



FORM 10-K

EMAGIN CORP – EMAN

Filed: April 02, 2007 (period: December 31, 2006)

Annual report which provides a comprehensive overview of the company for the past year

Table of Contents

PART I

Item 1 Business 4

PART I

ITEM 1. BUSINESS

ITEM 1A. RISK FACTORS

ITEM 1B. UNRESOLVED STAFF COMMENTS

ITEM 2. PROPERTIES

ITEM 3. LEGAL PROCEEDINGS

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITYHOLDERS

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED
STAREHOLDER MATTERS AND ISSUER PURCHASES OF E

ITEM 6. SELECTED FINANCIAL DATA

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
AND RESULTS OF OPERATION

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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

ITEM 9A. CONTROLS AND PROCEDURES

ITEM 9B. OTHER INFORMATION

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

ITEM 11. EXECUTIVE COMPENSATION

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND
MANAGEMENT AND RELATED STOCKHOLDER MATT

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND
DIRECTOR INDEPENDENCE

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

SIGNATURES

INDEX TO EXHIBITS

EX-23 (AUDIT CONSENT)

EX-31.1 (EXHIBIT 31.1)

EX-31.2 (EXHIBIT 31.2)

[EX-32.1 \(EXHIBIT 32.1\)](#)

[EX-32.2 \(EXHIBIT 32.2\)](#)

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K

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

For the fiscal year ended December 31, 2006

or

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

Commission file number 001-15751

eMAGIN CORPORATION

(Exact name of registrant as specified in its charter)

Delaware

*(State or other jurisdiction of
incorporation or organization)*

56-1764501

*(I.R.S. Employer
Identification No.)*

10500 NE 8th Street, Suite 1400, Bellevue, Washington 98004

(Address of principal executive offices)

(425) 749-3600

(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a well-known seasoned issuer as defined in Rule 405 of the Securities Act. Yes
No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

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

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

. Large accelerated filer Accelerated filer Non-accelerated filer

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

As of June 30, 2006, the aggregate market value of the issued and outstanding common stock held by non-affiliates of the registrant, based upon the closing price of the common stock as quoted on the American Stock Exchange of \$2.90 was approximately \$27.6 million. For purposes of the above statement only, all directors, executive officers and 10% shareholders are assumed to be affiliates.

This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

Number of shares of common stock outstanding as of March 16, 2007 was 11,049,164.

DOCUMENTS INCORPORATED BY REFERENCE – None

FORM 10-K

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2006

INDEX

		<u>Page</u>
PART I		
Item 1	Business	4
Item 1A	Risk Factors	16
Item 1B	Unresolved Staff Comments	20
Item 2	Properties	20
Item 3	Legal Proceedings	21
Item 4	Submission of Matters to a Vote of Security Holders	21
PART II		
Item 5	Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities	21
Item 6	Selected Financial Data	22
Item 7	Management's Discussion and Analysis of Financial Condition and Results of Operations	23
Item 7A	Quantitative and Qualitative Disclosures About Market Risk	28
Item 8	Financial Statements and Supplementary Data	29
Item 9	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	53
Item 9A	Controls and Procedures	53
Item 9B	Other Information	53
PART III		
Item 10	Directors, Executive Officers, and Corporate Governance	53
Item 11	Executive Compensation	53
Item 12	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	53
Item 13	Certain Relationships and Related Transactions	53
Item 14	Principal Accounting Fees and Services	53
PART IV		
Item 15	Exhibits and Financial Statement Schedules	54
	Signatures	

STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

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

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

PART I

ITEM 1. BUSINESS

Introduction

eMagin Corporation designs, develops, manufactures, and markets virtual imaging products which utilize OLEDs, or organic light emitting diodes, OLED-on-silicon microdisplays and related information technology solutions. We integrate OLED technology with silicon chips to produce high-resolution microdisplays smaller than one-inch diagonally which, when viewed through a magnifier, create virtual images that appear comparable in size to that of a computer monitor or a large-screen television. Our products enable our original equipment manufacturer, or OEM, customers to develop and market improved or new electronic products. We believe that virtual imaging will become an important way for increasingly mobile people to have quick access to high resolution data, work, and experience new more immersive forms of communications and entertainment.

Our first commercial product, the SVGA+ (Super Video Graphics Array of 800x600 picture elements plus 52 added columns of data) OLED microdisplay was initially offered for sampling in 2001, and our first SVGA-3D (Super Video Graphics Array plus built-in stereovision capability) OLED microdisplay was shipped in early 2002. 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 globally.

In 2006 we introduced our OLED-XL technology, which provides longer luminance half life and enhanced efficiency of eMagin's SVGA+ and SVGA-3D product lines. We are in the process of completing development of 2 additional OLED microdisplays, namely the SVGA 3DS (SVGA 3D shrink, a smaller format SVGA display with a new cell architecture with embedded features) and an SXGA (1280 x 1024 picture elements).

In January 2005 we announced the world's first personal display system to combine OLED technology with head-tracking and 3D stereovision, the Z800 3DVisor(tm), which was first shipped in mid-2005. This product was recognized as a Digital Living Class of 2005 Innovators, and received the Consumer Electronics Association's coveted Consumer Electronics Show (CES) 2006 Best of Innovation Awards for the entire display category as well as a Design and Innovations Award for the electronic gaming category. In February 2007 the Z800 3DVisor, as integrated in Chatten Associates' head-aimed remote viewer, was recognized as one of Advanced Imaging's Solutions of the Year.

We believe that our OLED-on-silicon microdisplays offer a number of advantages over current liquid crystal microdisplays, including greatly increased system level power efficiency, 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 alternative microdisplay technologies. We have developed our own technology to create high performance OLED-on-silicon microdisplays and related optical systems and we have licensed certain fundamental OLED and display technology from Eastman Kodak.

As the first to exploit OLED technology for microdisplays, and with the support of our partners and the development of our intellectual property, we believe that we enjoy a significant advantage in the commercialization of this display technology for virtual imaging. We believe we are the only company to sell full-color active matrix small molecule OLED-on-silicon microdisplays.

eMagin Corporation was created through the merger of Fashion Dynamics Corporation ("FDC"), which was organized on January 23, 1996 under the laws of the State of Nevada and FED Corporation ("FED"), a developer and manufacturer of optical systems and microdisplays for use in the electronics industry. FDC had no active business operations other than to acquire an interest in a business. On March 16, 2000, FDC acquired FED. The merged company changed its name to eMagin Corporation. Following the merger, the business conducted by eMagin is the business conducted by FED prior to the merger.

Our website is located at www.emagin.com and our e-commerce site is www.3dvisor.com. We make available on our website, free of charge, our annual report on Forms 10K, our proxy statement, our quarterly reports on Forms 10Q, our current reports on Form 8K, and all amendments to such reports filed under the Securities and Exchange Act, earnings press releases, and other business-related press releases. We also post on our website the charters of our Audit, Compensation, and Governance and Nominating committees, our Codes of Ethics and any amendments of or waiver to those codes of ethics, and other corporate governance materials recommended by the Securities and Exchange Commission as they occur.

Industry Overview

A recent (February 2007) study by NanoMarkets predicts the overall OLED market will approach \$10.9 billion in 2010 and grow to \$15.5 billion by 2014. These markets include various sizes devices for a range of applications from cell phone size to viewfinder displays to televisions to lighting. Displays in general are sold as independent products (such as TV monitors) or as components of other systems (such as laptop computers). Our products target one segment of the display industry, the near-eye, personal display, which is viewed through a lens rather than directly, in comparison to desktop computer screens which are known as direct view displays. As an off-shoot of our work in microdisplays, we are also participating in government-funded development studies for OLED-based lighting.

Personal displays, that is, near-eye systems based on microdisplays and optics, include video headsets, camcorders, viewfinders and other portable devices. Microdisplays are typically of such high resolution that they can be practically viewed only with magnifying optics. Although microdisplays 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 0.6-inch diagonal display can appear comparable to a 19- to 21-inch computer screen at about 2 feet from the viewer or a 60-inch TV screen at about 6 feet. The wearable display market, according to DisplaySearch, is expected to grow to at least \$153 million in 2010. McLaughlin Consulting, in a report published December 2006, projects that, with effective marketing, the Personal Viewer market could reach nearly \$1 billion in 2010.

We believe that the most significant driver of the longer term near-eye virtual imaging 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 near-eye microdisplay products in two general categories: (i) an established market for electronic viewers incorporated in products such as viewfinders for digital cameras and video cameras which may potentially also be developed as personal viewers for cell phones and (ii) an emerging market for headset-application platforms which include accessories for mobile devices such as notebook and sub-notebook computers, portable DVD systems, electronic games, and other entertainment, and wearable computers.

Until now, near-eye virtual imaging 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 alternative 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, or OLED, technology, dubbed single molecule or small molecule (monomer) 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 alternative technologies.

We have developed our own proprietary and patented 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 OEM customers.

We believe that our OLED-on-silicon microdisplays will initiate a new generation of virtual imaging products that could have a profound impact on many industries. Headsets providing virtual screens surrounding the user in a sphere of data become a practical reality with our displays and a low cost head tracker. 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 in comparison with LCDs and other near-eye display technologies:

- the user does not need to accurately position the head-wearable display to the eye;
- the image will change minimally with eye movement and appear more natural; and
- 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 much less power than competitive liquid crystal microdisplay systems. Our subsystem-level power consumption is so low that two SVGA, full color, full speed motion video computer displays can easily be run in stereovision off the power from a single USB port on a portable computer. Battery life is extended and weight is greatly reduced in systems using our products.

Our SVGA+ OLED microdisplay stores all the color and luminance value information at each of the more than 1.5 million picture elements, or pixels, between refresh cycles in the display array, eliminating the flicker or color breakup seen by most other high-resolution microdisplay technologies. Even power efficient frame rates as low as 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 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 digital-analog converters, application-specific integrated circuits (ASICs), light sources, multiple optical elements, and other components. We believe that these features will 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 they are in full production.

We have also developed advanced lens technology which permits our OLED-on-silicon microdisplays to provide large field of view images that can be viewed for extended periods with reduced eye-fatigue. Molded plastic prism lenses have been developed to help our OEM customers obtain better quality, large area virtual images using our displays at relatively low cost in comparison to alternate approaches.

Our Products

Our first commercial microdisplay products are based on our "SVGA series" OLED microdisplays. We offer products utilizing both our proprietary "OLED" or "OLED-XL" technologies, applied to the same integrated circuit base. We offer our products to OEMs and other large volume buyers as both separate components, integrated bundles coupled with our own optics, or full systems. We also offer engineering support to enable customers to quickly integrate our products into their own product development programs.

(1) OLED Microdisplay Component Products

SVGA+ OLED Microdisplay (Super Video Graphics Array of 800x600 plus 52 added columns of data). Our 0.62 inch diagonal SVGA+ OLED microdisplays have a resolution of 852x600 triad pixels (1.53 million picture elements). The product was dubbed "SVGA+" because it has 52 more display columns than a standard SVGA display, permitting 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 display also has an internal NTSC monochrome video decoder for low power night vision systems.

SVGA-3D OLED Microdisplay (Super Video Graphics Array plus built-in stereovision capability). Our 0.59 inch diagonal SVGA-3D OLED microdisplays have a resolution of 800x600 triad pixels (1.44 million picture elements). A built-in circuit provides compatibility with single channel frame sequential stereoscopic vision without additional external components.

Microdisplays Under Development. We are developing two additional display products, a smaller format ("shrink") version of our SVGA display, which will have 800 x 600 triad pixels and be 0.44 inch diagonal and an SXGA OLED microdisplay with resolution of 1280x 1024 triad pixels with diagonal size to be determined. The new products will include a number of embedded features such as luminance and dimming ranges.

Lens and Design Reference Kits. We offer a WF05 prism optic, with mounting brackets or combined with OLED microdisplays to form an optic-display module. We provide Design Reference Kits, which include a microdisplay and associated electronics to help OEMs evaluate our microdisplay products and to assist their efforts to build and test new products incorporating our microdisplays.

Integrated Modules. We provide near-eye virtual imaging modules that incorporate our OLED-on-silicon microdisplays with our lenses and electronic interfaces for integration into OEM products. We have shipped customized modules to several customers, some of which have incorporated our products into their own commercial products.

(2) Personal Display Systems (Head-Wearable and Headset Systems)

Our Z800 3DVisors(tm) give users the ability to work with their hands while simultaneously viewing information or video on the display. The Z800 3DVisor enables more versatile portable computing, using a 0.59-inch diagonal microdisplay (SVGA-3D capable of delivering an image that appears comparable to that of a 19-inch monitor at 22 to 24 inches from the eye, or a 105 inch movie screen at 12 foot distance. Our systems are currently being used for personal entertainment, electronic gaming, and military training and simulation, among other applications. We believe that personal display systems will fill the increasing demand for instant data accessibility and privacy in mobile workplaces. We sell the personal display systems to OEM systems and equipment customers, through distributors, and through our e-commerce website, www.3dvisor.com.

