amortization of deferred compensation | | | 739,191 | 35,329 |
| Stock Options Exercised | 2,125 | 2 | | 885 |
| Reversal and deferred compensation balance for forfeited options | | | 1,075,193 | (1,075,193) |
| Non-Cash Comp Expenses for Options | | | | 872,399 |
| Value related to beneficial conversion features of debt financing | | | | 783,691 |
| Issuance of common stock for services | 202,493 | 202 | | 111,716 |
| Net Loss for Period | | | | |
| Balance, December 31, 2002 | \$ 30,854,980 | \$ 30,855 | \$ (462,983) | \$ 119,221,276 |

The accompanying notes are an integral part of these financial statements

52

eMAGIN CORPORATION (a development stage company)

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2002, 2001 and 2000 and for the period from inception (January 2 December 31, 2002

| | 2002 | 2001 | 2000 |
|---|----------------|----------------|----------------|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | | |
| Net loss | (\$14,912,711) | (\$68,486,735) | (\$48,166,000) |
| Adjustments to reconcile net loss to net cash used in operating activities- | | | |
| Depreciation and amortization | 1,842,480 | 18,453,461 | 21,488,000 |
| Write-down of goodwill and purchased intangibles | | 32,145,863 | |
| Loss on disposal of assets | | | 98,000 |
| Non-cash charge for stock based compensation | | | |

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| | | | |
|--|-------------|--------------|----------|
| Non-cash interest related charges | 1,646,917 | 2,841,003 | 2,539 |
| Non-cash related to issuance of warrants | 1,446,654 | 1,222,562 | |
| Non-cash charge for services received | 140,387 | | |
| Non-cash charge due to beneficial conversion | 25,050 | 116,151 | |
| Acquired in-process research and development | 783,691 | | |
| Changes in operating assets and liabilities, net of acquisition: | | | 12,820 |
| Trade receivables | 593,300 | 340,606 | (693) |
| Interest receivable | | | |
| Unbilled costs and estimated profits on contracts in progress | 125,359 | | |
| Costs and estimated profits in excess of billings on contracts | (326,291) | 334,074 | (7) |
| Inventory | 341,718 | (90,720) | |
| Prepaid expenses and other current assets | 196,371 | 276,984 | (359) |
| Other long-term assets | 139,033 | 11,027 | (94) |
| Advanced payment on contracts to be completed | (398,343) | 86,531 | 311 |
| Deferred Revenue | 30,400 | | |
| Accounts payable, accrued expenses and accrued payroll | 2,738,847 | 1,932,619 | 51 |
| Other current liabilities | | | |
| Net cash used in operating activities | (5,587,137) | (10,816,574) | (12,012) |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | | |
| Purchases of equipment | (84,745) | (464,829) | (803) |
| Net proceeds from acquisition | | | 1,239 |
| Net cash used in investing activities | (84,745) | (464,829) | 436 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | | |
| Proceeds from sales of common stock, net of issuance costs | 3,475,621 | | 21,250 |
| Proceeds from exercise of stock options and warrants | 141,272 | 27,609 | |
| Proceeds from long and short term debt (net) | 1,443,478 | 4,875,000 | |
| Payments of long term debt and capital leases | (43,880) | (250,121) | (2,305) |
| Net cash provided by financing activities | 5,016,491 | 4,652,488 | 18,944 |
| NET INCREASE IN CASH AND CASH EQUIVALENTS | (655,391) | (6,628,915) | 7,367 |
| CASH AND CASH EQUIVALENTS, beginning of period | 738,342 | 7,367,257 | |
| CASH AND CASH EQUIVALENTS, end of period | \$ 82,951 | \$ 738,342 | \$ 7,367 |

The accompanying notes are an integral part of these financial statements

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Notes to the Consolidated Financial Statements

Note 1 - NATURE OF BUSINESS AND DEVELOPMENT STAGE RISKS

Fashion Dynamics Corporation ("FDC") was organized January 23, 1996, under the laws of the State of Nevada. FDC had no active business operations other than to acquire an interest in a business. On March 16, 2000, FDC acquired FED Corporation ("FED") (the "Merger"). FED was a developer and manufacturer of optical systems and micro displays for use in the electronics industry. FED's wholly owned subsidiary, Virtual Vision, develops and markets micro display systems and optics technology for commercial, industrial and military applications. The merged company changed its name to eMagin Corporation (the "Company" or "eMagin"). Following the Merger, the business conducted by the Company is the business conducted by FED prior to the Merger.

The Company continues to be a development stage company, as defined by Statement of Financial Accounting Standards ("SFAS") No. 7, "Accounting and Reporting by Development Stage Enterprises," as it continues to devote substantially all of its efforts to establishing a new business, and it has not yet commenced its planned principal operations. Revenues earned by the Company to date are primarily related to research and development type contracts and sales of its first two commercial organic light emitting diode ("OLED") micro display products.

Through December 31, 2002 we have incurred accumulated losses of approximately \$131.6million since our inception and we anticipate incurring significant losses as we fund our growth. Since inception we have financed our operations through private placements of equity securities, research and development contracts and borrowings. As of December 31, 2002, we had \$83 thousand in cash and cash equivalents, and a working capital deficit of \$13.6million. We are in default of our note agreements (see Note 5) and we are delinquent in our lease obligation to IBM in the amount of approximately \$150,000. We may be denied access to the premises although the company has entered into negotiations with IBM to settle the amount due in April 2003.

The Company's ability to continue as a going concern and its future success is dependent upon its ability to raise capital in the near future to continue: (1) its research and development efforts, (2) hiring and retaining key employees, (3) satisfaction of its commitments and (4) the successful development, marketing and production of its products.

The Company believes that it will be able to secure financing in the near term and that the proceeds from such financings, and its remaining cash resources at December 31, 2002, will be sufficient to fund the Company's operations into the first quarter of 2004 and beyond. However, there can be no assurance that sufficient capital will be available, when required, to permit the Company to realize its plan, or even if such capital is available, that it will be at terms favorable to the Company. Additionally, there can be no assurance that the Company's efforts to produce a profitable product will be successful or that the Company will generate sufficient revenues to provide positive cash flows from operations. These and other factors raise substantial doubt about the Company's ability to continue as a going concern. The accompanying consolidated financial statements do not include any adjustments that might result should the Company be unable to continue in existence.

Note 2 - SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

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The accompanying consolidated financial statements of eMagin Corporation include the assets, liabilities, revenues and expenses of all majority-owned subsidiaries over which the Company exercises control. Inter-company transactions and balances are eliminated in consolidation.

54

Revenue and Cost Recognition

The Company has historically earned revenues from certain of its research and development 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.

Product revenue is recorded when products are shipped to customers, at which time, title passes to the customer net of estimated returns. The Company provides a limited warranty that its products meet the formal specifications at the time of shipment. Customers are typically provided an ability to return products with out of specification initial manufacturing defects up to 1 year after shipment, depending on the arrangements made. Longer limited warrants may be made. The company does not provide any warranty other than the potential replacement of our own specific product.

As of December 31, 2002 and 2001, the Company had received advanced payments on contracts to be completed of \$0 and \$275,000, respectively. These amounts, classified as deferred revenues in the accompanying consolidated balance sheets, represent that portion of amounts billed by the Company, or cash collected by the Company, for which services have not yet been provided or products have not yet been delivered.

Costs and Estimated Profits in Excess of Billings on Contracts in Progress

The Company records costs and estimated profits in excess of billings on contracts in progress as an asset on its balance sheet to the extent such costs, and related profits, if any, have been incurred under outstanding contracts and are expected to be collected.

The components of costs and estimated profits in excess of billings on contracts in progress as of December 31, 2002 and 2001 were as follows:

| | 2002 |
|--|------------|
| Total costs incurred and estimated profits | \$ 840,658 |
| Less amounts billed | 840,658 |
| Costs and estimated profits in excess of billings on contracts in progress | \$ 0 |
| | ===== |

Research and Development/Cost-Sharing Arrangements

The Company has entered into three cost-sharing arrangements with an agency

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of the U.S. Government and one commercial customer. To date, activities of the Company include the performance of research and development under cooperative agreements. Current industry practices provide that costs and related funding under such agreements be accounted for as incurred and earned. The Company is reimbursed for expenses plus government rates for research and development costs and general and administrative costs.

The Company has incurred research and development costs and earned funding under these agreements as of December 31, 2002, 2001 and 2000 as follows:

| | 2002 | 2001 | |
|-----------------------------------|--------------|---------------|-------|
| Unfunded research and development | \$ 7,244,820 | \$ 11,442,000 | \$ 9 |
| Research and development costs | 331,956 | 2,838,000 | |
| Funding received | (331,956) | (1,556,000) | |
| | ----- | ----- | ----- |
| | \$ 7,244,820 | \$ 12,724,000 | \$ 9 |
| | ===== | ===== | ----- |

55

Cash and Cash Equivalents

The Company considers all highly liquid instruments with an original maturity of three months or less at the date of purchase to be cash equivalents.

Accounts Receivable

The majority of the Company's commercial accounts receivable are due from OEM manufacturers. 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 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Accounts outstanding longer than the contractual payment terms are considered past due. The Company determines its allowance by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes-off accounts receivable when they become uncollectable, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

Inventory

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

Equipment and Leasehold Improvements

Equipment and leasehold improvements are stated at cost. Depreciation on equipment is calculated using the straight-line method of depreciation over their estimated useful lives. Amortization of leasehold improvements is calculated by using the straight-line method over the shorter of their estimated useful lives or lease terms. Expenditures for maintenance and repairs are charged to expense as incurred.

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Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. In accordance with this standard, eMagin performs impairment tests on its long-lived assets, excluding goodwill and other intangible assets, when circumstances indicate that their carrying amounts may not be recoverable. If required, recoverability is tested by comparing the estimated future undiscounted cash flows of the asset or asset group to its carrying value. If the carrying value is not recoverable, the asset or asset group is written down to market value.

Goodwill and Other Intangible Assets

Identifiable intangible assets resulting from the acquisition of FED and the excess purchase price over net assets acquired ("goodwill") are being amortized on a straight-line basis over their respective estimated useful lives of approximately three years. The Company's ability to realize its goodwill is dependent upon its ability to raise sufficient financing in order to expand the rollout and commercialization of its products. In the third quarter of 2001, the Company was able to secure a limited amount of additional financing to fund its operations, however, such financing was not in the amount the Company expected to be able to secure, nor was it enough to rollout commercialization of its product on a wide scale basis, as had been contemplated by its business plan. Based on these factors, among others, the Company revised its future business plan and evaluated the carrying value of the identifiable intangible assets and goodwill. Based on this evaluation, the Company determined that the assets were impaired, and, accordingly, during the quarter ended September 30, 2001, the Company recorded an impairment write-down of its goodwill and other identifiable intangible assets of approximately \$32.1 based on the estimated discounted net

56

cash flow to be generated over the remaining life of the assets. The impairment charge is included in the accompanying consolidated statement of operations for the year ended December 31, 2001. Inclusive of this impairment write-down, amortization of identified intangibles expense for the year ended December 31, 2001 was approximately \$50.0 million and amortization of purchased intangibles expense for the year ended December 31, 2002 was approximately \$1.3 million.

As of December 31, 2002 and 2001, intangible assets was comprised of the patents as follows (in millions):

| | 2002 | 2001 |
|--------------------------------------|---------|---------|
| Patents | \$ 18.0 | \$ 18.0 |
| Less: Accumulated amortization | (17.7) | (16.3) |
| | ----- | ----- |
| Patents, net | \$ 0.3 | \$ 1.7 |
| | ===== | ===== |

Income Taxes

Deferred income taxes are recorded by applying enacted statutory tax rates to temporary differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. At December 31, 2002 and 2001, the Company has net deferred tax assets of approximately \$29.5 million and \$24.4 million respectively, primarily resulting from the future tax benefit of net operating loss carry forwards discussed below. Such net deferred tax assets are

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fully offset by valuation allowances due to the uncertainty as to their realizability.

At December 31, 2002, the Company has net operating loss carry forwards totaling approximately \$ 72.7 million, inclusive of the net operating losses acquired as part of the acquisition of FED, which expire through 2021, available to offset future Federal taxable income. Pursuant to Section 382 of the Internal Revenue Code, the usage of a portion of these net operating loss carry forwards is limited due to changes in ownership that have occurred.

Loss per Common Share

In accordance with SFAS No. 128, "Earnings Per Share," net loss per common share amounts ("basic EPS") were computed by dividing net loss by the weighted average number of common shares outstanding and excluding any potential dilution. Net loss per common share amounts assuming dilution ("diluted EPS") were computed by reflecting potential dilution from the exercise of stock options and warrants. Common equivalent shares have been excluded from the computation of diluted EPS for all periods presented as their effect is antidilutive.