Our Market Opportunity – Personal Display Systems Platforms, including Head-wearable Displays

The growth potential of our selected target market segments have been investigated using information gathered from key industry market research firms, including DisplaySearch, 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.

The virtual-imaging markets we are targeting include 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. Applications we are targeting the following:

Head-wearable displays incorporate microdisplays mounted in or on eyeglasses, goggles, simple headbands, helmets, or hardhats, and are often referred to as head-mounted displays (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, 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 have been selected for a range of defense-security applications, including a situational awareness HMD for the US Army Land Warrior programs, a handheld thermal imager for border patrol and training, and simulation virtual monitors for Quantum 3D. The 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. Rockwell Collins, the principal contractor for the US Army's Land Warrior HMD system, and eMagin applied 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 by General Dynamics and Rockwell Collins has delayed increased volume use of displays beyond small quantities for that program until a future date to be determined. Our display is also used in Rockwell Collins' commercially available ProView S035 Monocular HMD. Night Vision Equipment Corporation's HelmetIR-50(TM), a lightweight, military helmet mounted thermal imager, which provides hands-free operation and allows viewers to see through total darkness, battlefield obscuration, and even foliage, is the first OLED-equipped product to be listed on the US Government's GSA schedule. Virtually Better Inc. has incorporated our Z800 3Dvisor into its "Virtual Iraq" treatment for post-traumatic stress disorders. In addition, our displays have been commercialized, or planned to be commercialized, by military systems integrators including Insight Technologies, Elbit, Thales, Sagem, and Nivisys, among others. We cannot assure that Government projects will remain on schedule, or be fully implemented. 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 such as parts, tools and equipment availability; instant accessibility to maintenance or construction manuals; routine quality assurance inspection; endoscopic surgery; and real-time viewing of images and data for a variety of applications. As one potential example, a user wearing a HMD while using test equipment, such as oscilloscopes, can view technical data while simultaneously probing printed circuit boards. Commercial products in these sectors include Sage Technologies, Ltd.'s Helmet Vue (TM) Thermal Imaging System and Liteye's 500, which incorporates IBM's wearable PC technology. VRmagic GmbH, a leading developer of virtual reality simulators, is using our OLED microdisplays in their EYESI(TM) Virtual Reality Surgical Simulator, which provides real-time simulation of ophthalmic surgery, high performance biomechanical tissue simulation, precision tracking, and realistic stereo imaging. Sensics has incorporated our OLED displays in their immersive SkyVizor (TM) virtual reality headset to serve as the "eyes" of the

Robonaut, a humanoid robot being developed by NASA and Department of Defense agencies. The Robonaut system can work side by side with humans, or alone in high-risk situations. Telepresence uses virtual reality display technology to visually immerse the operator into the robot's workspace, facilitating operation and interaction with the Robonaut, and potentially reducing the number of dangerous space walks required of real astronauts.

Consumer

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

- 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. We believe that these new headset game systems can provide a game or telepresence experience not otherwise practical using conventional direct view display technology. The advent of video iPods and the rapidly increasing amount of downloadable content have accelerated the movement toward portable video technology. At the same time, the desire for larger screen sizes while retaining the iPod portability has been referenced in many publications. Virtual imaging uniquely provides a large, high resolution view in a small portable package, and we believe that our OLED on silicon technology is a best fit to help open this market.
- Notebook computers, which can use head-wearable devices to reduce power requirements 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. The display can be easily used as a second monitor on notebook computers for ease of editing multiple documents to provide multiple screens or for data privacy while traveling. It can also be used to provide larger screen capability for viewing spreadsheets or complex computer aided design (CAD) files. 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.
- 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.

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 propel the growth of new products and applications such as lightweight wearable computer systems.

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.
- Optimize manufacturing efficiencies by outsourcing while protecting proprietary processes. We outsource certain 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 color balance, which is known as chromaticity, as well as specialized boards or interfaces, and to 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, but we intend to outsource high volume manufacturing operations. There are numerous companies that provide these outsource services.

- 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 utilize in-house design capabilities supplemented by outsourced design services. 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 discussions regarding potential product applications for eMagin's microdisplays by Eastman Kodak.

We are working cooperatively with the US Army, US Navy, and with several military system integrators to further characterize operation of our displays in rugged military environments.

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 are currently partnering with the University of Michigan to develop advanced display process via a government-sponsored research program. 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 mean 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 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, top-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.

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:

- Low manufacturing cost;
- Low cost system solutions;
- Wide angle light emission resulting in large apparent screen size;
- Low power consumption for improved battery life and longer system life;
- High brightness for improved viewing;
- High-speed performance resulting in clear video images;
- Wide operating temperature range; and
- 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, or LCDs, because OLEDs do not require a space-wasting perimeter seal band. Expensive transparent wafers with CMOS silicon laminated onto quartz are not required for OLED microdisplays, as standard CMOS chips may be used as backplanes.

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, or 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 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, or 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 system life. OLEDs emit light rather than transmitting it, so no power-consuming backlight or front light, 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 extended.

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 image. OLEDs switch much more rapidly than liquid crystals or most cathode ray tubes, or 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 and 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, but 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 degrees Celsius, while our OLEDs turn on instantly and can operate between -55 degrees Celsius and 130 degrees Celsius. We specify a smaller temperature range on most consumer products to accommodate lower 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.

Complementary lens and system technologies. We have developed a wide range of technologies which complement our core OLED and lens technologies and which will enhance our competitive position in the microdisplay and head-wearable display markets. These include:

Lens technology. High quality, large view lenses with a wide range for eye positioning are essential for using our displays in near-eye systems. We have developed advanced lens technology for microdisplays and personal 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. We have engaged a firm to manufacture our lenses in order to provide them in larger quantities to our customers and are using them in our own personal display systems.

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

- Can be very low cost, with minimal assembly. A one piece, molded plastic optic attached to the microdisplay has been introduced and may potentially serve consumer end-product markets. Since our process is plastic molding, our per unit production costs are low;
- Allows a compact and lightweight lens system that can greatly magnify a microdisplay to produce a large field of view. For example, our WF05 prism lens, in combination with our SVGA OLED microdisplay, provides a virtual view equivalent to that of a 105-inch diagonal display viewed at 12 feet;
- 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;
- Can be designed to provide focusing to enable users with various eyesight qualities to view images clearly; and
- 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.

Personal display system 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. We have also incorporated low cost, small size, high speed headtrackers to further enhance game and telepresence applications.

Sales and Marketing

We primarily provide display components for OEMs to incorporate into their branded products and sell through their own 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.

We market our services in North America, Asia, and Europe primarily through direct technical sales from our headquarters. Regular purchase orders are processed by our customer service coordinators and technical questions related to product purchases or product applications are processed by our technical support team. 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. Our personal display systems are sold through select resellers and on-line through our e-commerce site, www.3dvisor.com, and via www.amazon.com, www.pcmall.com, and www.skymall.com.

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.

Near term sales efforts for OLED microdisplays have been focused on our military, industrial, and medical customers. We have received production orders and design wins for both the SVGA+ and SVGA 3D displays. To date, we have shipped products and evaluation kits to more than 200 OEM customers. An OEM design cycle typically requires between 6 and 36 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. 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. 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 French FELIN program, among others. (See "Our Market Opportunity: Military; Commercial, Industrial, and Medical; and Consumer")

Customers

Customers for our products include both large multinational and smaller OEMs. We maintain relationships with OEMs in a diverse range of industries encompassing the military, industrial, medical, and consumer market sectors. During 2006, 59% of our net revenue was to firms based in the United States and 41% was to international firms, compared to 49% domestic revenue and 51% international revenue during 2005. In 2006, we had 5 customers that accounted for more than 68% of our total revenue. In 2006, we had one customer that accounted for 13% of its total revenues as compared to 2005, where we had no customers that accounted for more than 10% of our total revenue.

Backlog

As of March 15, 2007, we had a backlog of approximately \$ 6.1 million for purchases through December 31, 2007. This backlog consists of purchase orders and purchase agreements but does not include expected revenue from our 2 military government R&D contracts of approximately \$2 million in 2007, expected NRE (non-recurring engineering) programs under development, or regular run rate orders from new or existing OEM customer orders.

The majority of our backlog consists of purchase agreements for delivery over the next 12 months. Most purchase orders are subject to rescheduling or cancellation by the customer with no or limited penalties. Because of the possibility of customer changes in delivery schedules or cancellations and potential delays in product shipments, our backlog as of a particular date may not be indicative of net sales for any succeeding period. Some customers have experienced delays in their expected product launch schedules due to their own product development delays not directly related to our microdisplays, such as development of custom optics or other aspects of their end product, or by delays in government programs contracted to them.

Research and Development

Near-to-the-eye virtual imaging and OLED technology are relatively new technologies that have considerable room for substantial improvements in luminance, life, power efficiency, voltage swing, design compactness, field of view, optical range of visibility, headtracking options, wireless control 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. In 2006, we spent approximately \$4.4 million on research and development. In 2006 we continued to research more efficient materials and processes. We also completed the primary development of our new smaller display the SVGA 3D shrink and our new visor products the X800 3DVisor and the Eyebud 800, for which continued development efforts have been discontinued until additional financial resources for these programs are available.

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").

The FY 2007 Department of Defense Appropriations Bill provided funding for two development programs managed by the US Army. The first aims to improve the power-efficiency of OLED microdisplays for U.S. Army thermal imaging applications, in cooperation with US Army NVESD (Night Vision and Electronic Sensors Directorate). The second will result in a very high-resolution, HD-compatible display for U.S. Army medical applications, in cooperation with US Army TATRC (Telemedicine and Advanced Technologies Research Center). The awards totaled approximately \$2.75 million to support the two projects for fiscal year 2007, and provide resources for development of higher performance OLED technology and higher resolution devices.

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 40,000 square feet of space housing our own equipment for OLED microdisplay fabrication and for research and development plus additional space for assembly and administrative offices. We also entered into lease agreement with IBM for a 16,300 square foot class 10 clean room space, along with additional, lower level clean room space.

Facilities services provided by IBM include our clean room, 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 lease additional non-clean room facilities for chemical mixing, cleaning, chemical systems, and glass/silicon cutting. OLED chemicals can be purified in our facility with our own 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.

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.

We also lease a facility in Bellevue, Washington where we operate our system development effort and business development activities. The lease for this facility expires in August of 2009. The facilities are well suited for designing and building limited volume prototypes and small quantity industrial or government products. Cables and electronic interfaces have recently been produced to permit our OEM customers to more rapidly create products and shorten their time-to-market. We plan to outsource medium to high volume subsystem production to low cost plastics, lenses, and assembly manufacturers. We are currently using domestic and international outside manufacturers and we are investigating new outsource opportunities.

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. The equipment required for initial profitable production is in place. Some equipment will be added when our production volume increases or as needed.

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:

- OLED Materials, Structures, and Processes;
- Display Color Processing and Sealing;
- Active Matrix Circuit Methodologies and Designs;
- Field Emission and General Display Technologies;
- Lenses and Tracking (Eye and Head);
- Ergonomics and Industrial Design; and
- 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 non-competition 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 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, or 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 Syntax/Brilliant Corporation, among others, although most of the companies are primarily focusing on projection microdisplays, which do not compete directly with us. 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 in Britain. We may also compete with potential licensees of Universal Display Corporation and Cambridge Display Corporation, each of which license OLED technology portfolios. Even though we could potentially license technology from these developers, potential competitors could also obtain such 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.

Employees

As of March 16, 2007, we had a total of 67 full time and part time staff. 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.

Executive Officers

The following table sets forth certain information with respect to our directors and executive officers as of March 9, 2007.

Name	Age	Position
K.C. Park	70	Interim Chief Executive Officer, President
John Atherly	47	Chief Financial Officer
Susan K. Jones	55	Chief Marketing and Strategy Officer, Secretary

Dr. K.C. Park was appointed Interim CEO and President in January 2007. He served as executive vice president of International Operations since 1998 and as president of eMagin's subsidiary, Virtual Vision, Inc., from 2002 to 2004. Earlier, with LG Electronics as an executive vice president and member of the Board, he built up LG's business in LCDs and PDPs, solidifying their world leadership position in flat-panel display products. At IBM, he managed flat panel display and semiconductor programs at the Watson Research Center; then served as director of Display Technology with worldwide responsibility at the IBM Corporate Headquarters, setting up technical operations in Korea as senior managing director. Dr. Park holds his Ph.D. in Solid-State Chemistry from the University of Minnesota and an MBA from New York University.

John Atherly has served as Chief Financial Officer since June of 2004. Before joining eMagin Corporation, Mr. Atherly worked for Click2learn, Inc., a NASDAQ listed enterprise Software Company from 1990 to 2004. He held the positions of Vice President of Finance and CFO for approximately 8 years and prior to that held the positions of Director of Finance and Controller. During his 14 years with Click2learn Mr. Atherly managed the firm's finance and administration, human resources, IT and manufacturing organizations. From 1987 to 1990, Mr. Atherly was a Finance and Operations Manager at MicroDisk Services, a manufacturing firm serving the software industry. Mr. Atherly holds a BA in Business Administration from the University of Washington.

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 was 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.

ITEM 1A. RISK FACTORS

You should carefully consider the following risk factors and the other information included herein as well as the information included in other reports and filings made with the SEC before investing in our common stock. If any of the following risks actually occurs, our business, financial condition or results of operations could be harmed. The trading price of our common stock could decline due to any of these risks, and you may lose part or all of your investment.

RISKS RELATED TO OUR FINANCIAL RESULTS

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

Our accumulated losses are \$181million as of December 31, 2006. We have not yet achieved profitability and we can give no assurances that we will achieve profitability within the foreseeable future as we fund operating and capital expenditures in areas such as establishment and expansion of markets, sales and marketing, operating equipment and research and development. We cannot assure investors that we will ever achieve or sustain profitability or that our operating losses will not increase in the future.

We may not be able to execute our business plan and may not generate cash from operations.

As we have reported, our business is currently experiencing significant revenue growth during the year ended December 31, 2006. We anticipate that our cash requirements to fund these requirements as well as other operating or investing cash requirements over the next twelve months will be greater than our current cash on hand. In the event that cash flow from operations is less than anticipated and we are unable to secure additional funding to cover our expenses, in order to preserve cash, we would be required to reduce expenditures and effect reductions in our corporate infrastructure, either of which could have a material adverse effect on our ability to continue our current level of operations. We do not currently have any financing commitments and no assurance can be given that additional financing will be available, or if available, will be on acceptable terms. If we are unable to obtain sufficient funds during the next twelve months we will further reduce the size of our organization and may be forced to reduce and/or curtail our production and operations, all of which could have a material adverse impact on our business prospects.

Our independent registered public accounting firm has expressed doubt about our ability to continue as a going concern, which may hinder our ability to obtain future financing.

Our consolidated financial statements as of December 31, 2006 have been prepared under the assumption that we will continue as a going concern for the year ending December 31, 2007. Our independent registered public accounting firm has issued a report dated March 27, 2007 that included an explanatory paragraph expressing substantial doubt in our ability to continue as a going concern without additional capital becoming available. Our ability to continue as a going concern ultimately is dependent on our ability to generate a profit which is likely dependant upon our ability to obtain additional equity or debt financing, attain further operating efficiencies and, ultimately, to achieve profitable operations. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

RISKS RELATED TO MANUFACTURING

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

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

We are dependent on a single manufacturing line.

We currently manufacture our products on a single manufacturing line. If we experience any significant disruption in the operation of our manufacturing facility or a serious failure of a critical piece of equipment, we may be unable to supply microdisplays to our customers. For this reason, some OEMs may also be reluctant to commit a broad line of products to our microdisplays without a second production facility in place. However, we try to maintain product inventory to fill the requirements under such circumstances. Interruptions in our manufacturing could be caused by manufacturing equipment problems, the introduction of new equipment into the manufacturing process or delays in the delivery of new manufacturing equipment. Lead-time for delivery of manufacturing equipment can be extensive. No assurance can be given that we will not lose potential sales or be unable to meet production orders due to production interruptions in our manufacturing line. In order to meet the requirements of certain OEMs for multiple manufacturing sites, we will have to expend capital to secure additional sites and may not be able to manage multiple sites successfully.

We could experience manufacturing interruptions, delays, or inefficiencies if we are unable to timely and reliably procure components from single-sourced suppliers.

We maintain several single-source supplier relationships, either because alternative sources are not available or the relationship is advantageous due to performance, quality, support, delivery, capacity, or price considerations. If the supply of a critical single-source material or component is delayed or curtailed, we may not be able to ship the related product in desired quantities and in a timely manner. Even where alternative sources of supply are available, qualification of the alternative suppliers and establishment of reliable supplies could result in delays and a possible loss of sales, which could harm operating results.

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

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

RISKS RELATED TO OUR INTELLECTUAL PROPERTY

We rely on our license agreement with Eastman Kodak for the development of our products.

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

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

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

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

RISKS RELATED TO THE MICRODISPLAY INDUSTRY

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

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

The microdisplay systems business is intensely competitive.

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

- our success in designing, manufacturing and delivering expected new products, including those implementing new technologies on a timely basis;
- our ability to address the needs of our customers and the quality of our customer services;
- the quality, performance, reliability, features, ease of use and pricing of our products;
- successful expansion of our manufacturing capabilities;
- our efficiency of production, and ability to manufacture and ship products on time;
- the rate at which original equipment manufacturing customers incorporate our product solutions into their own products;
- the market acceptance of our customers' products; and
- product or technology introductions by our competitors.

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

The display industry is cyclical.

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

Competing products may get to market sooner than ours.

Our competitors are investing substantial resources in the development and manufacture of microdisplay systems using alternative technologies such as reflective liquid crystal displays (LCDs), LCD-on-Silicon ("LCOS") microdisplays, active matrix electroluminescence and scanning image systems, and transmissive active matrix LCDs. Our competitive position could be damaged if one or more of our competitors' products get to the market sooner than our products. We cannot assure you that our product will get to market ahead of our competitors or that we will be able to compete successfully against current and future competition. The failure to do so would have a materially adverse effect upon our business, operating results and financial condition.

Our competitors have many advantages over us.

As the microdisplay market develops, we expect to experience intense competition from numerous domestic and foreign companies including well-established corporations possessing worldwide manufacturing and production facilities, greater name recognition, larger retail bases and significantly greater financial, technical, and marketing resources than us, as well as from emerging companies attempting to obtain a share of the various markets in which our microdisplay products have the potential to compete. We cannot assure you that we will be able to compete successfully against current and future competition, and the failure to do so would have a materially adverse effect upon our business, operating results and financial condition.

Our products are subject to lengthy OEM development periods.

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

Our products will likely experience rapidly declining unit prices.

In the markets in which we expect to compete, prices of established products tend to decline significantly over time. In order to maintain our profit margins over the long term, we believe that we will need to continuously develop product enhancements and new technologies that will either slow price declines of our products or reduce the cost of producing and delivering our products. While we anticipate many opportunities to reduce production costs over time, there can be no assurance that these cost reduction plans will be successful nor is there any assurance that our costs can be reduced as quickly as any reduction in unit prices. We may also attempt to offset the anticipated decrease in our average selling price by introducing new products, increasing our sales volumes or adjusting our product mix. If we fail to do so, our results of operations would be materially and adversely affected.

RISKS RELATED TO OUR BUSINESS

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

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

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

Changes in management could have an adverse effect on our business. We are dependent upon the active participation of several key management personnel and will also need to recruit additional management in order to expand according to our business plan. The failure to attract and retain additional management or personnel could have a material adverse effect on our operating results and financial performance.

Our business depends on new products and technologies.

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

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

Our business has primarily operated on the basis of short-term purchase orders. We are now receiving longer term purchase agreements, such as those which comprise our approximately \$6.1 million backlog, and procurement contracts, but we cannot guarantee that we will continue to do so. Our current purchase agreements can be cancelled or revised without penalty, depending on the circumstances. We plan production on the basis of internally generated forecasts of demand, which makes it difficult to accurately forecast revenues. If we fail to accurately forecast operating results, our business may suffer and the value of your investment in eMagin may decline.

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

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

Our business depends to some extent on international transactions.

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

Our business may expose us to product liability claims.

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

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

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

RISKS RELATED TO OUR STOCK

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

Sales of significant amounts of common stock in the public market, or the perception that such sales may occur, could materially affect the market price of our common stock. These sales might also make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate. As of March 16, 2007, we have outstanding (i) options to purchase 1,065,745 shares and (ii) warrants to purchase 3,548,174 shares of common stock.

We have a staggered board of directors and other anti-takeover provisions, which could inhibit potential investors or delay or prevent a change of control that may favor you.

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our corporate offices are located in Bellevue, Washington. Our Washington location includes administrative, finance, operations, research and development and sales and marketing functions and consists of leased space of approximately 19,000 square feet. The lease expires in 2009. Our manufacturing facility is located in Hopewell Junction, New York, where we lease approximately 40,000 square feet from IBM. The NY facility houses our equipment for OLED microdisplay fabrication, assembly operations, research and development, and administrative functions. The lease expires in 2009. We believe our facilities are adequate for our current and near-term needs. See Note 12 to our Consolidated Financial Statement for more information about our lease commitments.

ITEM 3. LEGAL PROCEEDINGS

On December 6, 2005, New York State Urban Development Corporation commenced action against eMagin in the Supreme Court of the State of New York, County of New York against eMagin, asserting breach of contract and seeking to recover a \$150,000 grant which was made to eMagin based on goals set forth in the agreement for recruitment of employees. On July 13, 2006, eMagin agreed to a settlement with the New York State Urban Development Corporation to repay \$112,200 of the \$150,000 grant. The settlement requires that repayments be made on a monthly basis in the amount of \$3,116.67 per month commencing August 1, 2006 and ending on July 1, 2009.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITYHOLDERS

Our Annual Meeting of Stockholders was held on October 20, 2006 in Bellevue, Washington at 2 P.M. local time.

There were present in person or by proxy 8,042,735 shares of Common Stock, of a total of 10,113,162 shares of Common Stock entitled to vote.

The number of shares voted in favor of the election of the following nominees for director is set forth opposite each nominee's name:

<u>Nominee</u>	<u>Number of Shares</u>
Paul C. Cronson	7,716,533
Rear Admiral Thomas Paulsen, USN (Ret.)	7,800,344
Brigadier Gen. Stephen Seay, US Army (Ret.)	7,814,189

Five proposals were presented and adopted.

The proposal to amend the Company's certificate of incorporation to increase the maximum number of directors which may be appointed to the Company's Board of Directors from 9 to 10 persons received 7,633,895 votes in favor.

The proposal to authorize the Company's Board of Directors, in its discretion, to amend the Company's certificate of incorporation to effect a reverse stock split of the outstanding shares of the Company's common stock received 7,244,636 votes in favor.

The proposal to authorize the Company's Board of Directors for the potential issuance of shares of our common stock underlying our 6% Senior Secured Convertible Notes and warrants to purchase shares of our common stock at a price below fair market value received 2,976,481 votes in favor.

The proposal to increase the number of authorized shares of common stock issuable pursuant to the 2004 Non-Employee Stock Compensation Plan from 200,000 to 950,000 shares received 2,817,761 votes in favor.

The proposal to appoint Eisner LLP as the Company's independent auditors received 7,822,205 votes in favor.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the American Stock Exchange under the symbol "EMA". The following table sets forth the range of high and low prices per share of our common stock for each period indicated.

	<u>2005</u>		<u>2006</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
First quarter	\$13.00	\$8.40	\$7.10	\$4.60
Second quarter	\$10.40	\$7.00	\$5.70	\$2.50
Third quarter	\$10.30	\$5.30	\$3.80	\$1.80
Fourth quarter	\$ 9.00	\$5.40	\$2.50	\$1.01

As of March 16, 2007, there were 491 holders of record of our common stock. Because brokers and other institutions hold many of the shares on behalf of shareholders, we are unable to determine the actual number of shareholders represented by these record holders.

Dividends

We have never declared or paid cash dividends on our common stock. We currently anticipate that we will retain all future earnings to fund the operation of our business and do not anticipate paying dividends on our common stock in the foreseeable future.

Recent Issuances of Unregistered Stock

None.

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations". The statements of operations data for the years ended December 31, 2006, 2005, and 2004 and the balance sheet data at December 31, 2006 and 2005 are derived from our audited financial statements which are included elsewhere in this Form 10-K. The statement of operations data for the year ended December 31, 2003 and 2002 and the balance sheet data at December 31, 2004, 2003 and 2002 are derived from our audited financial statements which are not included in this Form 10-K. The historical results are not necessarily indicative of results to be expected for future periods. The following information is presented in thousands, except per share data.