Comprehensive Income (Loss)

The Company complies with the provisions of SFAS No. 130, "Reporting Comprehensive Income," which requires companies to report all changes in equity during a period, except those resulting from investment by owners and distributions to owners, for the period in which they are recognized. Comprehensive income (loss) is the total of net income (loss) and all other non-owner changes in equity (or other comprehensive income (loss)) such as unrealized gains or losses on securities classified as available-for-sale, foreign currency translation adjustments and minimum pension liability adjustments. Comprehensive income (loss) must be reported on the face of the annual financial statements. The Company's operations did not give rise to any material items includable in comprehensive income (loss), which were not already in net income (loss) for the years ended December 31, 2002, 2001 and 2000. Accordingly, the Company's comprehensive income (loss) is the same as its net income (loss) for all periods presented.

Stock-Based Compensation

Accounting for Stock-Based Compensation: eMagin applies Accounting Principals Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations in accounting for its stock-based compensation plans. Accordingly, eMagin records expense for employee stock

57

compensation plans equal to the excess of the market price of the underlying eMagin shares at the date of grant over the exercise price, which equals the market price of the underlying shares at the grant date and therefore, no compensation expense is recorded. The following table summarizes the pro forma operating results of eMagin had compensation cost for stock options granted (See Note 8) been determined in accordance with the fair value based method prescribed by Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123). eMagin has presented the following disclosures in accordance with SFAS 148 "Accounting for Stock-Based Compensation-Transition and Disclosures."

For the year ended December 31,

2002

2001

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(In thousands, except per share amounts)

| | | | |
|--|-----------------|-----------------|----|
| Net loss applicable to common stockholders', as reported | \$ (14,912,711) | \$ (68,486,735) | \$ |
| Adjust: Stock-based employee compensation expense determined under fair value method | (1,225,884) | (992,265) | |
| Pro forma net loss. | \$ (16,138,595) | \$ (69,479,000) | \$ |
| Net loss per share applicable to common stockholders': | | | |
| Basic and diluted , as reported | \$ (0.51) | \$ (2.73) | |
| Basic and diluted, pro forma | \$ (0.55) | \$ (2.77) | |

The pro forma amounts that are disclosed in accordance with SFAS No. 123 reflect the portion of the estimated fair value of awards that were earned for the years ended December 31, 2002, 2001 and 2000.

The fair value of stock option grants is estimated using the Black-Scholes option-pricing model with the following assumptions:

| For the year ended December 31, | 2002 | 2001 | 2000 |
|---|---------|---------|---------|
| Term (years) | 5 | 3 | 1.6 |
| Volatility | 150% | 128% | 75% |
| Risk-free interest rate | 6.00% | 5.41% | 4.48% |
| Dividend yield | 0 % | 0 % | 0% |
| Weighted -average fair value per option | \$ 0.35 | \$ 2.72 | \$ 0.76 |

Concentration of Credit Risk

Financial instruments which potentially subject the Company to credit risk consist primarily of cash, cash equivalents, trade receivables, contract receivables and costs and estimate profits in excess of billings on contracts in progress.

The Company maintains cash and cash equivalents with various major financial institutions. The Company limits the amount of credit exposure with any one financial institution and believes that no significant concentration of credit risk exists with respect to cash investments.

Contract receivables and costs and estimated profits in excess of billings on contracts in progress subject the Company to the potential for credit risk

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with customers, primarily government contractors. The Company establishes its credit policies based on an ongoing evaluation of its customers' creditworthiness and competitive market conditions and does not require collateral.

The Company sells products to a large number of customers which are primarily in the United States. The Company performs ongoing credit evaluations of its customers' financial condition and, generally, requires no collateral from its customers. The Company's customer base includes 2 customers who account for 32%, 6% and 0% of sales in fiscal 2002, 2001 and 2000, respectively. One customer represented 18%, 6% and 0% and the other customer represented 14%, 0% and 0% of sales in fiscal 2002, 2001 and 2000. These same two customers represented \$0% and \$23% of accounts receivable at December 31, 2002 and 4% and 0% of accounts receivable at December 31, 2001. Although the Company is directly affected by the well-being of these customers, management does not believe significant credit risk exists at December 31, 2002.

58

Fair Value of Financial Instruments

The Company has various financial instruments, including cash, cash equivalents, accounts receivable, accounts payable and short and long-term debt. The Company believes the carrying values of its financial instruments approximate their fair values.

Use of Estimates

Use of Estimates in the Preparation of Financial Statements: The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These estimates and assumptions relate to recording net revenue, collectibility of accounts receivable, and the realizability of other intangible assets, accruals, income taxes, inventory realization and other factors. Management has exercised reasonable judgment in deriving these estimates; however, actual results could differ from these estimates. Consequently, change in conditions could affect eMagin's estimates.

Reclassifications

Certain prior-year amounts have been reclassified to conform to the current year presentation.

Recent Accounting Pronouncements

New Accounting Pronouncements: In August 2001, the FASB, issued SFAS, No. 143, "Accounting for Obligations Associated with the Retirement of Long-Lived Assets." SFAS No. 143 addresses financial accounting and reporting for the retirement obligation of an asset. This statement provides that companies should recognize the asset retirement cost at its fair value as part of the cost of the asset and classify the accrued amount as a liability. The asset retirement liability is then accreted to the ultimate payout as interest expense. The initial measurement of the liability would be subsequently updated for revised estimates of the discounted cash outflows. The Statement will be effective for fiscal years beginning after June 30, 2002. eMagin has not yet determined the effect that SFAS No. 143 will have on its consolidated financial position, results of operations or cash flows.

In April 2002, the FASB issued SFAS No. 145, "Rescission of FASB Statements

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No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." This statement eliminates the requirement under SFAS 4 to aggregate and classify all gains and losses from extinguishment of debt as an extraordinary item, net of related income tax effect. This statement also amends SFAS 13 to require that certain lease modifications with economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. In addition, SFAS No. 145 requires reclassification of gains and losses in all prior periods presented in comparative financial statements related to debt extinguishment that do not meet the criteria for extraordinary item in Accounting Principles Board Opinion ("APB") 30. The statement is effective for fiscal years beginning after May 15, 2002 with early adoption encouraged. eMagin does not believe the standard will have a material effect on its financial statements.

On July 30, 2002, The FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by the standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. eMagin is currently evaluating the requirements and impact of this statement on our consolidated results of operations and financial position.

59

In November 2002, the FASB issued interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN No. 45 requires certain guarantees to be recorded at fair value, which is different from current practice, which is generally to record a liability only when a loss is probable and reasonably estimable. FIN No. 45 also requires a guarantor to make significant new disclosures, even when the likelihood of making any payments under the guarantee is remote. The disclosure provisions of FIN No. 45 are effective for financial statements of interim or annual periods after December 15, 2002. eMagin has adopted the recognition and measurement provisions of FIN No. 45 on a prospective basis with respect to guarantees issued or modified after December 31, 2002. eMagin has adopted the recognition and measurement provisions of FIN 45 on a prospective basis with respect to guarantees issued or modified after December 31, 2002. The adoption of the disclosure provisions has been reflected in the December 31, 2002 financial statements.

In November 2002, the Emerging Issues Task Force reached a consensus opinion on EITF 00-21, "Revenue Arrangements with Multiple Deliverables." The consensus provides that revenue arrangements with multiple deliverables should be divided into separate units of accounting if certain criteria are met. The consideration for the arrangement should be allocated to the separate units of accounting based on their relative fair values, with different provisions if the fair value of all deliverables are not known or if the fair value is contingent on delivery of specified items or performance conditions. Applicable revenue recognition criteria should be considered separately for each separate unit of accounting. EITF 00-21 is effective for revenue arrangements entered into in fiscal periods beginning after June 15, 2003. Entities may elect to report the change as a cumulative effect adjustment in accordance with APB Opinion 20, Accounting Changes. eMagin has not determined the effect of adoption of EITF 00-21 on its financial statements or the method of adoption it will use.

In November 2002 the Emerging Issues Task Force reached a consensus opinion on EITF 02-16, "Accounting by a Customer (including a reseller) for Certain Consideration Received from a Vendor." EITF 02-16 requires that cash payments,

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credits, or equity instruments received as consideration by a customer from a vendor should be presumed to be a reduction of cost of sales when recognized by the customer in the income statement. In certain situations, the presumption could be overcome and the consideration recognized either as revenue or a reduction of a specific cost incurred. The consensus should be applied prospectively to new or modified arrangements entered into after December 31, 2002. eMagin has not yet determined the effects of EITF 02-16 on its financial statements

On December 31, 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for an entity that voluntarily changes to the fair value method of accounting for stock-based employee compensation. In addition, it also amends the disclosure provisions of SFAS No. 123 to require prominent disclosure about the effects on reported net income, including per share amounts, of an entity's accounting policy decisions with respect to stock-based employee compensation in annual and interim financial statements. SFAS No. 148 does not amend SFAS No. 123 to require companies to account for their stock-based employee compensation using the fair value method. The disclosure provisions of SFAS No. 123 were effective immediately in 2002. SFAS 148 is effective for fiscal years ending after December 15, 2002. The transition provisions for a change to the fair value based method may be early adopted, provided that financial statements for the 2002 fiscal year have not been issued as of December 31, 2002. As of December 31, 2002, the eMagin does not have any immediate plans to change its method of accounting for stock-based employee compensation to the fair value method. Included in the 2002 financial statements are the required disclosures of SFAS 148.

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities", an Interpretation of ARB No. 51 ("FIN 46"). FIN 46 requires certain variable interest entities to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective for all new variable interest entities created or acquired after January 31, 2003. For variable interest entities created or acquired prior to February 1, 2003, the provisions of FIN 46 must be applied for the first interim or annual period beginning after June 15, 2003. eMagin does not expect this new interpretation to have a material effect on its future results of operations or cash flows.

60

Note 3 - Receivables

Receivables consist of the following:

| | 2002 |
|---|------------|
| Trade receivables | \$ 203,928 |
| Contracts: | |
| Billed: | |
| Contracts completed and in progress | 72,352 |
| Unbilled | 125,359 |
| Other | 0 |
| | ----- |
| Total | \$ 401,639 |
| Less allowance for doubtful receivables | (36,144) |

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Net receivables

\$365,495
=====

Note 4 - INVENTORY

The components of inventories as of December 31, 2002 and 2001 are as follows:

| | 2002 | 2001 |
|------------------|------------|------|
| Raw Materials | \$106,800 | |
| Work In Process. | 48,831 | |
| Finished Goods | 95,367 | |
| | \$ 250,998 | |

Note 5 - EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Equipment and leasehold improvements and their estimated lives are as follows at December 31, 2002 and 2001:

| | Useful Lives | 2002 |
|---|---------------|------------------------------|
| Computer equipment and software | 3 | \$ 158,922 |
| Lab and factory equipment | 3 | 1,630,419 |
| Furniture, fixtures and office equipment | 10 | 111,594 |
| Leasehold improvements | Life of lease | 329,739 |
| | | ----- 2,230,674 |
| Less- Accumulated depreciation and amortization | | 1,596,142 |
| | | ----- \$ 634,532 ===== |

Depreciation and amortization expense of equipment and leasehold improvements for the years ended December 31, 2002 and 2001 was approximately \$473,142 and \$567,000, respectively. Cost of fixed assets acquired under a capital lease included above totals \$66,075 as of December 31, 2002 with accumulated depreciation of \$16,519.

Additionally, from time to time, the Company makes deposits on certain equipment that may ultimately be purchased by a financing company and leased to the Company. Amounts paid by the Company for such deposits totaled approximately

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\$225,000 for the year ended December 31, 2001.

61

Note 6 - DEBT

Debt is comprised of the following:

| | 2002 |
|---------------------------|--------------|
| Notes payable (1) | \$ 65,000 |
| Capital leases (1) | 59,000 |
| Convertible Debenture (3) | 3,069,000 |
| SK Loan (4) | 3,000,000 |
| | ----- |
| | 6,193,000 |
| Less-Debt Discount | (\$ 228,000) |
| | ----- |
| | \$ 5,965,000 |
| | ----- |
| Current | 5,737,000 |
| Long-Term | 228,000 |
| | ----- |
| | \$ 5,965,000 |
| | ===== |

1. Note Payable

In June 1999, eMagin entered into a \$155,000 five-year uncollateralized loan agreement. The proceeds were used to finance a leasehold improvement. The principal balance is \$64,653 at December 31, 2002 with payments due through 2004 at an interest rate of 18%.

2. Capital Leases

The Company is party to a capital lease for certain equipment with aggregate remaining principal balance totaling \$59,063 at December 31, 2002, excluding interest, due through 2007 at an interest rate of 7.27%.