Consolidated Statements of Operations Data:

	2006	For the Year Ended December 31,			2002
		2005	2004	2003	
	(In thousands, except per share data)				
Revenue	\$ 8,169	\$ 3,745	\$ 3,593	\$ 2,578	\$ 2,128
Cost of goods sold	11,359	10,219	5,966	5,141	---
Gross (loss) profit	(3,190)	(6,474)	(2,373)	(2,563)	2,128
Operating expenses:					
Research and development	4,406	4,020	898	19	7,255
Stock based compensation (1)	---	---	88	2,183	1,647
Selling, general and administrative	8,860	6,316	4,340	3,529	5,832
Total operating expenses	13,266	10,336	5,326	5,731	14,734
Loss from operations	(16,456)	(16,810)	(7,699)	(8,294)	(12,606)
Other income (expense), net	1,190	282	(5,012)	3,571	(2,306)
Net loss	\$ (15,266)	\$ (16,528)	\$ (12,711)	\$ (4,723)	\$ (14,912)
Basic and diluted loss per share	\$ (1.52)	\$ (1.94)	\$ (1.98)	\$ (1.31)	\$ (5.07)
Shares used in calculation of loss per share:					
Basic and diluted	10,058	8,541	6,428	3,599	2,941

Consolidated Balance Sheet Data:

	2006	2005	December 31,		2002
			2004	2003	
Cash, cash equivalents	\$ 1,415	\$ 6,727	\$ 13,457	\$ 1,054	\$ 83
Working capital (deficit)	\$ (305)	\$ 8,868	\$ 14,925	\$ 106	\$ (13,602)
Total assets	\$ 7,005	\$ 14,142	\$ 18,436	\$ 3,749	\$ 1,834
Long-term obligations	\$ 2,229	\$ 56	\$ 22	\$ 6,161	\$ 228
Total Shareholders' equity (capital deficit)	\$ (1,164)	\$ 10,401	\$ 16,447	\$ (4,767)	\$ (12,808)

(1) Represents amounts reported under FAS 123.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Introduction

The following discussion should be read in conjunction with the Financial Statements and Notes thereto. Our fiscal year ends December 31. This document contains certain forward-looking statements including, among others, anticipated trends in our financial condition and results of operations and our business strategy. (See Part I, Item 1A, "Risk Factors "). These forward-looking statements are based largely on our current expectations and are subject to a number of risks and uncertainties. Actual results could differ materially from these forward-looking statements. Important factors to consider in evaluating such forward-looking statements include (i) changes in external factors or in our internal budgeting process which might impact trends in our results of operations; (ii) unanticipated working capital or other cash requirements; (iii) changes in our business strategy or an inability to execute our strategy due to unanticipated changes in the industries in which we operate; and (iv) various competitive market factors that may prevent us from competing successfully in the marketplace.

Overview

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

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

Since our inception in 1996 through 2004, we derived the majority of our revenues from fees paid to us under research and development contracts, primarily with the U.S. federal government. We have devoted significant resources to the development and commercial launch of our products. We commenced limited initial sales of our SVGA+ microdisplay in May 2001 and commenced shipping samples of our SVGA-3D microdisplay in February 2002. From inception to December 31, 2006, we have recognized an aggregate of approximately \$19.5 million from sales of our products, and as of December 31, 2006, we have a backlog of approximately \$6.1 million in products ordered for delivery through December 31, 2007. These products are being applied or considered for near-eye and headset applications in products such as entertainment and gaming headsets, handheld Internet and telecommunication appliances, viewfinders, and wearable computers to be manufactured by original equipment manufacturer (OEM) customers. We have also shipped a limited number of our Z800 3DVisor personal display systems. In addition to marketing OLED-on-silicon microdisplays as components, we also offer microdisplays as an integrated package, which we call Microviewer that includes a compact lens for viewing the microdisplay and electronic interfaces to convert the signal from our customer's product into a viewable image on the microdisplay. Through our operations in Washington State we are also developing head-wearable displays that incorporate our Microviewer.

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

Company History

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

Critical Accounting Policies

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

Revenue and Cost Recognition

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

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

Use of estimates

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

Fair value of financial instruments

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

Stock-based Compensation

eMagin maintains several stock equity incentive plans. The 2005 Employee Stock Purchase Plan (the "ESPP") provides our employees with the opportunity to purchase common stock through payroll deductions. Employees purchase stock semi-annually at a price that is 85% of the fair market value at certain plan-defined dates. As of December 31, 2006, the number of shares of common stock available for issuance was 150,000. As of December 31, 2006, the plan had not been implemented.

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

On January 1, 2006, we adopted the provisions of Financial Accounting Standards Board ("FASB") Statement No. 123(R), "Share-Based Payment", and ("SFAS No. 123R"), which requires us to recognize expense related to the fair value of our share-based compensation issued to employees and directors. Prior to the January 1, 2006, we accounted for share-based compensation under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25 ("APB No. 25"), "Accounting for Stock Issued to Employees", and related interpretations, as permitted by FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"). In accordance with APB No. 25, no compensation cost was required to be recognized for options granted that had an exercise price equal to the market value of the underlying common stock on the date of grant.

We adopted SFAS No. 123R using the modified prospective transition method and consequently have not retroactively adjusted results for prior periods. Under this transition method, compensation cost associated with stock options includes: a) compensation cost for all share-based compensation granted prior to, but not vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No.123 and b) compensation cost for all share-based compensation granted beginning January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No.123R. We use the straight-line method for recognizing compensation expense. Compensation expense for awards under SFAS 123R includes an estimate for forfeitures.

Results of Operations

The following table presents certain financial data as a percentage of total revenue for the periods indicated. Our historical operating results are not necessarily indicative of the results for any future period.

	As a Percentage of Total Revenue		
	Year Ended December 31,		
	2006	2005	2004
Consolidated Statements of Operations Data:			
Revenue	100%	100%	100%
Cost of goods sold	139	273	166
Gross loss	(39)	(173)	(66)
Operating expenses:			
Research and development	54	107	25
Stock based compensation	-----	-----	2
Selling, general and administrative	109	169	121
Total operating expenses	163	276	148
Loss from operations	(202)	(449)	(214)
Other income (expense)	15	8	(140)
Net loss	(187)%	(441)%	(354)%

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Revenues

Revenues increased by approximately \$4.5 million to a total of approximately \$8.2 million for the year ended December 31, 2006 from approximately \$3.7 million for the year ended December 31, 2005, representing an increase of 118%. This increase was due to increased microdisplay demand and the broadening of our product revenue through the sales of the Z800 3D Visor. Our contract revenue increased approximately \$150 thousand while our product revenue increased approximately \$4.3 million. Average price per unit for microdisplays was \$386 in 2006 and \$372 in 2005. Our current expectation is that revenue will continue to grow in 2007 if we successfully execute our business plan.

Cost of Goods Sold

Cost of goods sold includes direct and indirect costs associated with production of our products. Cost of goods sold for the years ended December 31, 2006 and 2005 was approximately \$11.4 million and approximately \$10.2, respectively, an increase of \$1.2 million. The gross loss was approximately (\$3.2) million and approximately (\$6.5) million, respectively, for the years ended December 31, 2006 and 2005, respectively. The gross loss was (39%) for the year ended December 31, 2006 as compared to (173%) for the year ended December 31, 2005. The increase in cost of goods sold for the year ended December 31, 2006 was attributed to higher materials usage to support increased production as well as approximately \$343 thousand of stock compensation expense reflected in accordance with SFAS No. 123R in 2006. The decrease in gross loss was attributed to fuller utilization of our fixed production overhead due to higher unit volume. We expect that gross margins will improve in 2007 as a result of continued leverage of our production overhead as volumes and revenue increase.

Research and Development Expenses

Research and development expenses included salaries, development materials and other costs specifically allocated to the development of new microdisplay products, OLED materials and subsystems. Research and development expenses for the year ended December 31, 2006 were approximately \$4.4 million as compared to approximately \$4.0 million for the year ended December 31, 2005. The increase was primarily due to the stock-based compensation expense of approximately \$435 thousand in 2006.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of salaries and fees for professional services, legal fees incurred in connection with patent filings and related matters, as well as other marketing and administrative expenses. General and administrative expenses increased by approximately \$2.9 million to a total of approximately \$8.9 million for the year ended December 31, 2006 from \$6.3 million for the year ended December 31, 2005. The increase in selling, general and administrative expenses was due primarily to stock-based compensation expense of approximately \$2.9 million and an increase in marketing expenses related to our Z800 3DVisor.

Other Income (Expense)

Other income, net consists primarily of interest income earned on investments, interest expense related to the secured debentures, and gain from the change in the derivative liability. For the year ended December 31, 2006, interest income was approximately \$92 thousand as compared to approximately \$210 thousand for the year ended December 31, 2005. The decrease in interest income was primarily a result of lower cash balances available for investment. For the year ended December 31, 2006, interest expense was approximately \$1.3 million as compared to approximately \$4 thousand for the year ended December 31, 2005. The increase in the interest expense was a result of interest associated with our notes payable of approximately \$124 thousand, the amortization of the deferred costs associated with the notes payable of approximately \$221 thousand, and the amortization of the debt discount of approximately \$956 thousand. For the year ended December 31, 2006, income from the change in the derivative liability was approximately \$2.4 million as compared to \$0 for the year ended December 31, 2005.

Off-Balance Sheet Arrangements

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

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Revenues

Revenues increased by approximately \$152 thousand to a total of approximately \$3.7 million for the year ended December 31, 2005 from approximately \$3.6 million for the year ended December 31, 2004, representing an increase of 4%. This increase was due primarily to the broadening of our product offerings with the Z800 product and incremental revenue generated by these sales. Our contract revenue decreased approximately \$72 thousand while our product revenue increased approximately \$217 thousand. Average price per unit for microdisplays was \$372 in 2005 and 2004.

Cost of Goods Sold

Cost of goods sold includes direct and indirect costs associated with production of our products. In the year ended December 31, 2005 we recorded approximately \$10.2 million in cost of goods sold which resulted in a gross loss of approximately \$6.5 million as compared to approximately \$6.0 million in costs of goods sold resulting in a gross loss of \$2.4 million in the year ended December 31, 2004. The production expenses for 2005 include labor costs related to operating two full eight hour shifts and a partial third shift as compared to a single shift in 2004. To accommodate longer operating hours and expected higher product output in 2005 we initiated modifications to our production process that resulted in less than 10% of our expected capacity while underway. Stabilization of these modifications initially was expected to be completed early in 2005, but took until the first quarter of 2006 to achieve. As a result gross margins in 2005 declined as compared to 2004 due to the higher labor costs.

Research and Development Expenses

Gross research and development expenses increased by approximately \$3.1 million to a total of \$4.0 million for the year ended December 31, 2005 from approximately \$0.9 million for the year ended December 31, 2004. The approximately \$3.1 million increase in R&D expenses for the year ended December 31, 2005 reflects efforts to develop two new microdisplays and three visor products.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased by approximately \$2.0 million to a total of approximately \$6.3 million for the year ended December 31, 2005 from approximately \$4.3 million for the year ended December 31, 2004. The increase in selling, general and administrative expenses was due primarily to an increase in staff and personnel costs.

Other Income (Expense)

Other income, net, for 2005 was approximately \$282 thousand and was comprised of net interest income of approximately \$207 thousand; a gain on miscellaneous equipment sales of approximately \$38 thousand; and a gain on foreign exchange of approximately \$37 thousand. Other expense, net, for 2004 was approximately \$5.0 million and was comprised of approximately \$3.2 million of charges related to the value of the warrants issued to induce the holders of the approximately \$7.8 million in notes to agree to an early conversion of the notes into common stock; approximately \$1.6 million in charges related to the remaining unamortized debt discount and beneficial conversion feature associated with aforementioned notes; and approximately \$75 thousand in charges related to the write-off of the remaining unamortized deferred financing costs.

Off-Balance Sheet Arrangements

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

Liquidity and Capital Resources

At December 31, 2006, our principal source of liquidity was cash of \$1.4 million.

For the year ended December 31, 2006, net cash used by operating activities was approximately \$10.4 million, primarily attributable to our net loss of approximately \$15.3 million. For the year ended December 31, 2005, net cash used by operating activities was approximately \$15.7 million, primarily attributable to our net loss of approximately \$16.5 million.

For the year ended December 31, 2006, net cash used by investing activities was approximately \$257 thousand primarily related to purchases of equipment. Net cash used by investing activities for the year ended December 31, 2005 was approximately \$1.1 million primarily related to equipment purchases..

Net cash provided by financing activities the year ended December 31, 2006 was approximately \$5.3 million and was comprised primarily of approximately \$5.4 million in proceeds from debt issuance and offset by payments on long-term debt and capitalized lease obligations of approximately \$55 thousand. Net cash provided by financing activities during the year ended December 31, 2005 was approximately \$10.1 million and was comprised primarily of approximately \$8.4 million in proceeds from the sale of common stock and approximately 1.6 million from the exercise of stock options and warrants.

Our consolidated financial statements as of December 31, 2006 have been prepared under the assumption that we will continue as a going concern for the year ending December 31, 2007. Our independent registered public accounting firm has issued a report dated March 27, 2007 that included an explanatory paragraph expressing substantial doubt in our ability to continue as a going concern without additional capital becoming available. Our ability to continue as a going concern ultimately is dependent on our ability to generate a profit which is likely dependant upon our ability to obtain additional equity or debt financing, attain further operating efficiencies and, ultimately, to achieve profitable operations. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As we have reported our business is currently experiencing significant revenue growth during the year ended December 31, 2006. This trend, if it continues, may result in higher accounts receivable levels and may require increased production and/or higher inventory levels. In addition, in July 2007, we are responsible for repaying \$2.9 million to the noteholders. If the funds are not available, we will negotiate with the noteholders to defer the payment but no assurances can be made that they will agree. We anticipate that our cash requirements to fund these requirements as well as other operating or investing cash requirements over the next twelve months will be greater than our current cash on hand. While we received approximately \$5.4 million, net, from the sale of senior secured debentures pursuant to the Note Purchase agreements that we entered into on July 21, 2006, and such agreements provide for the investors to purchase an additional \$0.5 million, nevertheless we anticipate that we will still require additional funds over the next twelve months. We do not currently have commitments for these funds and no assurance can be given that additional financing will be available, or if available, will be on acceptable terms. If we are unable to obtain sufficient funds during the next twelve months we will further reduce the size of our organization and may be forced to reduce and/or curtail our production and operations, all of which could have a material adverse impact on our business prospects.

In addition to the foregoing, as previously reported, we have retained CIBC World Markets Corporation and Larkspur Capital Corporation to assist us in investigating and evaluating various strategic alternatives, ranging from investment to acquisition, in response to inquiries that we have received.

Contractual Obligations

The following chart describes the outstanding contractual obligations of eMagin as of December 31, 2006 (in thousands):

	Payments due by period			
	Total	1 Year	2-3 Years	4-5 Years
Capital lease obligations	\$ 6	\$ 6	\$ —	\$ —
Operating lease obligations	3,387	1,405	1,982	—
Purchase obligations (a)	1,476	1,476	—	—
Other long-term liabilities (b)	787	183	354	250
Total	<u>\$ 5,656</u>	<u>\$ 3,070</u>	<u>\$ 2,336</u>	<u>\$ 250</u>

(a) The majority of purchase orders outstanding contain no cancellation fees except for minor re-stocking fees.

(b) This amount represents the obligation for royalty payments, capitalized software and the New York Urban Development settlement.

Effect of Recently Issued Accounting Pronouncements

See Note 11 of the Consolidated Financial Statements in Item 8 for a full description of recent accounting pronouncements, including the expected dates of adoption and estimated effects on results of operations and financial condition.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market rate risk

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

Interest rate risk

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

Foreign currency exchange rate risk

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

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Financial Statement Index

	<u>Page</u>
Report of Independent Registered Public Accounting Firm	30
Consolidated Balance Sheets as of December 31, 2006 and 2005	31
Consolidated Statements of Operations for the years ended December 31, 2006, 2005 and 2004	32
Consolidated Statements of Changes in Shareholders' Equity (Deficit) for the years ended December 31, 2006, 2005 and 2004	33
Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005 and 2004	34
Notes to the Consolidated Financial Statements	35

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Stockholders
eMagin Corporation

We have audited the accompanying consolidated balance sheets of eMagin Corporation and subsidiary (the "Company") as of December 31, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity (deficit) and cash flows for each of the three years in the period ended December 31, 2006. 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 conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of eMagin Corporation and subsidiary as of December 31, 2006 and 2005 and the consolidated results of their operations and their consolidated cash flows for each of the three years in the period ended December 31, 2006 in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has had recurring losses from operations which it believes will continue, has working capital and capital deficits at December 31, 2006. These factors raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also discussed in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

As discussed in Note 2 to the consolidated financial statements, the Company changed its method of accounting for stock-based compensation effective January 1, 2006

/s/ Eisner LLP

Eisner LLP
New York, New York
March 27, 2007

eMAGIN CORPORATION
CONSOLIDATED BALANCE SHEETS

December 31,
2006 **2005**
(In thousands, except share and
per share amounts)

ASSETS

Current assets:		
Cash and cash equivalents	\$ 1,415	\$ 6,727
Investments – held to maturity	171	120
Accounts receivable, net	908	822
Inventory	2,485	3,839
Prepaid expenses and other current assets	656	1,045
Total current assets	5,635	12,553
Equipment, furniture and leasehold improvements, net	666	1,299
Intangible assets, net	55	57
Other assets	233	233
Deferred financing costs, net	416	—
Total assets	\$ 7,005	\$ 14,142

LIABILITIES AND SHAREHOLDERS' (DEFICIT) EQUITY

Current liabilities:		
Accounts payable	\$ 1,192	\$ 562
Accrued compensation	959	1,010
Other accrued expenses	749	1,894
Advanced payments	444	60
Deferred revenue	126	96
Current portion of capitalized lease obligations	6	16
Current portion of debt	1,217	—
Derivative liability – warrants	1,195	—
Other current liabilities	52	47
Total current liabilities	5,940	3,685
Capitalized lease obligations	—	6
Other long-term liabilities	2,229	50
Total liabilities	8,169	3,741
Commitments and contingencies		
Shareholders' (deficit) equity:		
Preferred stock, \$.001 par value: authorized 10,000,000 shares; no shares issued and outstanding	—	—
Common stock, \$.001 par value: authorized 200,000,000 shares, issued and outstanding, 10,341,029 shares in 2006 and 9,997,246 shares in 2005	10	10
Additional paid in capital	179,651	175,950
Accumulated deficit	(180,825)	(165,559)
Total shareholders' (deficit) equity	(1,164)	10,401
Total liabilities and shareholders' (deficit) equity	\$ 7,005	\$ 14,142

See notes to Consolidated Financial Statements.

eMAGIN CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Year Ended December 31,		
	2006	2005	2004
	(In thousands, except per share data)		
Revenue:			
Product revenue	\$ 7,983	\$ 3,719	\$ 3,502
Contract revenue	186	36	108
Sales returns and allowance	—	(10)	(17)
Total revenue, net	<u>8,169</u>	<u>3,745</u>	<u>3,593</u>
Cost of goods sold	<u>11,359</u>	<u>10,219</u>	<u>5,966</u>
Gross loss	<u>(3,190)</u>	<u>(6,474)</u>	<u>(2,373)</u>
Operating expenses:			
Research and development	4,406	4,020	898
Selling, general and administrative	8,860	6,316	4,428
Total operating expenses	<u>13,266</u>	<u>10,336</u>	<u>5,326</u>
Loss from operations	<u>(16,456)</u>	<u>(16,810)</u>	<u>(7,699)</u>
Other income (expense):			
Interest expense	(1,306)	(4)	(5,087)
Gain on warrant derivative liability	2,405	—	—
Other income, net	91	286	75
Total other income (expense), net	<u>1,190</u>	<u>282</u>	<u>(5,012)</u>
Net loss	<u>\$ (15,266)</u>	<u>\$ (16,528)</u>	<u>\$ (12,711)</u>
Loss per share, basic and diluted			
	<u>\$ (1.52)</u>	<u>\$ (1.94)</u>	<u>\$ (1.98)</u>
Weighted average number of shares outstanding:			
Basic and diluted	<u>10,058</u>	<u>8,541</u>	<u>6,428</u>

See notes to Consolidated Financial Statements.

eMAGIN CORPORATION
CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY (DEFICIT)

	<u>Common Stock</u> <u>Shares</u>	<u>Common Stock</u> <u>Amount</u>	<u>Deferred</u> <u>Compensation</u>	<u>Additional</u> <u>Paid-In</u> <u>Capital</u>	<u>Accumulated</u> <u>Deficit</u>	<u>Total</u> <u>Shareholders'</u> <u>Equity</u>
(In thousands, except share amounts)						
Balance, December 31, 2003	4,270	\$ 4	\$ (88)	\$ 131,638	\$ (136,320)	\$ (4,766)
Sale of common stock, net of issuance costs	1,641	2	--	16,383	--	16,385
Debt to equity conversion	1,139	1	--	8,566	--	8,567
Issuance of warrants for early conversion of debt to equity			--	3,180	--	3,180
Exercise of common stock warrants	353	--	--	3,790	--	3,790
Stock options exercised	522	1	--	1,383	--	1,384
Issuance of common stock for services	39	--	--	531	--	531
Amortization of deferred stock compensation	--	--	88	--	--	88
Net loss	--	--	--	--	(12,711)	(12,711)
Balance, December 31, 2004	7,964	\$ 8	\$ --	\$ 165,471	\$ (149,031)	\$ 16,448
Sale of common stock, net of issuance costs	1,662	2	--	8,398	--	8,400
Stock options exercised	11	--	--	37	--	37
Exercise of common stock warrants	306	--	--	1,584	--	1,584
Issuance of common stock for services	54	--	--	461	--	460
Net loss	--	--	--	--	(16,528)	(16,528)
Balance, December 31, 2005	9,997	\$ 10	\$ --	\$ 175,950	\$ (165,559)	\$ 10,401
Debt to equity conversion	85	--	--	220	--	220
Issuance of common stock for services	254	--	--	580	--	580
Stock-based compensation	--	--	--	2,891	--	2,891
Stock options exercised	5	--	--	10	--	10
Net loss	--	--	--	--	(15,266)	(15,266)
Balance, December 31, 2006	10,341	\$ 10	\$ --	\$ 179,651	\$ (180,825)	\$ (1,164)

See notes to Consolidated Financial Statements.

eMAGIN CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31,		
	2006	2005	2004
	(In thousands)		
Cash flows from operating activities:			
Net loss	\$ (15,266)	\$ (16,528)	\$ (12,711)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	841	908	620
Amortization of deferred financing fees	221	---	8
Increase (reduction) of provision for sales returns and doubtful accounts	(39)	(284)	467
Stock based compensation	2,891	---	88
Non-cash interest related charges	---	---	5,094
Issuance of common stock for services, net	553	470	531
Amortization of discount on notes payable	956	---	---
Gain on warrant derivative liability	(2,405)	---	---
Loss on other asset	157	---	---
Changes in operating assets and liabilities:			
Accounts receivable	(42)	(2)	(235)
Unbilled costs and estimated profits on contracts in progress	---	---	75
Inventory	1,354	(1,821)	(1,742)
Prepaid expenses and other current assets	389	(175)	(400)
Advance Payments	384	(4)	(58)
Deferred revenue	30	96	---
Accounts payable, accrued compensation, and accrued expenses	(566)	1,613	(51)
Other current liabilities	153	14	17
Net cash used in operating activities	<u>(10,389)</u>	<u>(15,713)</u>	<u>(8,297)</u>
Cash flows from investing activities:			
Purchase of equipment	(204)	(898)	(721)
Purchase of investments – held to maturity	(51)	(120)	---
Purchase of intangibles and other assets	(2)	(54)	(99)
Net cash used by investing activities	<u>(257)</u>	<u>(1,072)</u>	<u>(820)</u>
Cash flows from financing activities:			
Proceeds from sale of common stock, net of issuance costs	---	8,400	16,385
Proceeds from exercise of stock options and warrants	10	1,621	5,173
Proceeds from long-term debt	5,970	50	---
Payments related to deferred financing costs	(591)	---	---
Payments of long-term debt and capitalized lease obligations	(55)	(16)	(38)
Net cash provided by financing activities	<u>5,334</u>	<u>10,055</u>	<u>21,520</u>
Net (decrease) increase in cash and cash equivalents	<u>(5,312)</u>	<u>(6,730)</u>	<u>12,403</u>
Cash and cash equivalents, beginning of year	6,727	13,457	1,054
Cash and cash equivalents, end of year	<u>\$ 1,415</u>	<u>\$ 6,727</u>	<u>\$ 13,457</u>
Cash paid for interest			
	<u>\$ 128</u>	<u>\$ 4</u>	<u>\$ 8</u>
Cash paid for taxes			
	<u>\$ 40</u>	<u>\$ 15</u>	<u>\$ -----</u>
Supplemental non-cash transactions:			
Conversion of debt to equity	\$ 220	\$ ---	\$ 8,567

During the year ended December 31, 2006, the Company

- entered into several Note Purchase Agreements with investors and issued warrants that are exercisable at \$3.60 per share into approximately 1.6 million shares of common stock valued at \$3.4 million;
- issued 10,000 shares of common stock in lieu of cash payment of \$26,000 as compensation for services performed and recorded as deferred costs; and
- issued approximately 85,000 shares for the conversion of Notes totaling \$220,000.

See notes to Consolidated Financial Statements.

eMAGIN CORPORATION
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – NATURE OF BUSINESS

eMagin Corporation and its wholly owned subsidiary (the “Company”) designs, develops, manufactures, and markets virtual imaging products for consumer, commercial, industrial and military applications. The Company's products are sold mainly in North America, Asia, and Europe,

Note 2 – SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The accompanying audited consolidated financial statements include the accounts of eMagin Corporation and its wholly owned subsidiary. All intercompany transactions have been eliminated in consolidation.