3. Convertible Debentures

a) 2001 Bridge Loan

On November 27, 2001, the Company entered into a secured convertible note purchase agreement (the "note agreement") with an investor group (the "Investors") whereby the Company could issue up to \$1.5 million of secured convertible notes to the Investors, as defined. Concurrent with the note agreement, the Company issued secured promissory notes to the Investors in the amount of \$875,000 (the "secured notes"). The secured notes accrue interest at an annual rate of 9.00% per annum and mature on August 30, 2002. The Company is also required to meet certain debt covenants, as defined. In addition, the Company granted a total of 359,589 warrants to the Investors in connection with the secured notes at an exercise price of \$1.67 per share. Such warrants are exercisable through November 2004. The fair value of the warrants in the amount of approximately \$262,000 was recorded as original issue discount, resulting in a reduction in the carrying value of the debt. The fair value of the warrants was calculated using the Black-Scholes option-pricing model.

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The original issue discount was being amortized into interest expense over the life of the debt. Due to a default on the secured notes which occurred on November 30, 2001, as discussed below, the remaining value of the original issue discount as of the date of default was amortized into interest expense. Accordingly, the related interest expense in the amount of \$262,000 is included in "Other expense, net" in the accompanying consolidated statement of operations for the year ended December 31, 2001. The secured notes were convertible into common stock at any time at a conversion price of \$1.46 per share. Such conversion terms provided for a beneficial conversion feature. As the Investors had the option to convert the notes immediately upon execution of the agreement,

62

the value of the beneficial conversion feature of approximately \$244,000 was recognized immediately as interest expense and is included in "Other expense, net" in the accompanying consolidated statement of operations for the year ended December 31, 2001.

On November 30, 2001, the Company was not in compliance with a certain debt covenant, as defined, and consequently defaulted on the secured notes, causing the maturity date of the notes to accelerate and become immediately due (the "default"). The Investors elected not to demand payment immediately. Certain investors elected to reinvest their respective funds in a subsequent financing (see below 2002 Bridge Loan), while certain other investors elected for repayment of their respective funds. The repayments to those investors occurred in January 2002. The loans have been extended through June 30, 2003 and as of December 31, 2002 \$625,000 of the loans are still outstanding.

b) Bridge Loan 2002

On January 14, 2002, the Company entered into a \$1.0 million bridge loan arrangement convertible into our common stock at a rate of \$0.5264 per share. All of the outstanding warrants issued under the Secured Note Purchase Agreement, including those issued pursuant to the January 2002 transactions, are exercisable for an aggregate of up to 1,954,944 shares of our common stock at an exercise price of \$0.5468 per share. The loan had an original maturity date of August 30, 2002 which has been extended through June 30, 2003. Such warrants are exercisable through January 2005. Certain investors of the November 27, 2001 financing who elected to remain in the new bridge loan arrangement received reset provisions of the previous conversion rate and warrant exercise prices to be equivalent to the terms granted to the new Investor.

The company repriced the warrants issued to the original investors to \$0.5468 per share. The total of the intrinsic value of the warrants issued to the new Investor and the incremental intrinsic value of the repriced warrants of certain existing investors of approximately \$480,000 has been recorded as original issue discount. The original issue discount will be amortized into interest expense over the period of the debt. In the event the debt is converted prior to maturity, the remaining discount will be amortized into interest expense at the conversion date. As of December 31, 2002 the entire \$480,000 has been amortized and is included in non-cash interest expense in the accompanying consolidated statements of operations.

In addition, based on the terms of the bridge loan arrangement, the conversion terms of the debt provide for a beneficial conversion feature. The total value of the beneficial feature of the new debt and the incremental value of the reset conversion feature of the existing debt of approximately \$780,000 was recorded at January 14, 2002 as non-cash interest expense in the accompanying consolidated statements of operations for year ended December 31, 2002

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c) Travelers

On August 20, 2001, the Company entered into a \$1.0 million bridge loan arrangement with The Travelers Insurance Company ("Travelers"). The loan accrues interest at an annual rate of 9.25%. Additionally, for each week the loan is outstanding following the closing date of the arrangement (August 20, 2001), the Company is required to issue \$50,000 worth of warrants to Travelers, as defined. Total warrants issuable to Travelers, per the agreement, are not to exceed an amount such that the exercise of all related warrants would provide Travelers greater than 19.9% ownership of the outstanding common stock of the Company. This agreement has been extended to June 30, 2003.

Through December 31, 2002, the Company has issued an aggregate of 451,852 warrants to Travelers at exercise prices ranging from \$1.28 to \$1.93 per share in connection with this arrangement. Such warrants are exercisable through November 2004. Terms of the 2002 bridge loan arrangement entered into by the Company and certain private investors (see Note 10) included a cap on the maximum number of warrants issuable to Travelers under the Travelers bridge loan arrangement at 451,842 warrants. Travelers agreed to the aforementioned amendment.

d) Series B Convertible Debentures

On August 21, 2002, the Company issued two Series B Convertible Debentures in the amount of \$121,739 each. The debentures bear interest at the rate of 8% per annum and are due August 21, 2004. The Debenture also includes a fixed conversion rate of \$0.18 per share. Based on the terms of the loan arrangement, the conversion terms of the debt provide for a beneficial conversion feature.

63

Due to the fact that the note holder had the option to convert the note immediately upon execution of the agreement, the value of the beneficial conversion feature of approximately \$108,000 was recognized immediately as interest expense and is included in "Other expense, net" in the accompanying statement of operations for the nine months ended December 31, 2002.

e) \$0.2 million Secured Note Purchase Agreement

On June 20, 2002, the Company entered into a \$0.2 million Secured Note Purchase Agreement with an Investor. The secured note accrues interest at 11% per annum and matures on June 30, 2003. The Company also granted warrants, exercisable for a period of three years, to purchase 300,000 shares of common stock with an exercise price of \$0.4419 per share to the investor. The fair value warrants issued to this Investor approximated \$84,000 has been recorded as original issue discount, resulting in a reduction in the carrying value of this debt. The original issue discount has been fully amortized. Related interest expense of approximately \$12,000 has been recognized in "Other expense, net" in the accompanying consolidated statement of operations for the year ended December 31, 2002.

4. SK Loan

On September 18, 2001 (the "closing date") the Company entered into a \$3.0 million convertible debt arrangement with SK Corporation ("SK loan"). The SK loan accrues interest at an annual rate of 4.00% and matures on September 18, 2004. In connection with the debt arrangement, the Company issued warrants for the purchase of 205,479 shares of the Company's common stock at an exercise price of \$1.46 per share. Such warrants are exercisable through September 2004. The fair value of the warrants in the amount of \$240,000 has been recorded as original issue discount, resulting in a reduction in the carrying value of the debt. The fair value of the warrants was calculated using the Black-Scholes

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option-pricing model. The original issue discount is being amortized into interest expense over the three-year life of the debt using the effective interest method. In the event the debt is converted prior to maturity, the remaining discount will be amortized into interest expense at the conversion date. The SK loan is convertible into common stock at any time at a fixed conversion price of \$1.28 per share. Such conversion terms of the debt provide for a beneficial conversion feature. Due to the fact that the note holder had the option to convert the note immediately upon execution of the agreement, the value of the beneficial conversion feature of approximately \$287,000 was recognized immediately as interest expense and is included in "Other expense, net" in the accompanying statement of operations for the year ended December 31, 2001.

Additionally, the terms of the debt arrangement provide for a put option, exercisable at the option of SK Corporation, to redeem up to 25% of the face value of the debt each 90-day period beginning on September 19, 2002. Accordingly, 25% of the face value of the debt and the proportionate share of the original issue discount had been classified as short-term debt and was included in "Current portion of long-term liabilities" in the accompanying consolidated balance sheet for December 31, 2001. The remaining 75% of principal, original issue discount and accrued interest was classified as other long-term debt in the accompanying consolidated balance sheet for December 31, 2001. As of December 31, 2002, the Company was not in compliance on its \$3,000,000 debt payable to SK Corporation, as defined, and consequently defaulted on the note, causing the maturity date of the notes to accelerate and become immediately due (the "default"). Accordingly, at December 31, 2002, the original liability of the notes of \$3,000,000, plus accrued but unpaid interest, is included in current liabilities in the accompanying consolidated balance sheet.

Maturity of debt for years ending December 31 is as follows:

| | |
|------------------|-------------|
| 2003 | 5,737,000 |
| 2004 | 191,743 |
| 2005- Thereafter | 36,257 |
| | ----- |
| Total | \$5,965,000 |

64

Note 7 INCOME TAXES

Significant components of eMagin's deferred tax assets are as follows:

December 31,

| | 2002 | 2001 |
|----------------------|---------------|---------------|
| Net operating losses | \$ 29,114,272 | \$ 24,207,988 |
| Bad debt reserve | 14,458 | 0 |
| Deferred payroll | 261,370 | 11,400 |
| Accrued vacation pay | 108,811 | 183,277 |

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| | | | | | |
|------------------------|-------|----|--------------|----|--------------|
| | Total | \$ | 29,498,911 | \$ | 24,402,665 |
| Valuation allowance | | | (29,498,911) | | (24,402,665) |
| Net Deferred Tax Asset | | \$ | - | \$ | - |

As of December 31, 2002, eMagin has Federal and state net operating loss carryforwards of approximately \$72.7 million that will be available to offset future taxable income, if any, through December 2021. The utilization of net operating losses is subject to a substantial limitation due to the change of ownership provisions under Section 382 of the Internal Revenue Code and similar state provisions. Such limitation may result in the expiration of the net operating losses before their utilization. A valuation allowance has been established to reserve for the deferred tax assets arising from the net operating losses and other temporary differences due to the uncertainty that their benefit will be realized in the future.

Note 8- SHAREHOLDERS' EQUITY (DEFICIT)

On July 16, 2001, the shareholders approved an increase in the number of authorized shares of common stock of the Company to 100,000,000 shares with a par value of \$0.001 per share.

In October 2001, the Company entered into an agreement with a third-party whereby the Company issued 86,038 shares of common stock in lieu of cash payment for services rendered on behalf of the Company. The Company recorded an expense in the amount of approximately \$116,000, the fair value of the shares granted based on the market value of the stock on the date of grant. The expense is included in "General and administrative" expense in the accompanying consolidated statement of operations for the year ended December 31, 2001. Additionally, the issuance of the shares is reflected in the consolidated statement of shareholders' equity(deficit) for the year ended December 31, 2001. In connection with the stock agreement, the Company also entered into a supply agreement with the third-party for future purchases of supplies. (see Note 10)

In June 2001, The Travelers Insurance Company exercised warrants to purchase 16,002 shares of common stock of the Company at an exercise price of \$1.72 per share.

On December 31, 1999 the Company forward split its common stock 3.054:1, increasing the number of issued and outstanding common stock from 6,600,000 to 20,156,400.

On March 30, 1998 the Company forward split its common stock 6:1 increasing the number of issued and outstanding common shares from 1,100,000 to 6,600,000.

Prior to the Merger on March 16, 2000, net proceeds of approximately \$23.3 million were raised through the private placement issuance of approximately 3.5 million shares of common stock. Additionally, approximately 9.4 million shares of common stock held by FDC's principal shareholders were cancelled at the time of the Merger.

In October 2001, the Company entered into an agreement with a third-party whereby the Company issued 86,038 shares of common stock in lieu of cash payment for services rendered on behalf of the Company. In connection with the stock agreement, the Company also entered into a supply agreement with the third-party

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for future purchases of supplies. In May of 2002, the Company issued 10,000 shares in exchange for supplies valued at \$11,000.

In January 2002, the Company negotiated settlement of amounts due to a related party for services previously rendered via issuance of 192,493 shares of common stock. As such, the Company recorded the fair value of the shares of approximately \$135,000 in selling, general and administrative expenses in the accompanying consolidated statement of operations.

65

On February 27, 2002, the Company completed a private placement of securities with several institutional and individual investors of 3,617,128 shares of common stock at a price per share of \$0.6913, generating gross proceeds of approximately \$2,500,000, less issuance costs of approximately \$35,000. In connection with the financing arrangement, the Company issued to the investors warrants to purchase 1,446,852 shares of common stock of the Company at an exercise price of \$0.7542 per share. Also, the Company issued to an institution warrants to purchase 36,164 shares of common stock in connection with a finder fee arrangement entered into between the two parties. Such warrants are exercisable through February 2005. We entered into a registration rights agreement providing for the registration of shares to be issued pursuant to a conversion of the Secured Convertible Promissory Notes and the shares to be issued pursuant to the exercise of the warrants issued thereunder. We are currently in default of this filing requirement. As a result of the default, the Company has accrued \$87,362 in interest and penalties.