Basis of presentation

The consolidated financial statements have been prepared assuming that the Company will continue as a going concern. The Company has had recurring losses from operations which it believes will continue through in a foreseeable future. The Company's cash requirements over the next twelve months are greater than the Company's current cash on hand. At December 31, 2006, the Company's has working capital and shareholders' deficits. These factors raise substantial doubt regarding the Company's ability to continue as a going concern without continuing to obtain additional funding. The Company does not have commitments for such financing and no assurance can be given that additional financing will be available, or if available, will be on acceptable terms. If the Company is unable to obtain sufficient funds during the next twelve months, the Company will further reduce the size of its organization and/or curtail operations which will have a material adverse impact on the Company's business prospects. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

On November 3, 2006, the Company effected a one-for-ten (1-for-10) reverse stock split of its issued and outstanding common stock. See Note 9 to the Consolidated Financial Statements for a further discussion. All common share amounts and per share amounts in the accompanying financial statements and this Form 10-K have been adjusted to reflect the 1-for-10 reverse stock split. The Company has adjusted its shareholders' equity accounts by reducing its stated capital and increasing its additional paid-in capital by approximately \$91 thousand as of December 31, 2006, 2005 and 2004 to reflect the reduction in outstanding shares as a result of the reverse stock split.

Use of estimates

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

Revenue and cost recognition

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

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

Research and development expenses

Research and development costs are expensed as incurred.

Cash and cash equivalents

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

Investments—held to maturity

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

Accounts receivable

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

Allowance for doubtful account

The allowance for doubtful accounts reflects an estimate of probable losses inherent in the accounts receivable balance. The allowance is determined based on a variety of factors, including the length of time receivables are past due, historical experience, the customer's current ability to pay its obligation, and the condition of the general economy and the industry as a whole. The Company will record a specific reserve for individual accounts when the Company becomes aware of a customer's inability to meet its financial obligations, such as in the case of bankruptcy filings or deterioration in the customer's operating results or financial position. If circumstances related to customers change, the Company would further adjust estimates of the recoverability of receivables.

Inventory

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

Equipment, furniture and leasehold improvements

Equipment, furniture and leasehold improvements are stated at cost. Depreciation on equipment is calculated using the straight-line method of depreciation over its estimated useful life. 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.

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," the Company performs impairment tests on its long-lived 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. Impairment losses, if any, are recognized based on the excess of the assets' carrying amounts over their estimated fair values.

Intangible Assets

The Company's intangible assets consist of patents that are amortized over their estimated useful lives of fifteen years using the straight line method. Total intangible amortization expense was approximately \$4 thousand, \$4 thousand, and \$2 thousand for the years ended December 31, 2006, 2005, and 2004, respectively.

Advertising

Costs related to advertising and promotion of products is charges to sales and marketing expense as incurred. Advertising expense for the years ended December 31, 2006, 2005 and 2004 were \$296 thousand, \$108 thousand, and \$0, respectively.

Income taxes

The Company accounts for income taxes in accordance with the provisions of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS No. 109"). SFAS No. 109 requires that the Company recognize deferred tax liabilities and assets for the expected future tax consequences of events that have been included in the financial statements or tax returns. Under this method, deferred tax liabilities and assets are determined on the basis of the difference between the tax basis of assets and liabilities and their respective financial reporting amounts ("temporary differences") at enacted tax rates in effect for the years in which the temporary differences are expected to reverse. The Company records an estimated valuation allowance on its deferred income tax assets if it is not more than likely that these deferred income tax assets will be realized.

Loss per common share

In accordance with SFAS No. 128, "Basic Earnings Per Share", net loss per common share amounts ("basic EPS") is 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") reflects the potential dilution from the exercise of stock options and warrants. These common equivalent shares have been excluded from the computation of diluted EPS for all periods presented as their effect is antidilutive. The years ended December 31, 2006, 2005, and 2004 do not include options and warrants to purchase 4,613,919, 4,424,988 and 3,517,739 respectively, of common equivalent shares, as their effect would be antidilutive.

Comprehensive income (loss)

SFAS No. 130, "Reporting Comprehensive Income", 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 other comprehensive income (loss) items, such as unrealized gains or losses on foreign currency translation 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 loss for the years ended December 31, 2006, 2005, and 2004. Accordingly, the Company's comprehensive loss is the same as its net income (loss) for the periods presented.

Stock-based compensation

On January 1, 2006, the Company adopted the provisions of SFAS No. 123R, "Share-Based Payment", which requires the Company to recognize expense related to the fair value of the Company's share-based compensation issued to employees and directors. Prior to January 1, 2006, the Company accounted for share-based compensation under the recognition and measurement provisions of APB No. 25 and related interpretations, as permitted by SFAS No. 123. We adopted SFAS No. 123R using the modified prospective transition method. Accordingly, periods prior to adoption have not been restated. Compensation cost recognized for the twelve months ended December 31, 2006 includes a) compensation cost for all share-based compensation granted prior to, but not vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No.123 and b) compensation cost for all share-based compensation granted beginning January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No.123R. The compensation cost was recognized using the straight-line attribution method. See Note 10 for a further discussion on stock-based compensation.

Fair value of financial instruments

At December 31, 2006, the Company's cash, cash equivalents, accounts receivable, short-term investments and accounts payable are shown at cost which approximates fair value due to the short-term nature of these instruments.

Note 3– RECEIVABLES

Receivables consisted of the following (in thousands):

	December 31,	
	2006	2005
Trade receivables	\$ 1,351	\$ 1,309
Less allowance for doubtful accounts	(443)	(487)
Net receivables	<u>\$ 908</u>	<u>\$ 822</u>

Note 4 – INVENTORY

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

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Raw materials	\$ 1,146	\$ 2,353
Work in process	558	107
Finished goods	781	1,379
Total Inventory	<u>\$ 2,485</u>	<u>\$ 3,839</u>

Note 5 – EQUIPMENT, FURNITURE AND LEASEHOLD IMPROVEMENTS

Equipment, furniture and leasehold improvements consist of the following (in thousands):

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Computer hardware and software	\$ 1,017	\$ 893
Lab and factory equipment	3,312	3,182
Furniture, fixtures, and office equipment	306	256
Assets under capital leases	66	66
Leasehold improvements	473	473
Construction in progress	---	100
Total equipment, furniture and leasehold improvements	<u>5,174</u>	<u>4,970</u>
Less: accumulated depreciation	(4,508)	(3,671)
Equipment, furniture and leasehold improvements, net	<u>\$ 666</u>	<u>\$ 1,299</u>

Depreciation expense was \$837, \$904 and \$617 for the years ended December 31, 2006, 2005, and 2004, respectively. Assets under capital leases are fully amortized.

Note 6 – DEBT

Debt is as follows (in thousands):

	<u>December 31,</u>	
	<u>2006</u>	<u>2005</u>
Current portion of long-term debt:		
Capitalized lease obligations	\$ 6	\$ 16
Other debt	58	---
6% Senior Secured Convertible Notes	2,880	---
Less: Unamortized discount on notes payable	(1,721)	---
Current portion of long-term debt, net	<u>1,223</u>	<u>16</u>
Long-term debt:		
Capitalized lease obligations	---	6
Other debt	104	50
6% Senior Secured Convertible Notes	2,890	---
Less: Unamortized discount on notes payable	(765)	---
Long-term debt, net	<u>2,229</u>	<u>56</u>
Total debt, net	<u>\$ 3,452</u>	<u>\$ 72</u>

Maturities with respect to the capitalized lease obligation, other debt and the 6% Senior Secured Convertible Notes as of December 31, 2006 are as follows (in thousands):

<u>Years Ending December 31,</u>	
2007	\$ 2,944
2008	\$ 2,934
2009	\$ 60

On July 21, 2006, the Company entered into several Note Purchase Agreements for the sale of approximately \$5.99 million of senior secured debentures (the "Notes") together with warrants to purchase approximately 1.8 million shares of common stock, par value \$.001 per share. 50% of the aggregate principal amount matures on July 21, 2007 and the remaining 50% matures on January 21,

2008. The Notes pay 6% per annum interest quarterly beginning September 1, 2006. Interest of approximately \$124 thousand was paid to investors in the year ended December 31, 2006.

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

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

The discount is being amortized to interest expense using the straight-line method as it approximates the effective interest method over the term of the Notes. For the twelve months ended December 31, 2006, debt discount of \$956 thousand was amortized to interest expense. See Note 9.

The Notes have specific terms that the Company must adhere to, i.e. maintaining minimum cash and cash equivalent balances and trading its stock on specific Exchanges. On March 9, 2007, the terms of the Note were amended to allow the Company to trade its common stock on the Over-The-Counter Bulletin Board and also requiring the Company to maintain cash and cash equivalent balances of \$200,000 from February 26, 2007 through March 31, 2007. Subsequent to March 31, 2007, the company must maintain cash and cash equivalent balances of \$600,000. On March 12, 2007, the Company was suspended from trading on the AMEX and is currently trading the Company's common stock on the Over-The Counter Bulletin Board. The delisting from the AMEX triggered a compliance condition on the notes payable. As a result the Company is required to pay the noteholders monthly interest at 1% on the outstanding principal of the notes payable. The Company received a waiver from the noteholders that allows the Company to accrue the interest and delay the interest payment until the earliest of the Company (i) completing \$2 million of debt or equity financing or (ii) the occurrence of a Repurchase Event per the note. On March 27, 2007, the cash and cash equivalents balances requirement was amended to maintain cash and cash equivalents balances of \$200,000 from April 1, 2007 through May 15, 2007. Subsequent to May 15, 2007, the Company must maintain \$600,000 in cash and cash equivalent balances.

Note 7 – DEBT SETTLEMENT AND DEBT CONVERSION

In February 2004, eMagin entered into an agreement whereby the holders of eMagin's Secured Convertible Notes (the "Notes"), which were due in November 2005, agreed to an early conversion of all of the \$7.8 million principal amount of the Notes, together with the \$.742 million of accrued interest on the Notes, into 1,139,462 shares of common stock of eMagin. On the date of the conversion the Company recorded \$1.6 million in interest expense related to the unamortized debt discount and beneficial conversion feature and \$75 thousand in interest expense related to the write-off of deferred financing costs.

In consideration of the Noteholders agreeing to the early conversion of the Notes, eMagin issued the Noteholders warrants to purchase an aggregate of 250,000 shares of common stock (the "Warrants"), which Warrants are exercisable at a price of \$27.60 per share. 150,000 of the Warrants, "D warrants", were exercisable until December 31, 2005. The remaining 100,000 of the Warrants, "E warrants", are exercisable until June 10, 2008. Using the Black-Scholes method of valuating warrants, an expense totaling \$3.18 million was recorded in interest expense in the first quarter of 2004 to record an estimated value for these warrants. The fair value of the warrants was estimated at \$23.00 using the Black-Scholes option-pricing model with the following assumptions for the two sets of warrants: (1) average expected volatility of 100%, (2) average risk-free interest rates of 3.52%, (3) dividends of 0%, and (4) Average Term (in days) of 670 for the D warrants and 1,460 for the E warrants.

Note 8 – INCOME TAXES

The difference between the statutory federal income tax rate on the Company's pre-tax income and the Company's effective income tax rate is summarized as follows:

	For the years ended December 31,		
	2006	2005	2004
U.S. Federal income tax provision (benefit) at federal statutory rate	(34) %	(35) %	(35) %
Change in valuation allowance	32 %	35 %	35 %
Permanent difference	2 %	0 %	0 %

Significant components of eMagin's deferred tax assets and liabilities are as follows (numbers are in thousands):

	For the years ended December 31,		
	2006	2005	2004
Net operating losses	\$ 53,974	\$ 54,607	\$ 39,262
Goodwill and other intangibles	14,422	17,957	19,894
Allowance for doubtful accounts	159	195	274
Deferred payroll	13	18	25
Accrued vacation payable	132	142	81
Depreciation	(44)	(120)	-----
Stock compensation	279	-----	-----
Total	68,935	72,799	59,536
Less valuation allowance	(68,935)	(72,799)	(59,536)
Net deferred tax asset	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>

As of December 31, 2006, eMagin has federal and state net operating loss carryforwards of approximately \$149.9 million that will be available to offset future taxable income, if any, through December 2026. 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. As of December 31, 2006 and 2005, the Company has gross deferred tax assets of approximately of \$68 and \$73 million, respectively, primarily resulting from the future tax benefit of net operating loss carryforwards and temporary differences relating to amortization of intangible assets. Such net deferred tax assets are fully offset by a federal valuation allowance due to the uncertainty as to their realizability. A federal 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. The federal valuation allowance decreased approximately \$3.9 million for the year ended December 31, 2006 and increased \$13.3 million for the year ended December 31, 2005.

Note 9 – SHAREHOLDERS' EQUITY

Common Stock

2006

At the Company's 2006 Annual Meeting of Shareholders held on October 20, 2006, the Company's shareholders approved an amendment to the Company's certificate of incorporation to effect a reverse stock split of the issued and outstanding common stock on a ratio of 1-for-10. On November 3, 2006, the reverse stock split became effective. The Company has adjusted its shareholders' equity accounts by reducing its stated capital and increasing its additional paid-in capital by approximately \$91 thousand as of December 31, 2006, 2005 and 2004 to reflect the reduction in outstanding shares as a result of the reverse stock split.

On July 21, 2006, the Company entered into several Note Purchase Agreements for the sale of approximately \$5.99 million of senior secured debentures (the "Notes") and warrants to purchase approximately 1.8 million shares of common stock, par value \$.001 per share. The investors purchased \$5.99 million principal amount of Notes with conversion prices of \$2.60 per share that may convert into approximately 2.3 million shares of common stock and 5 year warrants exercisable at \$3.60 per share into approximately 1.6 million shares of common stock. If the Notes are not converted, 50% of the principal amount will be due on July 21, 2007 and the remaining 50% will be due on January 21, 2008. Commencing September 1, 2006, 6% interest is payable in quarterly installments on outstanding notes. For the year ended December 31, 2006, the Company paid approximately \$124,000 of interest to investors. The Company received approximately \$5.4 million, net of deferred financing costs of approximately \$0.6 million which are amortized over the life of the Notes. The Company amortized approximately \$221 thousand of deferred financing costs in 2006. For the year ended December 31, 2006, two note holders converted their promissory notes valued at approximately \$220 thousand and were issued an aggregate of approximately 85,000 shares.

An additional \$0.5 million was to be invested through the exercise of a warrant to purchase approximately 192,000 shares of common stock at \$2.60 per share on or prior to December 14, 2006, or at the election of the Company, by the purchase of additional Notes and warrants. The Company determined the relative fair value of the warrants to be approximately \$157,000 which was recorded as an other asset. The following assumptions were used to determine the fair value of the warrant:

Dividend yield	0%
Risk free interest rates	5.25%
Expected volatility	122%
Expected term (in years)	0.4 years

The investor elected not to exercise its warrants prior to December 14, 2006. The fair value of the warrants which was recorded as an other asset was written off as a sales, general and administrative expense.

Under EITF 00-19 "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in, a Company's Own Stock", the fair value of the warrants, \$3.6 million, have been recorded as a liability since the warrant agreement requires a potential net-cash settlement in the first year of the warrant agreement if the registration statement is not effective. As of December 31, 2006, the registration statement is effective. The liability will be adjusted to fair value at each reporting period. The change in the fair value of the warrants will be recorded in the Consolidated Statement of Operations as other income (expense). For the twelve months ended December 31, 2006, the Company recorded approximately \$2.4 million of gain from the change in the fair value of the derivative liability.

In connection with the Notes, a registration rights agreement was entered into which requires the Company to file a registration statement for the resale of the common stock underlying the Notes and the warrants. The Company must use its best efforts to have the registration statement declared effective by the end of a specified grace period and also maintain the effectiveness of the registration statement until all shares of common stock underlying the Notes and the warrants have been sold or may be sold without volume restrictions pursuant to Rule 144(k) of the Securities Act. If the Company fails to have the registration statement declared effective within the grace period or fails to maintain the effectiveness as set forth in the preceding sentence, the Company is required to pay each investor cash payments equal to 1.0% of the aggregate purchase price monthly until the failure is cured. If the Company fails to pay the liquidated damages, interest at 16.0% will accrue until the liquidated damages are paid in full. The registration statement was filed and declared effective by the Securities and Exchange Commission within the specified grace period. As of December 31, 2006, the registration statement remains effective.

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

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

For the year ended December 31, 2006, the Company received approximately \$10,000 for the exercise of 5,000 options and there were no warrants exercised. For year ended December 31, 2006, the Company issued approximately 254,000 shares of common stock in lieu of cash payments in the amount of approximately \$580,000 as compensation for services rendered and to be rendered in the future. The fair value of the services was measured at market value of the common stock at the time of payment. As such, the Company recorded the fair value of the services rendered in selling, general and administrative expenses in the accompanying audited consolidated statement of operations for the year ended December 31, 2006.

The 2004 Non-Employee Compensation Plan (the "2004 Plan") was established to help the Company retain consultants, professionals and service providers. The Board of Directors will select the recipient of the awards, the nature of the awards and the amount. At the 2006 Annual Shareholder meeting, the shareholders approved an increase in the number of authorized shares of common stock usable from 200,000 to 950,000. This number is subject to adjustment in the event of a recapitalization, reorganization or similar event.

2005

On October 20, 2005, the Company entered into a Securities Purchase Agreement, pursuant to which the Company sold and issued 1,661,906 shares of common stock, par value \$0.001 per share, at a price of \$5.50 per share and warrants to purchase up to 997,143 shares of common stock for an aggregate purchase price of approximately \$9.14 million. The net proceeds received after expenses were approximately \$8.4 million.

The warrants are exercisable at a price of \$10.00 per share and expire on April 20, 2011. Of the 997,143 warrants, 664,763 of the warrants are exercisable on or after May 20, 2006. The remaining 332,381 are exercisable after March 31, 2007, however these warrants will be cancelled if the Company's net revenue for fiscal year 2006 exceeds \$20 million or if the investor has sold more than 25% of the shares purchased under the securities purchase agreement prior to December 31, 2006.

As a result of the above transaction, the outstanding 121,335 Series A Common Stock Purchase Warrants, that were issued to participants of the Securities Purchase Agreement dated January 9, 2004, were re-priced from \$10.50 to \$5.50 and the outstanding 650,001 Series F Common Stock Purchase Warrants, that were issued to participants of the Securities Purchase Agreement dated October 25, 2004, were re-priced from \$12.10 to \$10.90.

A registration rights agreement was entered into in connection with the private placement which requires the Company to file a registration statement for the resale of the common stock and the shares underlying the warrants. The Company must use its best efforts to have the registration statement declared effective by the end of a specified grace period and also maintain the effectiveness of the registration statement until all common stock have been sold or may be sold without volume restrictions pursuant to Rule 144(k) of the Securities Act. If the Company fails to have the registration statement declared effective within the grace period or fails to maintain the effectiveness, the agreement requires the Company to pay each investor cash payments equal to 2.0% of the aggregate

purchase price monthly until the failure is cured. If the Company fails to pay the liquidated damages, interest at 15.0% will accrue until the liquidated damages are paid in full. The registration statement was filed and declared effective within the specified grace period. As of December 31, 2006, the registration statement remains effective.

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

In 2005, the Company received approximately \$1.6 million for the exercise of approximately 11,100 options and 306,000 warrants. The Company also issued approximately 54,300 shares of common stock for the payment of \$461,000 of services rendered and to be rendered in the future. The fair value of the services was measured at market value of the common stock at the time of payment. As such, the Company recorded the fair value of the services rendered in selling, general and administrative expenses in the accompanying audited consolidated statement of operations for the year ended December 31, 2005.

2004

On January 9, 2004, the Company entered into a Securities Purchase Agreement with several accredited institutional and private investors whereby such investors purchased an aggregate of 333,336 shares of common stock and 431,221 warrant shares for an aggregate purchase price of approximately \$4.2 million.

The shares of common stock were priced at a 20% discount to the average closing price of the stock from December 30, 2003 to January 6, 2004, which ranged from \$13.80 to \$19.40 per share during the period for an average closing price of \$12.60 per share. In addition, the investors received warrants to purchase an aggregate of 200,002 shares of common stock (subject to anti-dilution adjustments) exercisable at a price of \$17.40 per share for a period of five (5) years. The warrants were priced at a 10% premium to the average closing price of the stock for the pricing period.

In connection with the Securities Purchase Agreement, eMagin also issued additional warrants to the investors to acquire an aggregate of 231,219 shares of common stock. 120,691 of such warrants are exercisable, within 6 months from the effective date of the registration statement covering these securities, at a price of \$17.40 per share (a 10% premium to the average closing price of the stock for the pricing period), and 110,528 of such warrants are exercisable within 12 months from the effective date of the registration statement covering these securities, at a price of \$19.00 per share (a 20% premium to the average closing price of the stock for the pricing period).

The Company also entered into a registration rights agreement with the aforementioned investors with respect to the common stock issued and common stock issuable upon the exercise of the warrants. A registration rights agreement was entered into in connection with the private placement which requires the Company to file a registration statement for the resale of the common stock and the shares underlying the warrants. The Company must use its best efforts to have the registration statement declared effective by the end of a specified grace period and also maintain the effectiveness of the registration statement until all common stock have been sold or may be sold without volume restrictions pursuant to Rule 144(k) of the Securities Act. If the Company fails to have the registration statement declared effective within the grace period or fails to maintain the effectiveness, the agreement requires the Company to pay each investor cash payments equal to 2.0% of the aggregate purchase price monthly until the failure is cured. If the Company fails to pay the liquidated damages, interest at 15.0% will accrue until the liquidated damages are paid in full. The registration statement was filed and declared effective within the specified grace period. As of December 31, 2006, the registration statement remains effective.

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

In February 2004, the Company and all of the holders of the Secured Convertible Notes (the "Notes"), which were due in November 2005, entered into an agreement whereby the holders agreed to an early conversion of 100% of the principal amount of the Notes aggregating \$7.825 million, together with all of the accrued interest of approximately \$742,000 on the Notes, into 1,139,462 shares of the Company's common stock. The listing of the shares issuable pursuant to such agreement was approved by the American Stock Exchange.

In consideration of the Noteholders agreeing to the early conversion of the Notes, eMagin agreed to issue the Noteholders warrants to purchase an aggregate of 250,000 shares of common stock (the "warrants"), which warrants are exercisable at a price of \$27.60 per share. 150,000 of the warrants (series D warrants) are exercisable until the later of (i) twelve (12) months from the date upon which a registration statement covering the shares issuable upon exercise of the Warrants is declared effective by the Securities and Exchange Commission, or (ii) December 31, 2005. The remaining 100,000 of the warrants (series E warrants) are exercisable until June 10, 2008. Using the Black-Scholes method of valuating warrants, an expense totaling \$3.18 million was recorded in interest expense during 2004 to record an estimated fair value of these warrants. The fair value of the warrants, \$3.18 million, was estimated at \$23.00 using the Black-Scholes option-pricing model with the following assumptions for the two sets of warrants: (1) average expected volatility of 100%, (2) average risk-free interest rates of 3.52%, (3) dividends of 0%, and (4) Average Term (in days) of 670 for the series D warrants and 1,460 for the series E warrants.

In connection with the above conversion, eMagin also entered into a Registration Rights Agreement with the holders of the Notes providing the holders with certain registration rights under the Securities Act of 1933, as amended, with respect to the common stock issuable upon exercise of the warrants.

In August 2004, the Company and certain of the holders of its outstanding Class A, B and C common stock purchase warrants entered into an agreement pursuant to which the Company and the holders of the warrants agreed to the \$9.00 re-pricing and exercise of Class A, B and C common stock purchase warrants. As a condition to the transaction, the holders of the warrants agreed to limit the right of participation that they were granted in January 9, 2004. As a result of the transaction, the holders agreed to re-price and exercise approximately, 209,989 Class A, B and/or C common stock purchase warrants for an aggregate of \$1,889,900.

On October 21, 2004, the Company entered into a Securities Purchase Agreement, pursuant to which eMagin sold and issued 1,033,453 shares of common stock, and series F common stock warrants to purchase 512,976 of common stock for an aggregate purchase price of \$10,772,500. The common stock was priced at \$10.50. The common stock and the shares underlying the warrants were drawn-down off of a shelf registration statement which was filed by the Company on May 5, 2004, and declared effective by the Securities and Exchange Commission on June 10, 2004. Net proceeds received after deducting expenses was approximately \$9.75 million.

The Series F Warrants are exercisable from April 25, 2005 until April 25, 2010 at an exercise price of \$12.10 per share, subject to adjustment upon the occurrence of specific events, including stock dividends, stock splits, combinations or reclassifications of the Company's common stock or distributions of cash or other assets. In addition, the Series F Warrants contain provisions protecting against dilution resulting from the sale of additional shares of the Company's common stock for less than the exercise price of the Series F Warrants, or the market price of the common stock, on the date of such issuance or sale.