On March 4, 2002, the Company entered into an equity line of credit agreement with a private equity fund (the "Fund") whereby the Company has the option, but not the obligation, to sell shares of common stock to the Fund for a three-year period at a price per share, as defined. The agreement provides for certain minimum and maximum monthly amounts up to a maximum of \$15 million and, in certain circumstances, up to \$20 million.

On March 4, 2002 the Company and the Fund entered into an agreement whereby the Company issued 50,000 shares and the Fund agreed to extend the agreement. This agreement was terminated in December whereby the Investor, retained it's warrants, the Company agreed to issue 500,000 shares of common stock and to pay the sum of \$25,000 upon the completion of specific financing.

In connection with the equity line of credit, the Company issued 30,000 shares of common stock to the Fund as compensation for certain services rendered in connection with the closing of the line of credit. As such, the Company recorded the fair value of the shares of approximately \$31,000 in selling, general and administrative expenses for the three months ended March 31, 2002. Also, the Company granted warrants purchasing up to 150,000 shares of common stock of the Company at an exercise price of \$0.8731 per share. Such warrants are exercisable through September 2005. The intrinsic value of said warrants of approximately \$140,000 is included in selling, general and administrative expenses in the first quarter of 2002.

In April 2002, the Company announced a strategic investment from ROHM Company LTD. ROHM purchased 1,282,051 shares of eMagin Common Stock at \$0.78 per share as well as warrants to purchase an additional 512,820 shares of Common Stock at a conversion price of \$0.85 per share for an investment of \$1,000,000. The fair value of each warrant was estimated on the date of grant using the Black-Scholes option-pricing model. Such warrants are exercisable through April 2005.

In 2002 the Company issued a third party 192,493 shares for consulting fees in lieu of cash.

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Note 9- STOCK-BASED COMPENSATION PLANS

Stock Option Plans

In 1994, eMagin established the 1994 Stock Plan (the "1994 Plan"), which has been assumed by the Company. The plan provided for the granting of options to purchase an aggregate of 1,286,000 shares of the Common Stock to employees and consultants of FED Corporation.

In 2000, eMagin established the 2000 Stock Option Plan (the "2000 Plan"), which has been assumed by the Company. On July 16, 2001, the shareholders approved an increase in the aggregate number of shares of the Company's common stock reserved for issuance under the 2000 Plan from 3,900,000 to 5,900,000 shares. The Plan permits the granting of options and stock purchase rights to employees and consultants of the Company. The 2000 Plan allows for the grant of incentive stock options meeting the requirements of Section 422 of the Internal Revenue Code of 1986 (the "Code") or non-qualified stock options which are not intended to meet the requirements Section 422 of the Code.

In May 2001, the Company's Board of Directors adopted the eMagin Corporation Employee Stock Purchase Plan (the "Stock Purchase Plan"), under which a total of 750,000 shares of its common stock have been reserved for

66

issuance, subject to the approval of the shareholders of the Company. The shareholders approved the Stock Purchase Plan on July 16, 2001. The Purchase Plan, which is intended to qualify as an employee stock purchase plan within the meaning of Section 423 of the Code, provides for consecutive, overlapping 24-month offering periods. Each offering period contains four six-month purchase periods. Each participant will be granted an option to purchase the Company's common stock on the first day of each of the six-month purchase periods and such option will be automatically exercised on the last day of each such purchase period. The purchase price of each share of common stock under the Purchase Plan will be equal to 85% of the lesser of the fair market value per share of common stock on the starting date of that offering period or on the date of the purchase. Offering periods begin on the first trading day on or after January 1 and July 1 of each year and terminate 24-months later. The first offering period, however, began on July 16, 2001 and will end on June 30, 2003.

Employees are eligible to participate in the Stock Purchase Plan if they are employed by the Company, or a subsidiary of the Company designated by the Board of Directors, for at least 20 hours per week and for more than five months in any calendar year. The Stock Purchase Plan permits eligible employees to purchase common stock through payroll deductions, which may not exceed 15% of an employee's compensation, subject to certain limitations. Employees may modify or end their participation in the offering at any time during the offering period or on the date of purchase, subject to certain limitations. Participation ends automatically on termination of employment with the Company. The Company's Board of Directors may amend, suspend or terminate the Stock Purchase Plan at any time, except that certain amendments may be made only with the approval of the stockholders of eMagin.

Vesting terms of the options range from immediate vesting to a ratable vesting period of 5-1/2 years. Option activity for the years ended December 31, 2002, 2001 and 2000 is summarized as follows:

| | Weighted Average Exercise Price |
|--------|---------------------------------------|
| Shares | |

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| | | |
|----------------------------------|-------------|-------|
| Outstanding at December 31, 1999 | -- | \$ -- |
| Options assumed | 3,342,832 | 2.01 |
| Options granted, post-merger | 329,200 | 9.30 |
| Options exercised | -- | -- |
| Options canceled | (281,842) | 1.77 |
| | ----- | |
| Outstanding at December 31, 2000 | 3,390,190 | 2.72 |
| Options granted | 1,078,594 | 1.05 |
| Options exercised | -- | |
| Options canceled | (924,063) | 2.17 |
| | ----- | |
| Outstanding at December 31, 2001 | 3,544,721 | 2.41 |
| | 4,788,722 | 0.40 |
| Options granted | -- | |
| Options exercised | (2,440,358) | 2.11 |
| | ----- | |
| Options cancelled | | |
| Outstanding at December 31, 2002 | 5,893,085 | |
| | ===== | |

At December 31, 2002, there were 6,915 shares available for grant under the 2000 Plan and the 1994 Plan. Incentive options for 5,185,000 Common Shares at \$0.21 per share were approved by the eMagin Board of Directors on October 9, 2002 for issue to employees, directors, and officers. The options were not yet granted, pending the future availability of Common shares for the options under the company's qualified option plan. Upon availability, the company may issue these options at which time the strike price will remain \$0.21 and the difference between the strike price and the fair market value, if the strike price is under the fair market value at the date of issue, will be recognized as compensation expense. As December 31, 2002, there were only 100,000 shares available within the plan. The number of shares actually granted may be prorated to a much small number.

67

The following table summarizes information about stock options outstanding at December 31, 2002:

| Range of Exercise Prices | Options Outstanding | | | Number Exercisable December 31, |
|--------------------------|---|--|---------------------------------|---------------------------------|
| | Number Outstanding at December 31, 2002 | Weighted Average Remaining Contractual Life (In Years) | Weighted Average Exercise Price | |
| \$ 0.18 - \$1.02 | 4,739,369 | 8.45 | \$ 0.41 | 4,525,619 |
| \$ 1.72 - \$1.72 | 929,716 | 7.11 | 1.72 | 750,034 |
| \$ 2.25 - \$11.06 | 224,000 | 7.58 | 4.08 | 156,652 |
| | ----- | | | ----- |
| | 5,893,085 | 7.92 | \$ 0.75 | 5,432,305 |
| | ===== | ===== | ===== | ===== |

Options granted at greater or lesser fair market value on date of grant for shares outstanding as of December 31, 2002

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| | 2002 | Weighted Average Fair Market Value | Weighted Av Strike Pr |
|---|-----------|---------------------------------------|--------------------------|
| Options granted above fair market value | 450,000 | \$0.81 | |
| Options granted at fair market value | 2,751,216 | \$0.61 | |
| Options granted below fair market value | 2,691,869 | \$2.99 | |
| Total Options Granted | 5,893,085 | | |

Deferred Compensation

Non-cash stock-based compensation expense represents expenses associated with stock option grants to our officers and employees at below fair market value as additional compensation for their services and to induce them to lock-up their options for a longer time than would normally be specified under the Company's standard option grant. Deferred compensation is amortized over the remaining vesting period of the underlying options. The expense also represents warrant grants with exercise prices below fair market value to security holders of eMagin for a reduced number of warrants to induce them to lock-up prior to the merger.

In March 2000, eMagin repriced approximately 325,000 common stock options issued to employees. The repricing resulted in a non-cash compensation expense of approximately \$2.7 million for the period ended March 15, 2000.

In addition, in March 2000 eMagin repriced approximately 108,000 warrants issued to outside consultants and organizations that provided bridge loans and funding commitments to the Company. The repricing resulted in a non-cash charge of approximately \$1.2 million, which is included in the accompanying consolidated statement of operations for the Company.

In March 2000, eMagin issued options to purchase common stock to employees at an exercise price below the fair market value on the date of grant of \$7.00. These options vest over a period of 1 - 60 months with a minimum lockup period of 18 months. As a result, the Company recorded deferred compensation expense in the amount of approximately \$12.5 million, which will be amortized over the vesting period of the options.

eMagin also issued warrants to shareholders at an exercise price below the fair market value on the date of grant. As a result, eMagin recorded a one-time compensation expense of approximately \$2.5 million for the period ended March 15, 2000.

The recipients of the repriced options and warrants were required to execute lock-up agreements that prohibit disposition of the underlying shares for a period of 18 months following the Merger. Thereafter the recipients may transfer no more that 20% of the underlying shares in the 6 months following the end of the 18-month period, and the balance of the underlying shares may be transferred 24-27 months after the Merger.

Warrants

At December 31, 2002, 6,894,153 warrants to purchase shares of common stock are issued, outstanding and exercisable at exercise prices ranging from \$0.43 to

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\$26.25.

Note 10 - COMMITMENTS AND CONTINGENCIES

Royalty Payments

The Company is obligated to make minimum annual royalty payments to a corporation commencing January 1, 2001. The minimum royalty of \$31,500 per year due under this agreement commences in the first year of the agreement, and increases to minimum royalty payment of \$125,000 per year starting in the sixth year of the agreement. Under this agreement, the Company must pay to the corporation a certain percentage of net sales of certain products, which percentages are defined in the agreement with the corporation. 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.

For the year ended December 31, 2002, approximately \$61,000 is included in general and administrative expense in the accompanying consolidated statement of operations.

License and Technology Agreement

eMagin has a technology development agreement with a large Asian corporation to permit potential commercialization of small-format OLED displays. The primary objective of this program is to design a small format, low cost QVGA display. Other aspects of the effort involve the potential creation of a new version of eMagin's SVGA-3D display and potentially additional display product lines. There is no assurance that any such effort(s) will be successful.

Supply Agreement

The Company has, and may again in the future, enter into supply agreements whereby stock is issued in lieu of cash.

Operating Leases

The Company leases certain office facilities and office, lab and factory equipment under operating leases expiring through 2007. Certain leases provide for payments of monthly operating expenses. The approximate future minimum lease payments through 2007 are as follows:

Year ending December 31:

| | |
|-------|--------------|
| 2003 | \$ 1,708,000 |
| 2004 | 595,000 |
| 2005 | 575,000 |
| 2006 | 23,000 |
| 2007 | 5,000 |
| | ----- |
| Total | \$ 2,906,000 |
| | ===== |

Rent expense for the years ended December 31, 2002 and 2001 was approximately \$1,107,000 and \$1,999,000, respectively. Our lease with IBM expires in 2004. We have the option to renew for five years, in yearly increments. Our lease with Redson Building Partners has been paid in advance through December 2003.

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EMPLOYMENT BENEFIT PLANS

eMagin has a defined contribution plan (the Plan) under Section 401(k) of the Internal Revenue Code, which is available to all employees who meet established eligibility requirements. Employee contributions are generally limited to 15% of the employee's compensation. Under the provisions of the Plan, eMagin may match a portion of the participating employees' contributions. There was no matching to the plan for the years ended December 31, 2002, 2001 and 2000.

LITIGATION

eMagin provides accruals for all direct costs associated with the estimated resolution of contingencies at the earliest date at which it is deemed probable that a liability has incurred and the amount of such liability can be reasonably estimated.

Note 11 - Related Party Transactions

The Company entered into a consulting agreement dated March 16, 2000 with Verus International Ltd., of which Mr. Ajmal Khan is Chief Executive Officer and Mr. Rivkin is the Non-Executive Chairman. Mr. Khan and Mr. Rivkin are also members of our Board of Directors. Terms of the agreement included monthly payments of \$15,000 by us to Verus International Ltd. for consulting services rendered. The term of the agreement expired on March 16, 2002.

On November 27, 2001, eMagin Corporation entered into a Secured Note Purchase Agreement whereby five accredited initial investors agreed to lend us an aggregate of \$875,000 in exchange for (i) 9.00% per annum Secured Convertible Promissory Notes in an aggregate principal amount of \$875,000, and (ii) three-year warrants to purchase up to an aggregate of 359,589 shares of our common stock. Mr. Rivkin, who at the time of the transaction was a member of our Board of Directors, participated as an investor in the transaction and invested \$125,000 in the company. In return for this investment, Mr. Rivkin received (i) Secured Convertible Promissory Notes in an aggregate principal amount of \$125,000, and (ii) warrants exercisable for 51,370 of our common shares, which represent a comparable transaction to the outside investors in the bridge loan.

Sovereign Bancorp Ltd also invested \$100,000 under the transaction and received (i) a Secured Convertible Promissory Note in an aggregate principal amount of \$100,000, and (ii) warrants exercisable for 41,096 of our common shares. The brother of Mr. Khan, a director of the company, is an officer of Sovereign Bancorp Ltd. This note has since been redeemed.

The Company believes that the transactions described above were made on terms no less favorable than could have been obtained from third parties. All transactions were negotiated at arm's length.

Note 12 Quarterly Information (Unaudited)

| | Year ended December 31, 2002 | | |
|--------------------|------------------------------|----------------|---------------|
| | First Quarter | Second Quarter | Third Quarter |
| Revenues | \$ 158,027 | \$ 268,127 | \$ 497,851 |
| Net loss | \$(6,489,514) | \$(4,001,043) | \$(2,754,638) |
| Net loss per share | | | |
| Basic and diluted | \$ (0.24) | \$(0.13) | \$(0.09) |

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70

Year ended December 31, 2001

| | First Quarter | Second Quarter | Third Quarter |
|--------------------|---------------|----------------|---------------|
| Revenues | \$2,030,201 | \$1,616,005 | \$1,176,628 |
| Net loss | (9,708,435) | (10,832,756) | (42,377,769) |
| Net loss per share | | | |
| Basic and diluted | \$ (0.39) | \$ (0.43) | \$ (1.69) |

During the fourth quarter of 2002, the Company reclassified amounts recorded as expense recovery to revenues, representing amounts earned on shipment of products to a former cost recovery contract customer.

The effect on the quarterly financial statements is as follows:

| | September 30, 2002 | |
|------------------------|------------------------|----------------|
| | As originally reported | As adjusted |
| Contract revenue | \$ 176 | \$ 391,966 |
| Product revenue | 497,675 | 497,675 |
| Cost and expenses | 2,844,479 | 3,236,269 |
| Other income (expense) | (408,010) | (408,010) |
| Net Loss | \$ (2,754,638) | \$ (2,754,638) |

Note 13 - SUBSEQUENT EVENTS

On March 20, 2003, we auctioned off unused leased equipment. The equipment had zero value on the books. The equipment that sold brought \$187,440 in gross proceeds. Of that amount, Comdisco (lessor) received \$81,106. which completes all of our lease obligations with Comdisco. We paid \$23,867. to miscellaneous vendors involved in the auction and the auctioneer received a 10% commission of the gross proceeds totaling \$18,744 plus auction expenses. The auction expenses cannot exceed \$54,000. If this total is reached, it would mean a net to the company of \$9,721.

ITEM 9: CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

On July 29, 2002, eMagin Corporation was notified by the Security and Exchange Commission that Arthur Andersen LLP ("Arthur Andersen") had notified it that Arthur Andersen was unable to perform future audit services for eMagin as a result of the wind-down of Arthur Andersen's business, effectively terminating eMagin's relationship with Arthur Andersen. On September 23, 2002, eMagin, upon recommendation of the Audit Committee of its Board of Directors, engaged Grant Thornton LLP ("Grant Thornton") to serve as the Company's independent certified public accountants.

71

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Part III

Item 10. Directors and Executive Officers of the Registrant

Our executive officers and directors, and their ages and positions are:

| Name | Age | Position |
|-------------------------|-----|---|
| Gary W. Jones (1) | 47 | Chairman, Chief Executive Officer, President |
| K. C. Park | 66 | President, Virtual Vision, Inc. |
| Susan K. Jones | 51 | Chief Marketing and Strategy Officer, Secretary |
| Claude Charles (2) | 66 | Director |
| Jacob (Jack) Goldman | 81 | Director |
| Jack Rivkin (1) (2) (3) | 62 | Director |

(1) Executive Committee

(2) Audit Committee

(3) Compensation Committee

Gary W. Jones has served as our Chairman, Chief Executive Officer, and President since 1992. Mr. Jones has over 25 years of experience in both public and private companies in the areas of business development, high volume manufacturing, product development, research, and marketing. Previously, Mr. Jones managed both semiconductor manufacturing and research and development programs at Texas Instruments. Mr. Jones is a director, a member of the Executive Committee of the Board, and Chairman of the Technology Committee of the United States Display Consortium. Mr. Jones received a B.S. in electrical engineering and physics from Purdue University.

Dr. K.C. Park was named President of our wholly owned subsidiary, Virtual Vision, Inc., in 2002 after serving as our Executive Vice President of International Operations since 1998. During his twenty-seven year tenure with IBM he managed flat panel display and semiconductor programs at the IBM Watson Research Center, directed the corporate display programs at the IBM Corporate Headquarters, and established Technical Operations in IBM Korea and served as Senior Managing Director. Dr. Park joined LG Electronics in 1993 as Executive Vice President and initiated and led corporate-wide efforts to shift the major emphasis of the corporation into multimedia. Dr. Park holds a B.S. from the University of Minnesota, an M.S. from MIT, and a Ph.D. in Solid State Chemistry from the University of Minnesota and an MBA from New York University.

Susan K. Jones has served as Executive Vice President and Secretary since 1992, and assumed responsibility of Chief Marketing and Strategy Officer in 2001. Ms. Jones has 25 years of industrial experience, including senior research, management, and marketing assignments at Texas Instruments and Merck, Sharp, & Dohme Pharmaceuticals. Ms. Jones serves on the boards or chairs committees for industry organizations including IEEE, SPIE, and SID. Ms. Jones served as a director of eMagin Corporation from 1993 to 2000 and is a director of Virtual Vision, Inc. Ms. Jones graduated from Lamar University with a B.S. in chemistry and biology, holds more than a dozen patents, and has authored more than 100 papers and talks.

Claude Charles has served as a director since April of 2000. Mr. Charles has served as President of Great Tangle Corporation since 1999. From 1996 to 1998 Mr. Charles was Chairman of Equinox Group Holdings in Singapore. Mr. Charles has also served as a director and in senior executive positions at SG

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Warburg and Co. Ltd., Peregrine Investment Holdings, Trident International Finance Ltd., and Dow Banking Corporation. Mr. Charles holds a B.S. in economics from the Wharton School at the University of Pennsylvania and a M.S. in international finance from Columbia University.

Dr. Jack Goldman joined our board of directors in February of 2003. Dr. Goldman is the retired senior vice-president for R&D and chief technical officer of the Xerox Corporation. While at Xerox, he founded and directed the celebrated Xerox PARC laboratory. Prior to joining Xerox, Dr. Goldman was Director of Ford Motor Company's Scientific Research Laboratory. He also served as Visiting Edwin Webster Professor at MIT. Dr. Goldman presently serves on the Boards of Directors of Umbanet Inc. and Medis Technologies Inc., and he has served on the Boards of Xerox, General Instrument Corp., United Brands, Intermagnetics General, GAF and Bank Leumi USA. He has also been active in government and professional advisory roles including service on the US Dept. of Commerce Technical Advisory Board, chairman of Statutory Visiting Committee of The National Bureau of Standards (National Institute of Standards and Technology), vice-president of the American Association for the Advancement of Science and president of the Connecticut Academy of Science and Engineering.

72

Jack Rivkin has served as a director since June of 1996. Mr. Rivkin is Executive Vice President and Chief Investment Officer of Neuberger Berman, LLC. He previously served as Executive Vice President of Citigroup Investments Inc., through which the Travelers Group investments in the Company were managed. He also served as Vice Chairman and a director of Smith Barney, and held positions at Procter and Gamble, Mitchell Hutchins, Paine Webber and Lehman Brothers. Mr. Rivkin holds an engineering degree in metallurgy from the Colorado School of Mines and an MBA from Harvard University.

In April 2003 Ajmal Khan resigned as a director to pursue other interests. He had served as a director of the Company since March of 2000, when eMagin was formed through the merger of FED Corporation with the public predecessor of the Company. Mr. Kahn was an officer of Verus Corporation which advised the Company ..in the course of the merger.

General Information Concerning the Board of Directors

The Board of Directors of eMagin is classified into three classes: Class A, Class B and Class C. Each Class A director will hold office until the 2002 Annual Meeting of our stockholders. Currently, Mr. Gary Jones and Mr. Jack Rivkin are the Class A directors. The Class B directors have resigned and the board has not yet elected or nominated new directors to replace them. Class C directors will hold office until the 2004 Annual Meeting of our stockholders. Currently, Mr. Claude Charles and Dr. Jacob Goldman are the Class C directors. In each case, each director will hold office until his successor is duly elected or appointed and qualified in the manner provided in eMagin's Amended and Restated Certificate of Incorporation and our Amended and Restated Bylaws, or as otherwise provided by applicable law.

The Board of Directors held 19 meetings during 2002. Each incumbent director attended at least 75% of the aggregate of all meetings of the Board of Directors during the period for which he was a director and the meetings of the committees on which he or she served. The Board of Directors has established an Executive Committee, an Audit Committee and a Compensation Committee.

During 2002, the Company's directors received compensation for service to the Company as directors. (See "Executive Compensation- Compensation of Directors".) Directors also received reimbursement of ordinary expenses incurred in connection with attendance at such meetings.

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Executive Officers of the Company

Officers are appointed to serve at the discretion of the Board of Directors. Except for Mr. Gary Jones, who is the spouse of Ms. Susan Jones, the Company's Executive Vice President and Secretary, none of the executive officers or directors of the Company has a family relationship with any other executive officer or director of the Company.

Committees of the Board of Directors

The Audit Committee is responsible for (i) determining the adequacy of the Company's internal accounting and financial controls, (ii) reviewing the results of the audit of the Company performed by the independent public accountants, and (iii) recommending the selection of independent public accountants. Messrs. Charles, Rivkin and Khan, prior to his resignation in 2003, were members of the Audit Committee during fiscal 2002. During the year, the Board examined the composition of the Audit Committee in light of the adoption by The American Stock Exchange, Inc. (the "Amex") of new rules governing audit committees. Based upon this examination, the Board confirmed that all members of the Audit Committee are "independent" within the meaning of the Amex's new rules. The Audit Committee met four times during fiscal 2002.

73

The Compensation Committee determines matters pertaining to the compensation of certain executive officers of the Company and administers the Company's stock option, incentive compensation, and employee stock purchase plans. Mr. Rivkin was the sole member of the Compensation Committee during fiscal year 2002. The Compensation Committee met once during fiscal year 2002.

The Executive Committee has authority to act for the Board on most matters during intervals between Board meetings, subject to Board approval. Messrs. Jones, Rivkin and Khan, prior to his resignation in April 2003, were members of the Executive Committee during fiscal year 2002. The Executive Committee met twice during the fiscal 2002.

The Company has adopted its Code of Ethics and Business Conduct for Officers, Directors and Employees that applies to all of the officers, directors and employees of the Company.

Section 16(a) Beneficial Ownership Reporting Compliance

Based on the Company's review of copies of all disclosure reports filed by directors and executive officers of the Company pursuant to Section 16(a) of the Securities Exchange Act of 1934, as amended, the Company believes that there was compliance with all filing requirements of Section 16(a) applicable to directors and executive officers of the Company during fiscal 2002, except that Mr. Ajmal Khan failed to file once.

Item 11. Executive Compensation

Summary compensation table for named executive officers

The following table provides information about the total compensation for services in all capacities to the Company or its subsidiary for the last three fiscal years of those persons who at December 31, 2002, were (i) the Chief Executive Officer of the Company and (ii) the other two most highly compensated executive officers of the Company (collectively, the "named executive officers"). Prior to establishment of the Compensation Committee, the Chief Executive Officer and Board elected not to cash pay bonuses as part of executive compensation during the development stage years of the Company, and the officers have not accepted cash bonuses to date. The Compensation Committee plans to

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allocate a bonus in stock options to officers and directors for the fiscal year 2002 during 2003.

| Name and Positions | Year | Salary | Bonus | Other Annual Compensation | Awar | Under |
|---------------------|--|--------|---------|---------------------------|------|-------|
| Gary W. Jones | President, Chief Executive Officer, Acting | 2002 | 136,050 | 0 | (1) | 0 |
| | Chief Financial Officer, | 2001 | 234,393 | | (1) | 0 |
| | Chairman Director | 2000 | 227,863 | 0 | | 0 |
| Susan K. Jones | Executive Vice President, Chief Strategy and | 2002 | 143,683 | 0 | (2) | 0 |
| | Marketing Officer, and | 2001 | 189,207 | 0 | (2) | 0 |
| | | 2000 | 183,837 | 0 | | 0 |
| K.C. Park | President, Virtual Vision | 2002 | 109,797 | 0 | (3) | 0 |
| | | 2001 | 171,877 | 0 | | 0 |
| | | 2000 | 168,623 | 0 | | 0 |
| Andrew P. Savadelis | Former Executive Vice President and Chief | 2002 | 17,389 | 0 | (4) | 0 |
| | Financial Officer | 2001 | 255,769 | 112,500 | (4) | 0 |
| | | 2000 | 91,667 | 37,500 | (4) | 0 |

74

- (1) In 2002 Mr. Jones deferred pay in the amount of \$166,522. In January 2002 Mr. Jones was granted a bonus of 750,000 shares awarded for the years 2000 and 2001. Also in January all staff received options based on salary. Mr. Jones received 45,900 options. In July, all officers were granted options for regular pay they deferred. Mr. Jones was granted 444,344 options for deferred pay from January through July 15, 2002. In October Mr. Jones was granted 349,583 options for deferred pay from July 16 through October 8, 2002.
- (2) In 2002 Mrs. Jones deferred pay in the amount of \$127,740. In January 2002 Mrs. Jones was granted a bonus of 350,000 shares awarded for the years 2000 and 2001. Also in January all staff received options based on salary. Mrs. Jones received 37,000 options. In April, Mrs. Jones was awarded 300,000 options in recognition of additional duties as Chief Strategy Officer, Chief Marketing Officer, and Secretary. In July, all officers were granted options for regular pay they deferred. Mrs. Jones was granted 324,572 options for deferred pay from January through July 15, 2002. In October Mrs. Jones was granted 281,796 options for deferred pay from July 16 through October 8, 2002.
- (3) In 2002 Dr. Park deferred pay in the amount of \$65,735. In January all staff received options based on salary. Dr. Park received 33,600 options. In April, Dr. Park was awarded 100,000 options as compensation for additional duties as President of Virtual Vision. In July, all officers were granted options for regular pay they deferred. Dr. Park was granted 112,210 options for deferred pay from January through July 15, 2002. In

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October Dr. Park was granted 192,500 options for defer red pay from July 16 through October 8, 2002.

- (4) Mr. Savadelis was employed for less than a full year in 2000. As such, his salary amount for that year represents salary earned from his start date through the end of the fiscal year. Mr. Savadelis' compensation included an annual salary of \$250,000 and a non-milestone-driven bonus of \$150,000 to be paid quarterly in the period from September 11, 2000 to September 10, 2001. \$37,500 of the non-milestone-driven bonus was paid to Mr. Savadelis during 2000. In addition, the Company paid relocation assistance in the amount of \$50,000 in October, 2000. Mr. Savadelis ceased to be employed by the Company in January 2002. In 2003 the Company reached a settlement with Mr. Savadelis in which he received \$100,000 for 2002 salary due him.

Options/SARs Grants During Last Fiscal Year

The following table provides information related to options granted to our named executive officers during the fiscal year ended December 31, 2002.

The following table provides information related to options granted to our named executive officers during the fiscal year ended December 31, 2002.

| Name | Number of Securities Underlying Options Granted (1) | % of Total Options Granted in Fiscal 2002 (2) | Exercise Price Per Share | Expiration Date (3) | Ann Appr |
|-------------------|--|--|--------------------------|------------------------|-------------|
| Gary W. Jones (1) | 750,000 | 15.7% | \$ 0.42 | 1/2/07 | 8 |
| Gary W. Jones (4) | 45,900 | 1.0% | \$ 0.42 | 1/2/07 | |
| Gary W. Jones (7) | 444,344 | 9.3% | \$ 0.32 | 7/14/05 | 4 |
| Gary W. Jones (8) | 349,583 | 7.3% | \$ 0.18 | 10/8/05 | 3 |
| Susan K Jones (1) | 350,000 | 7.3% | \$ 0.42 | 1/2/07 | 3 |
| Susan K Jones (4) | 37,000 | 0.8% | \$ 0.45 | 1/14/07 | |
| Susan K Jones (6) | 300,000 | 6.3% | \$ 0.83 | 4/30/05 | 3 |
| Susan K Jones (7) | 324,572 | 6.8% | \$ 0.32 | 7/14/05 | 3 |
| Susan K Jones (8) | 281,796 | 5.9% | \$ 0.18 | 10/8/05 | 3 |
| K.C. Park (4) | 33,600 | 0.7% | \$ 0.42 | 1/2/07 | |
| K.C. Park (5) | 100,000 | 2.1% | \$ 0.83 | 4/30/05 | 1 |
| K.C. Park (7) | 112,210 | 2.3% | \$ 0.32 | 7/14/05 | 1 |
| K.C. Park (8) | 192,500 | 4.0% | \$ 0.18 | 10/8/05 | 2 |

(1) Gary W Jones and Susan K Jones were awarded an additional grant of options during fiscal year 2002 in recognition of their respective contributions to the Company during fiscal years 2001 and 2002.

(2) All options issued in 2002 vested immediately

(3) The exercise price of the stock options was based on the fair market value of the stock on the day of the grant.

(4) Options issued to retain key employees based on a percentage of salary.

(5) Dr. Park was awarded an additional grant of options during fiscal year 2002 as compensation for additional duties as President of Virtual Vision, Inc.

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(6) Mrs. Jones was awarded an additional grant of options during fiscal year 2002 in recognition of additional duties as Chief Strategy Officer, Chief Marketing Officer, and Secretary.

(7) Options issued to compensate employees for deferred salary Jan-July 15, 2002.

(8) Options issued to compensate employees for deferred salary July 16-Oct 8, 2002.

Aggregated Option Exercises in Last Fiscal Year and Fiscal Year-End Option Value

The following table provides information regarding the aggregate number of options exercised during the fiscal year ended December 31, 2002 by each of the named executive officers and the number of shares subject to both exercisable and unexercisable stock options as of December 31, 2002. The common stock price at December 31, 2002 was \$0.40 per share.

| | Shares Acquired on Exercise | Value Realized | # of Securities Underlying Unexercised Options at FY-End Exercisable | Unexercisable | Value of Unexerci In-the-m Options FY-End Exercisa |
|---------------------|-----------------------------------|-------------------|--|---------------|---|
| Gary Jones----- | - | - | 941,110 | 874,472 | 2 |
| Susan K. Jones----- | - | - | 1,071,362 | 749,274 | 1 |
| K.C. Park----- | - | - | 419,570 | 152,571 | |

In October 2002, the Board allocated options that were not issued due to the unavailability of shares in the 2000 Stock Option Plan. Of the options allocated, the Board allocated 2,000,000 options to Mr. Jones, 1,000,000 options to Mrs. Jones and 500,000 options to Dr. Park. These options may or may not be granted in whole or in part in 2003. These were incentive options to retain the management and staff through a very difficult period

Compliance with internal Revenue Code Section 162(m) disallows a tax deduction to publicly held companies for compensation paid to certain of their executive officers to the extent that such compensation exceeds \$1.0 million per covered officer in any fiscal year. The limitation applies only to compensation that is not qualified performance based compensation under the IRS code.

Compensation of Directors

Non-management directors receive options under the 2000 Stock Option Plan (the "2000 Plan"). Under the 2000 Plan, a grant of options to purchase 40,000 shares of common stock will automatically be granted on the date a director is first elected or otherwise validly appointed to the Board with an exercise price per share equal to 100% of the market value of one share on the date of grant. Such options granted will expire ten years after the date of grant and will become exercisable in four equal installments commencing on the date of grant and annually thereafter. In addition to the 40,000 shares of common stock automatically granted upon joining the Board, Directors thereafter receive an annual grant of options to purchase 10,000 shares of common stock at the fair market value as determined on the date of grant, which options will vest on

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December 31 in the year granted. In addition, each non-management director is reimbursed for ordinary expenses incurred in connection with attendance at such meetings.

76

Executive Employment Agreements

We currently have no Employment Agreements in place with any officers of the company. The Company had Employment Agreements with Gary Jones and Susan Jones that expired on March 16, 2002.

Compensation Committee Interlocks and Insider Participation

Jack Rivkin served as the sole member of the Compensation Committee during the fiscal year 2002. Mr. Rivkin has never been an officer or employee of the Company or any of its subsidiaries.

Compensation Committee Report

The Company's executive compensation program is designed to attract, retain and motivate executive officers capable of leading the Company to meet its business objectives, to align the interests of executive management with those of the stockholders, and to incentivize and reward both short and long term performance based on the success of the Company in meeting its development milestones and business objectives. The Compensation Committee places a particular emphasis on variable, performance based components, such as the bonus potential and stock option awards, the value of which could increase or decrease to reflect changes in corporate and individual performances.

Components of Compensation. Each executive officer's compensation package is generally comprised of the following elements: (1) A base salary which is established at levels considered appropriate for the duties and scope of responsibilities of each officer's position; (2) A performance-based annual bonus; (3) Periodic grants of stock options to strengthen the mutuality of interests between the executive officers and the Company's stockholders. Annual or quarterly cash bonuses related to the performance of the Company may be made to executive officers in the sales and marketing functions, and other executive officers in certain other circumstances, for such executive officer's functional area. Executive officers are also eligible to participate in compensation and employee benefits generally available to all employees of the Company, such as health insurance and participation in the eMagin Employee Savings and Protection Plan ("401(k) Plan").

The Compensation Committee believes that this three-part approach best serves the interests of the Company and its stockholders. It enables the Company to meet the requirements of the highly competitive environment in which the Company operates while ensuring that executive officers are compensated in a way that advances both the short- and long-term interests of stockholders. Under this approach, compensation for these officers involves a high proportion of pay that is "at risk"--namely, the annual bonus and stock options. The variable annual bonus is also based, in significant part, on Company performance. Stock options relate a significant portion of long-term remuneration directly to stock price appreciation realized by all of the Company's stockholders.

Base Salary. Base salaries for executive officers are set at levels believed by the Committee to be sufficient to attract and retain qualified executive officers based on the stage of development of the Company, the salary levels in effect for comparable positions in similarly situated companies within relevant industries, and internal comparability considerations. Base salaries for the Company's executive officers other than the Chief Executive Officer, as well as changes in such salaries, are based upon recommendations by the Chief

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Executive Officer, taking into account such factors as competitive industry salaries, a subjective assessment of the nature of the position and the contribution and experience of the officer and the length of the officer's service. All such recommendations are subject to approval or disapproval by the Compensation Committee. Other than provisions provided for in Employment Agreements, changes in base salaries of executives are based on an evaluation of the personal performance of the executive, prevailing market practices, and the performance of the Company as a whole. In determining base salaries, the Compensation Committee not only considers the short term performance of the Company, but also the success of the executive officers in developing and executing the Company's strategic plans, developing management employees and exercising leadership in the development of the Company.

Cash-Based Incentive Bonus. The Compensation Committee believes that a portion of the total cash compensation for executive officers should be based on

77

the Company's success in meeting its short term performance objectives and contributions by the executive officers that enable the Company to meet its long term objectives, and has structured the executive compensation program to reflect this philosophy. This approach creates a direct incentive for executive officers to achieve desired short term corporate goals that also further the long term objectives of the Company, and places a significant portion of each executive officer's annual compensation at risk.

Stock Options. The Compensation Committee believes that equity participation is a key component of the Company's executive compensation program. Stock options are awarded by the Compensation Committee to executive officers primarily based on potential contributions to the Company's growth and development and marketplace practices. These awards are designed to retain executive officers and to motivate them to enhance stockholder value by aligning the financial interests of executive officers with those of stockholders. Stock options provide an effective incentive for management to create stockholder value over the long term because the full benefits of the option grants cannot be realized unless an appreciation in the price of the Company's common stock occurs over a number of years.

Variable Bonus. The Compensation Committee may award annual or interim Special Bonuses in the form of cash, stock options, or restricted stock to executive management and employees for achieving certain milestones, progress made in the staff and organizational development of the Company, and advances in the market acceptance and commercialization of the Company's technology.

Compensation of Chief Executive Officer. Mr. Jones's base salary as of December 31, 2002 was \$305,095 of which he received \$136,049.85. In July 2002, Mr. Jones was granted 444,344 stock options in lieu of deferred compensation from January through July 15, 2002. In October 2002, Mr. Jones was granted 349,583 stock options in lieu of deferred compensation from July 15, 2002 through October 8, 2002. The Compensation Committee awarded Mr. Jones a bonus of 750,000 stock options for the combined years 2001 and 2002, which were issued in January 2002, for accomplishments in readying the company's product, market, and capability. Additionally, Mr. Jones received an award of 45,900 options as part of a general retention award.

Compensation Committee
Jack Rivkin

Performance Graph

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The following graph compares the cumulative total shareholder return on our Common Stock from the initial listing date of our Common Stock on the American Stock Exchange through December 30, 2003 to the AMEX Computer Technology Index and an index of peer companies selected by the Company ("Peer Index") based on an unweighted average monthly closing price of the companies in the index. The companies in the Peer Index are Kopin Corporation (KOPN), Microvision Corporation (MVIS), Three Five Systems, Inc. (TFS), and Universal Display Corporation (PANL). The past performance of the Company's Common Stock is not an indication of future performance. We cannot assure you that the price of the Company's Common Stock will appreciate at any particular rate or at all in future years. Notwithstanding any statement to the contrary in any of the Company's previous or future filings with the Securities and Exchange Commission, the graph shall not be incorporated by reference into any such filings.

78

[GRAPHIC OF PERFORMANCE GRAPH]

The above performance graph is based upon the following data:

| Date | eMagin Corporation | AMEX Computer Technology Index | Company Determined Peer Index |
|----------|-----------------------|---|-------------------------------------|
| ===== | ===== | ===== | ===== |
| 12/31/00 | \$ 100 | \$ 100 | \$ 100 |
| 12/31/01 | \$ 20 | \$ 85 | \$ 99 |
| 12/31/02 | \$ 19 | \$ 56 | \$ 44 |

Item 12. Security Ownership of Certain Beneficial Owners and Management

The following table sets forth the number of shares of our common stock beneficially owned by (i) each member of our board of directors; (ii) certain of our executive officers (including all of our named executive officers); (iii) all of our directors and executive officers as a group; and (iv) all those known by us to be beneficial owners of more than five percent of the outstanding shares of our common stock as of April 28, 2003. Unless otherwise indicated, the shareholders listed in the table have sole voting and investment power with respect to the shares indicated.

| Name of Beneficial Owner ----- | Common Stock Beneficially Owned ----- |
|-----------------------------------|---|
| Stillwater LLC (1) | 13,906,589 |
| Travelers Insurance Company (2) | 9,583,852 |
| Ginola Limited (3) | 5,970,926 |
| Gary W. Jones (4) | 4,977,225 |

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| | |
|---|-----------|
| Susan K Jones (4) | 4,977,225 |
| SK Corporation (5) | 2,700,792 |
| Jack Rivkin (7) | 956,184 |
| K.C. Park (6) | 664,082 |
| Claude Charles (8) | 130,000 |
| All Directors and Executive Officers as a Group (9) | 6,727,491 |

The share information in the table set forth above has been updated from the share information presented in the Form 10-K/A previously filed by the Company on May 2, 2003 primarily to reflect the recent financing completed by eMagin, as well as information subsequently provided to eMagin from certain of its beneficial owners.

* Less than 1% of the outstanding common stock.

** Beneficial Ownership is determined in accordance with the rules of the Securities and Exchange Commission and generally includes voting or investment power with respect to securities. Shares of common stock subject to options or warrants currently exercisable or convertible, or exercisable or convertible within 60 days of April 28, 2003 are deemed outstanding for computing the percentage of the person holding such option or warrant but are not deemed outstanding for computing the percentage of any other person. Percentages are based on a total of 35,961,223 shares of common stock outstanding on April 28, 2003, and the shares issuable upon the exercise of options and warrants exercisable on or within 60 days of April 28, 2003, as described below.

79

The fully diluted number of shares outstanding as of April 28, 2003, assuming the exercise of all outstanding options and/or warrants and the conversion of all convertible notes, is 75,647,796 shares.

(1) This figure represents:

(i) 1,053,022 shares owned by Stillwater LLC, which includes 961,597 shares owned by Rainbow Gate Corporation, in which Mr. Sackler is the investment manager of the corporation;

(ii) warrants held by Stillwater LLC to purchase 5,223,966 shares, which includes

(a) a warrant to purchase 300,000 shares that may not be exercised by Stillwater LLC so long as Stillwater LLC is the beneficial owner, directly or indirectly, of more than ten percent (10%) of the common stock of eMagin for purposes of Section 16 of the Securities Exchange Act of 1934, and

(b) a warrant to purchase 289,310 shares held by Rainbow Gate Corporation, in which Mr. Sackler is the investment manager of the corporation;

(iii) options held by Stillwater LLC to purchase 1,733,335 shares held by Travelers and its affiliates TRAL and Citicorp; and

(iv) convertible notes held by Stillwater LLC to purchase 5,896,266 shares.

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- (2) Shares are owned by Travelers and its affiliates TRAL and Citicorp. This figure includes warrants held by Travelers and Citicorp to purchase 1,655,845 and 127,292 shares of common stock respectively. [Address: Citigroup Inc. 399 Park Avenue, New York, NY 10043].
- (3) This figure represents:
- (i) 1,476,936 shares owned by Ginola Limited, which includes 119,116 shares owned by Ogier Trustee Limited and 396,223 shares owned by Crestflower Corporation.. Ginola Limited disclaims beneficial ownership of the shares owned by Crestflower Corporation and Ogier Trustee Limited;
 - (ii) warrants held by Ginola Limited to purchase 1,965,764, which includes a warrant to purchase 42,858 shares held by Techalpha LLC, as to which Ginola Limited disclaims beneficial ownership;
 - (iii) options held by Ginola Limited to purchase 666,667 shares held by Travelers and its affiliates TRAL and Citicorp; and
 - (iv) convertible notes held by Ginola Limited to purchase 1,861,559 shares.
- (4) This figure represents shares owned by Gary Jones and Susan Jones who are married to each other, including (i) 1,967,094 shares of common stock issuable upon exercise of stock options held by Gary Jones and (ii) 1,959,066 shares of common stock issuable upon exercise of stock options held by Susan Jones. Does not include (i) 2,460,168 shares of common stock issuable upon exercise of stock options held by Gary Jones that are not presently exercisable and are not exercisable within 60 days of April 28, 2003, and (ii) 1,357,954 shares of common stock issuable upon exercise of stock options held by Susan Jones that are not presently exercisable and are not exercisable within 60 days of April 28, 2003.
- 80
- (5) These shares are owned by SK Corp. This figure includes warrants held by SK Corp. to purchase 205,479 shares of common stock.
- (6) This figure represents shares owned by K.C. Park. This figure includes 663,910 common stock shares issuable upon exercise of stock options. Does not include 703,471 shares of common stock issuable upon exercise of stock options that are not presently exercisable and are not exercisable within 60 days of April 28, 2003.
- (7) These shares are owned by Jack Rivkin. This figure includes warrants held by Mr. Rivkin to purchase 303,933 shares of common stock and 253,333 common stock shares issuable upon exercise of stock options.
- (8) This figure represents 130,000 common stock shares issuable upon exercise of stock options.
- (9) This figure includes (i) warrants to purchase 303,933 shares of common stock, (ii) 4,973,403 shares of common stock issuable upon exercise of stock options, and (iii) a convertible note to purchase 398,918 shares.

Item 13. Certain Relationships And Related Transactions

We entered into a consulting agreement dated as of March 16, 2000 with

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Verus International Ltd., of which Mr. Ajmal Khan is Chief Executive Officer and Mr. Jack Rivkin served as Non-Executive Chairman until he resigned that position in early 2002 upon retirement from Citigroup. Mr. Khan was a member of our Board of Directors, but resigned from such position effective as of April 25, 2003. Mr. Rivkin is a member of our Board of Directors. Terms of the agreement include monthly payments of \$15,000 by us to Verus International Ltd. for consulting services rendered during 2001. The term of the agreement expired on March 16, 2002.

On November 27, 2001, eMagin Corporation entered into a Secured Note Purchase Agreement whereby five accredited initial investors agreed to lend us an aggregate of \$875,000 in exchange for (i) 9.00% per annum Secured Convertible Promissory Notes in an aggregate principal amount of \$875,000, and (ii) three-year warrants to purchase up to an aggregate of 359,589 shares of our common stock. Messrs. Rivkin and Solomon, who at the time of the transaction were each members of our Board of Directors, participated as investors in the transaction and each invested \$125,000 in the Company. In return for such investment, Messrs. Rivkin and Solomon collectively received (i) Secured Convertible Promissory Notes in an aggregate principal amount of \$250,000, and (ii) warrants exercisable for 102,740 of our common shares. Sovereign Bancorp Ltd. also invested \$100,000 under the transaction and received (i) a Secured Convertible Promissory Note in an aggregate principal amount of \$100,000, and (ii) warrants exercisable for 41,096 of our common shares. The brother of Mr.

81

Khan, a director of the Company, is an officer of Sovereign Bancorp Ltd. In addition, Mr. Mortimer D.A. Sackler, who is currently a beneficial owner of more than five percent of the outstanding shares of our common stock, invested \$200,000 under the transaction and collectively received (i) Secured Convertible Promissory Notes in an aggregate principal amount of \$200,000, and (ii) warrants exercisable for 82,192 of our common shares. As of January 14, 2002, the Secured Note Purchase Agreement was amended to increase (i) the aggregate principal amount of the Secured Convertible Promissory Notes issued thereunder to \$1,625,000, and (ii) the number of shares issuable pursuant to the warrants issued thereunder to 1,954,944. Pursuant to these amendments, Mr. Mortimer D.A. Sackler invested an additional \$1,000,000 under the Secured Note Purchase Agreement and received (i) additional Secured Convertible Promissory Notes with an aggregate principal amount of \$1,000,000, and (ii) additional warrants exercisable for 1,285,589 shares of our common stock. Rainbow Gate Corporation, pursuant to the November 27, 2001 transaction and the January 14, 2002 amendment, invested \$300,000 under the transaction and collectively received (i) Secured Convertible Promissory Notes in an aggregate principal amount of \$300,000, and (ii) warrants exercisable for 341,945 of our common shares. After the close of the January 14, 2002 amended transaction, Dr. Mortimer D. Sackler purchased from Rainbow Gate Corporation the Secured Convertible Promissory Notes in an aggregate principal amount of \$300,000, and (ii) warrants exercisable for 341,945 of our common shares. At the time of the amendment, the Company also redeemed \$250,000 in aggregate principal amount of the then outstanding notes held by three of the initial investors under the agreement. Pursuant to this redemption, the notes held by Mr. Solomon, (who at the time of the redemption was no longer a member of our Board of Directors) and by Sovereign Bancorp Ltd. were redeemed.

On February 27, 2002, eMagin Corporation and a group of several accredited institutional and individual investors entered into a Securities Purchase Agreement providing for the issuance and sale to the investors of (i) an aggregate of approximately 3.6 million shares of our common stock, and (ii) warrants exercisable for a period of three (3) years from the Closing Date for an aggregate of approximately 1.4 million shares of our common stock (subject to certain customary anti-dilution adjustments). Rainbow Gate Corporation invested \$500,000 in the Company under the agreement and received pursuant to such

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investment (i) 723,275 shares of our common stock, and (ii) warrants exercisable for 289,310 shares of our common stock.

On April 25, 2003, eMagin Corporation and a group of several accredited institutional and individual investors (collectively, the "Investors") entered into a Global Restructuring and Secured Note Purchase Agreement (the "Secured Note Purchase Agreement") dated as of April 25, 2003 (the "Closing Date") whereby Investors agreed to lend eMagin \$6,000,000 in exchange for (i) the issuance of \$6,000,000 principal amount of 9.00% Secured Convertible Promissory Notes due on November 1, 2005 (the "Secured Notes") and (ii) Warrants (the "Warrants") to purchase an aggregate of 7,749,921 shares of common stock of eMagin (subject to certain customary anti-dilution adjustments), which Warrants are exercisable for a period of three (3) years. Mr. Rivkin, who at the time of the transaction was a member of our Board of Directors, participated as an investor in the transaction and invested \$125,000 in the Company. In return for such investment, Mr. Rivkin received (i) a Secured Convertible Promissory Note in an aggregate principal amount of \$125,000, and (ii) warrants exercisable for 161,456 of our common shares. In addition, Stillwater LLC, an entity controlled by Mr. Mortimer D.A. Sackler, who is currently a beneficial owner of more than five percent of the outstanding shares of our common stock, agreed to invest an aggregate of \$2,000,000 under the transaction and will receive (i) Secured Convertible Promissory Notes in an aggregate principal amount of \$2,000,000, and (ii) warrants exercisable for 3,358,300 of our common shares. As part of the transactions, Messrs. Sackler and Rivkin, who were the holders of an aggregate of \$1,325,000 principal amount of secured notes that were purchased pursuant to a secured note purchase agreement entered into as of November 27, 2001 (collectively, the "Original Secured Notes"), and Mr. Sackler, who additionally was the holder of a \$200,000 principal amount secured note that was purchased pursuant to a Secured Note Purchase Agreement entered into as of June 20, 2002 (the "Bridge Note"), agreed to (a) amend their respective Original Secured Notes and Bridge Note issued to them, (b) terminate the Security Agreement dated

82

November 20, 2001 that was entered into in connection with the purchase of the Original Secured Notes and the Security Agreements dated June 20, 2002 that were entered into in connection with the purchase of the Bridge Note and allow the new investors to enter into a New Security Agreement (as defined below) with them on a pari passu basis in order for the Company to continue its operations as a developer of virtual imaging technology. The amendments to the Original Secured Notes and Bridge Note included (i) amending the Bridge Note so as to provide that the Bridge Note shall be convertible and will have the same conversion price as the Notes issued pursuant to the Secured Note Purchase Agreement, (ii) extending the maturity dates of the Original Secured Notes and Bridge Note from June 30, 2003 to November 1, 2005, and (iii) revising and clarifying certain of the other terms and conditions of the Original Secured Notes and Bridge Note, including provisions relating to interest payments, conversions, default and assignments of the Original Secured Notes and Bridge Note. For a complete description of the transaction, including the Secured Note Purchase Agreement, the Notes and the Warrants, see "Item 7 - Management's Discussion and Analysis of Financial Conditions and Results of Operations - Subsequent Event."

The Company believes that the transactions described above were made on terms no less favorable than could have been obtained from third parties. All transactions were negotiated at arm's length.

Item 14. Controls and Procedures

As of December 31, 2002, an evaluation was performed by our Chief Executive Officer and Acting Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that

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evaluation, Our Chief Executive Officer and Acting Chief Accounting Officer, concluded that our disclosure controls and procedures were effective as of December 31, 2002. There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to December 31, 2002.

Item 15: Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) Exhibit List

| Exhibit Number | Description |
|----------------|---|
| 2.1 | Agreement and Plan of Merger between Fashion Dynamics Corp., FED Capital Acquisition Corporation dated March 13, 2000, as filed in the Registrant's Form 8-K/A Report (file number 000-24757) incorporated herein by reference. |
| 3.1 | Articles of Incorporation filed January 23, 1996, as filed in the Registrant's Form 10-SB (file no. 000-24757) incorporated herein by reference. |
| 3.2 | Bylaws, as filed in the Registrant's Form 10-SB (file no. 000-24757) incorporated herein by reference. |
| 4.1 | See Exhibits 3.1 and 3.2 for provisions of the Articles of Incorporation and Bylaws of the Registrant for the holders of common stock of the Registrant herein by reference. |
| 4.2 | Form of Secured Convertible Promissory Note dated as of April 25, 2003 filed April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference. |
| 4.3 | Form of Amended and Restated Secured Convertible Promissory Note dated as of April 25, 2003 filed April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference. |
| 4.4 | Form of Warrant dated as of April 25, 2003 filed April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference. |
| 10.1 | 2000 Stock Option Plan, as filed in the Registrant's Form S-8 (file no. 333-32474) incorporated herein by reference. |
| 10.2 | Consulting Agreement between eMagin Corporation and Verus International Ltd., dated March 16, 2000, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. |
| 10.3 | Employment Agreement with Gary W. Jones, dated March 16, 2000, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. |
| 10.4 | Employment Agreement with Susan K. Jones, dated March 16, 2000, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. |
| 10.5 | Nonexclusive Field of Use License Agreement relating to OLED Technology for miniature, high resolution displays between the Eastman Kodak Company and FED Corporation dated March 29, 1999, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. |
| 10.6 | Amendment Number 1 to the Nonexclusive Field of Use License Agreement relating to the OLED Technology for miniature, high resolution displays between the Eastman Kodak Company and FED Corporation dated March 29, 1999, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. |
| 10.7 | Amendment Number 1 to the Lease between International Business Machines Corporation and Verus International Ltd., dated March 16, 2000, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. |
| 10.8 | Lease between International Business Machines Corporation and FED Corporation dated May 1, 2000, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. |

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- Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference.
- 10.9 Amendment Number 2 to the Lease between International Business Machines Corporation and 2001, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference.
- 10.10 Virtual Vision lease between Redson Building Partnership and Vision Newco dated December 31, 2000, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference.
- 10.11 Securities Purchase Agreement dated as of September 18, 2001 by and between eMagin Corporation and certain investors named therein, as filed in the Registrant's Form 8-K dated September 26, 2001 incorporated herein by reference.
- 10.12 Registration Rights Agreement dated as of September 19, 2001 by and between eMagin Corporation and certain investors named therein, as filed in the Registrant's Form 8-K dated September 26, 2001 incorporated herein by reference.
- 10.13 Note Purchase Agreement entered into as of August 20, 2001, by and among eMagin Corporation and certain investors named therein, as filed in the Registrant's Form 8-K dated September 4, 2001 incorporated herein by reference.
- 10.14 Secured Note Purchase Agreement entered into as of November 27, 2001, by and among eMagin Corporation and certain investors named therein, as filed in the Registrant's Form 8-K dated December 18, 2001 incorporated herein by reference.
- 10.15 Registration Rights Agreement dated November 27, 2001 by and between eMagin Corporation and certain investors named therein, as filed in the Registrant's Form 8-K dated December 18, 2001 incorporated herein by reference.
- 10.16 Security Agreement dated as of November 20, 2001, by and between eMagin Corporation, Verano Corporation and certain investors named therein, as filed in the Registrant's Form 8-K dated December 18, 2001 incorporated herein by reference.

84

- 10.17 Securities Purchase Agreement dated as of April 25, 2003 by and among eMagin and the investors named therein, as filed in the Registrant's Form 8-K dated April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference.
- 10.18 Security Agreement dated as of April 25, 2003 by and among eMagin and certain investors named therein, as filed in the Registrant's Form 8-K dated April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference.
- 10.19 Registration Rights Agreement dated as of April 25, 2003 by and among eMagin and certain investors named therein, as filed in the Registrant's Form 8-K dated April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference.
- 21.1 Subsidiaries of the Registrant.
- 23.1 Consent of Independent Certified Public Accountant.
- 99.1 Certification of the Chief Executive Officer and Acting Chief Accounting Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 99.2 Code of Ethics and Business Conduct of Officers, Directors and Employees, as filed in the Registrant's Form 8-K dated April 15, 2003, incorporated herein by reference.

(b) Financial Statement Schedules

None

(c) Reports on Form 8-K

The Company filed twenty-six reports on form 8-K during the year ended December 31, 2002. Information regarding the items reported on is as follows:

DATE OF REPORT

ITEM REPORTED ON

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January 28, 2002 eMagin Corporation entered into a series of transaction documents to facilitate additional funding of \$1,000,000 of eMagin by a private investor.

March 20, 2002 eMagin Corporation and a group of several accredited institutional and individual investors entered into a Securities Purchase Agreement providing for the issuance and sale to the Investors of an aggregate of approximately 3.6 million shares of common stock, par value \$.001 of eMagin and warrants exercisable for a period of three years from the Closing Date for an aggregate of approximately 1.4 million shares of Common Stock.

March 26, 2002 eMagin Corporation entered into a common stock purchase agreement and related documents with Northwind Associates, Inc., a Cayman Islands corporation, pursuant to which the Company may receive in periodic draw downs at its option, subject to the terms and conditions of the Transaction Agreements, up to \$15,000,000 inequity financing over a three year period.

May 21, 2002 eMagin Corporation and The Travelers Insurance Company entered into an amendment agreement to extend the maturity date of the Convertible Promissory Note.

85

June 3, 2002 eMagin Corporation and The Travelers Insurance Company entered into a second amendment agreement to amend and extend the maturity date of the Convertible Promissory Note.

June 06, 2002 eMagin Corporation and The Travelers Insurance Company entered into a third amendment agreement to amend and extend the maturity date of the Convertible Promissory Note.

June 10, 2002 eMagin Corporation and The Travelers Insurance Company entered into a fourth amendment agreement to amend and extend the maturity date of the Convertible Promissory Note.

June 17, 2002 eMagin Corporation and The Travelers Insurance Company entered into a fifth amendment agreement to amend and extend the maturity date of the Convertible Promissory Note.

June 18, 2002 eMagin Corporation and The Travelers Insurance Company entered into memorandum of understanding to amend and extend the maturity date of the Convertible Promissory Note.

June 24, 2002 eMagin Corporation and The Travelers Insurance Company entered into a sixth amendment agreement to amend and extend the maturity date of the Convertible Promissory Note.

July 3, 2002 eMagin Corporation and an Investor entered into a Secured Note Purchase Agreement whereby Investors agreed to lend eMagin \$200,000 in exchange for \$200,000 11.00% per annum Secured Promissory Note and Warrants exercisable for a period of three years to purchase 300,000 shares of common stock of eMagin.

August 06, 2002 Change in registrant's Certifying Accountant, Arthur Andersen will no longer serve as eMagin's independent auditor.

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September 3, 2002 eMagin Corporation issued to each of two Investors 8% Series B Convertible Debentures whereby each of the Investors agreed to lend eMagin \$121,739 for a total of \$243,478. Interest is payable on the Debentures at a rate of 8% per annum.

September 24, 2002 eMagin Corporation engaged Grant Thornton LLP to serve as the company's Independent auditors upon the recommendation of its audit committee and Board of Directors.

October 04, 2002 eMagin Corporation and The Travelers Insurance Company entered into an eighth amendment agreement to amend and extend the maturity date of the Convertible Promissory Note.

eMagin and Mr. Mortimer D.A. Sackler entered into second amendment agreement to amend and extend the maturity date of the Secured Promissory Note and to amend and extend the maturity date of the Secured Convertible Promissory Notes.

eMagin and Ginola Limited, an assignee of Rainbow Gate Corporation, entered into a second amendment agreement to amend and extend the maturity date of the Secured Convertible Promissory.

86

eMagin and Mr. Jack Rivkin entered into a second amendment agreement to amend and extend the maturity date of the Secured Convertible Promissory.

November 01, 2002 eMagin Corporation and The Travelers Insurance Company entered into a ninth amendment agreement to amend and extend the maturity date of the Convertible Promissory Note.

eMagin and Mr. Mortimer D.A. Sackler entered into a third amendment agreement to amend and extend the maturity date of the Secured Promissory Note and to amendment agreement to extend the maturity date of the Secured Convertible Promissory Notes.

eMagin and Ginola Limited an assignee of Rainbow ate Corporation, entered into a third amendment agreement to amend and extend the maturity date of the Secured Convertible Promissory Note.

eMagin and Mr. Jack Rivkin entered into a third amendment agreement to amend and extend the maturity date of the Secured Convertible Promissory.

December 04, 2002 eMagin Corporation and The Travelers Insurance Company entered into a tenth amendment agreement to amend and extend the maturity date of the Convertible Promissory Note.

eMagin and Mr. Mortimer D.A. Sackler entered into a fourth amendment agreement to amend and extend the maturity date of the Secured Promissory Note. As well, eMagin and Sackler entered into a fourth amendment agreement to amend and extend the maturity date of the Secured Convertible Promissory Notes.

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eMagin and Ginola Limited, an assignee of Rainbow Gate Corporation, entered into a fourth amendment agreement to amend and extend the maturity date of the Secured Convertible Promissory Note.

eMagin and Mr. Jack Rivkin entered into a fourth amendment agreement to amend and extend the maturity date of the Secured Convertible Promissory Note.

87

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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 the 6th day of May 2003.

EMAGIN CORPORATION

BY: /s/ Gary Jones
 Gary Jones
 CHIEF EXECUTIVE OFFICER,
 PRESIDENT AND ACTING CHIEF
 FINANCIAL OFFICER

88

PURSUANT TO THE REQUIREMENTS OF THE SECURITIES EXCHANGE ACT OF 1934, THIS REPORT HAS BEEN SIGNED BY THE FOLLOWING PERSONS IN THE CAPACITIES AND ON THE DATES INDICATED:

| NAME | TITLE | DATE |
|---|---|-------|
| ----- | ----- | ----- |
| /s/ Gary Jones ----- Gary Jones Gary Jones | President, Chief Executive Officer, and Acting Chief Financial Officer and Director (Principal Executive Officer) | May |
| /s/ Claude Charles ----- Claude Charles | Director | May |
| /s/ Jack Goldman ----- Dr. Jacob E Goldman | Director | May |
| /s/ Jack Rivkin ----- Jack Rivkin | Director | May |

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89

CERTIFICATION

I, Gary W. Jones, CEO and Acting CFO, certify that:

1. I have reviewed this annual report on Form 10-K/A of eMagin Corporation;

2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements report;

3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;

b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and

c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

90

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and

6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

May 6, 2003

/s/ Gary W. Jones
Chief Executive Officer
Acting Chief Financial Officer