On October 28, 2004, eMagin entered into a Securities Purchase Agreement, pursuant to which eMagin sold and issued 274,048 shares of common stock, and series F common stock purchase warrants to purchase eMagin's common stock to purchasers for an aggregate purchase price of \$2,877,500. The common stock was priced at \$10.50. The common stock and the shares underlying the warrants were drawn-down off of a shelf registration statement which was filed by us on May 5, 2004, and declared effective by the Securities and Exchange Commission on June 10, 2004. Net proceeds received after deducting expenses was approximately \$2.65 million.

The Series F Warrants are exercisable from April 25, 2005 until April 25, 2010 to purchase up to 137,024 shares of common stock at an exercise price of \$12.10 per share, subject to adjustment upon the occurrence of specific events, including stock dividends, stock splits, combinations or reclassifications of eMagin's common stock or distributions of cash or other assets. In addition, the Series F Warrants contain provisions protecting against dilution resulting from the sale of additional shares of eMagin's common stock for less than the exercise price of the Series F Warrants, or the market price of the common stock, on the date of such issuance or sale.

As a result of the above transaction, 121,335 outstanding Series A Common Stock Purchase Warrants, that were issued to participants of the Securities Purchase Agreement dated January 9, 2004, were re-priced from \$17.40 to \$10.50.

The Company paid a Placement Agent \$814,000, a fee equal to 6% of the gross proceeds of these offerings.

In addition, the Company engaged Larkspur Capital Corporation, a Related Party, to act as an adviser in connection with the sale of these securities. For such services, the Company paid Larkspur Capital Corporation a fee of \$136,500, an amount equal to 1% of the gross proceeds of these offerings and 9,326 warrants.

In 2004, the Company received \$5,173,945 for the exercise of 552,105 options and 353,335 warrants.

The Company also issued 38,602 shares of common stock for the payment of \$531,031 for services rendered and to be rendered in the future. The fair value of the services was measured at market value of the common stock at the time of payment. As such, the Company recorded the fair value of the services rendered in selling, general and administrative expenses in the accompanying audited consolidated statement of operations for the year ended December 31, 2004.

Note 10 – STOCK COMPENSATION

Employee stock purchase plan

In 2005, the stockholders approved the 2005 Employee Stock Purchase Plan (“ESPP”). The ESPP provides the Company's employees with the opportunity to purchase common stock through payroll deductions. Employees purchase stock semi-annually at a price that is 85% of the fair market value at certain plan-defined dates. At December 31, 2006, the number of shares of common stock available for issuance was 150,000 and the plan will automatically increase 75,000 shares on January 1 of each year for a period of three years starting January 1, 2006. As of December 31, 2006, the plan had not been implemented.

Incentive compensation plans

In 1994, the Company established the 1994 Stock Plan (the "1994 Plan"). 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. This Plan expired in 2004.

In 2000, the Company established the 2000 Stock Option Plan (the "2000 Plan"). 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 such requirements.

In 2003, the Company established the 2003 Stock Option Plan (the "2003 Plan"). The 2003 Plan provided for the granting of options to purchase an aggregate of 9,200,000 shares of the common stock to employees and consultants. On July 2, 2003, the shareholders approved the plan and the 2003 Plan was subsequently amended by the Board of Directors on July 2, 2003 to reduce the number of additional shares that may be provided for issuance under the "evergreen" provisions of the 2003 Plan. The amended 2003 Plan provides for an increase of 2,000,000 shares in January 2004 and an annual increase on January 1 of each year for a period of nine (9) years commencing on January 1, 2005 of 3% of the diluted shares outstanding. The shareholders approved an amendment to the 2003 Plan to provide grants of shares of common stock in addition to options to purchase shares of common stock. In 2005, approximately 2.4 million shares were added to the plan.

Vesting terms of the options range from immediate vesting to a ratable vesting period of 5 years. Option activity for the years ended December 31, 2006, 2005 and 2004 is summarized as follows:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value
Balances at December 31, 2003	1,216,177	\$ 5.30		
Options granted	677,990	16.00		
Options exercised	(16,146)	2.70		
Options cancelled	(522,105)	11.20		
Balances at December 31, 2004	1,355,916	\$ 11.40		
Options granted	582,400	9.60		
Options exercised	(11,059)	3.40		
Options cancelled	(121,993)	13.90		
Balances at December 31, 2005	1,805,264	\$ 10.90		
Options granted	185,744	4.30		
Options exercised	(5,000)	2.10		
Options forfeited	(453,115)	7.47		
Options cancelled	(467,148)	11.97		
Balances at December 31, 2006	1,065,745	\$ 2.94	3.75	\$ -----
Vested or expected to vest at December 31, 2006 (1)	991,143	\$ 2.94	3.75	\$ -----
Exercisable at December 31, 2006	711,310	\$ 2.93	3.01	\$ -----

At December 31, 2006, there were 1,069,423 shares available for grant under the 2003 Plan and the 2000 Plan.

The following table summarizes information about stock options outstanding at December 31, 2006:

Number Outstanding	Options Outstanding			Options Exercisable	
	Weighted Average Remaining Contractual Life (In Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercisable Price	
\$2.10 – \$2.70	925,689	4.04 \$	2.57	590,894	\$ 2.54
\$3.40 – \$5.80	105,924	1.09	3.69	100,424	3.58
\$6.60 – \$22.5	34,132	4.31	10.59	19,992	11.16
	<u>1,065,745</u>	<u>3.75</u> \$	<u>2.94</u>	<u>711,310</u>	<u>\$ 2.93</u>

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

The aggregate intrinsic value in the table above represents the difference between the exercise price of the underlying options and the quoted price of the Company's common stock for the options that were in-the-money. As of December 31, 2006 there were no options that were in-the-money. The Company's closing stock price was \$1.04 as of December 31, 2006. The Company issues new shares of common stock upon exercise of stock options.

On July 21, 2006, certain employees and Directors of the Company agreed to cancel approximately 467,000 shares underlying existing stock options in return for the re-pricing of approximately 869,000 existing options at \$2.60 per share having a weighted average original exercise price of \$11.97. Option grants that have not been re-priced will remain unchanged. The unvested options which were re-priced will continue to vest on original vesting schedules, but in no event vest prior to January 19, 2007. Previously vested options which were re-priced will now vest on January 19, 2007. Re-priced grants will be forfeited if the individual leaves voluntarily. The Company has accounted for the re-pricing and cancellation transactions as a modification under SFAS No. 123R. The Company will recognize the additional compensation charges over the four months ended January 19, 2007 for previously vested options and over the remaining vesting period for unvested options. Incremental cost was \$171 thousand and the amount recognized in 2006 was \$118 thousand, net of forfeitures.

At the Company's 2006 Annual Meeting of Shareholders held on October 20, 2006, the Company's shareholders approved an amendment to the Company's Certificate of Incorporation to effect a reverse stock split of the Company's outstanding common stock at an exchange ratio of one-for-ten. On November 3, 2006, the reverse stock split became effective. Each holder of ten shares of the Company's common stock became the holder of one share of the Company's common stock. In addition, all outstanding options, warrants, and convertible notes were adjusted in accordance with their terms and pursuant to the ratio of the reverse split. All fractional shares were rounded up to the next whole number of shares.

Stock based compensation

On January 1, 2006, the Company adopted the provisions of SFAS No. 123R, which requires the Company to recognize expense related to the fair value of the Company's share-based compensation issued to employees and directors. Prior to January 1, 2006, the Company accounted for share-based compensation under the recognition and measurement provisions of APB No. 25 and related interpretations, as permitted by SFAS No. 123. The Company adopted SFAS No. 123R using the modified prospective transition method. Accordingly, periods prior to adoption have not been restated. Compensation cost recognized for the twelve months ended December 31, 2006 includes a) compensation cost for all share-based compensation granted prior to, but not vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No.123 and b) compensation cost for all share-based compensation granted beginning January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No.123R. The compensation cost was recognized using the straight-line attribution method.

The following table summarizes the allocation of stock-based compensation to expense categories for the year ended December 31, 2006 (in thousands):

	For the year ended December 31, 2006
Cost of revenue	\$ 343
Research and development	435
Selling, general and administrative	2,113
Total stock compensation expense	<u>\$ 2,891</u>

For the year ended December 31, 2006, stock compensation was approximately \$2.9 million. At December 31, 2006, total unrecognized compensation costs related to stock options was approximately \$3.4 million, net of estimated forfeitures. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures and is expected to be recognized over a weighted average period of approximately 5.3 years.

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

In determining the fair value of stock options granted during the twelve month periods ended December 31, 2006, 2005, and 2004, the following key assumptions were used in the Black-Scholes option pricing model:

	For the years ended December 31,		
	2006	2005	2004
Dividend yield	0%	0%	0%
Risk free interest rates	4.59% – 4.82%	4.4%	3.6%
Expected volatility	123% – 126%	126%	139%
Expected term (in years)	5 years	5 years	5 years

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

The following table shows the proforma effect on eMagin's net loss and net loss per share had compensation expense been determined based on the fair value at the award grant date in accordance with SFAS No. 123 for the twelve months ended December 31, 2005 and 2004 (in thousands, except per share data):

	For the years ended December 31,	
	2005	2004
Net loss applicable to common stockholders, as reported	\$ (16,528)	\$ (12,711)
Add: Stock-based employee compensation expense included in reported net loss	-----	88
Deduct: Stock-based employee compensation expense determined under fair value method	(3,035)	(1,743)
Pro forma net loss	<u>\$ (19,563)</u>	<u>\$ (14,366)</u>
Net loss per share:		
Basic and diluted, as reported	<u>\$ (1.94)</u>	<u>\$ (1.98)</u>
Basic and diluted, pro forma	<u>\$ (2.29)</u>	<u>\$ (2.23)</u>

Warrants

At December 31, 2006, 3,548,174 warrants to purchase shares of common stock are outstanding and exercisable at exercise prices ranging from \$2.60 to \$27.60 and expiration dates ranging from June 20, 2007 to February 27, 2012.

	Outstanding Warrants	
	Shares	Weighted Average Exercise Price
Balances at December 31, 2003	1,233,629	\$ 8.00
Warrants granted	1,335,587	16.90
Warrants exercised	(353,335)	15.20
Warrants cancelled	(54,058)	11.20
Balances at December 31, 2004	2,161,823	\$ 11.40
Warrants granted	997,143	10.00
Warrants exercised*	(370,820)	6.10
Warrants cancelled	(168,421)	26.70
Balances at December 31, 2005	2,619,725	\$ 10.20
Warrants granted	1,805,037	3.49
Warrants exercised	--	--
Warrants expired	(876,588)	6.90
Balances at December 31, 2006	3,548,174	\$ 7.05

*Cashless exercise – 647,619 warrants

Note 11 – RECENTLY ISSUED ACCOUNTING STANDARDS

The Financial Accounting Standards Board (“FASB”) has issued interpretation No. 48, “Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109” (“FIN 48”), regarding accounting for, and disclosure of, uncertain tax positions. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, “Accounting for Income Taxes.” FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We do not anticipate that the adoption of this statement will have a material effect on the Company's financial position or results of operation.

In September 2006, the SEC issued SAB 108. SAB 108 provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. SAB 108 establishes an approach that requires quantification of financial statement errors based on the effects of each of the Company's balance sheet and statement of operations and the related financial statement disclosures. SAB 108 permits companies to record the cumulative effect of initial adoption by recording the necessary “correcting” adjustments to the carrying values of assets and liabilities as of the beginning of that year with the offsetting adjustment recorded to the opening balance of retained earnings only if material. SAB 108 is effective for fiscal years ending on or after November 15, 2006.

In November 2004, the FASB issued Statement No. 151 (“SFAS 151”), “Inventory Costs, an Amendment of ARB No. 43, Chapter 4.” SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material and requires that these items be recognized as current period charges. SFAS 151 applies only to inventory costs incurred during periods beginning after the effective date and also requires that the allocation of fixed production overhead to conversion costs be based on the normal capacity of the production facilities. SFAS 151 is effective beginning in fiscal 2007. The Company does not believe that the adoption of SFAS 151 will have a material impact on its financial position or results of operations.

In June 2005, the FASB issued SFAS No. 154, “Accounting Changes and Error Corrections”, a replacement of APB No. 20, “Accounting Changes” (“APB No. 20”) and SFAS No. 3, “Reporting Accounting Changes in Interim Financial Statements” (“SFAS No. 3”). SFAS No. 154 changes the requirements for the accounting for and reporting of, a change in accounting principle. Previously, most voluntary changes in accounting principles required recognition of a cumulative effect adjustment within net income of the period of the change. SFAS No. 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005; however, it does not change the transition provisions of any existing accounting pronouncements. The Company adopted the statement as of January 1, 2006.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements” (SFAS 157”). SFAS 157 provides guidance for using fair value to measure assets and liabilities. It also responds to investors' requests for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair

value, and does not expand the use of fair value in any new circumstances. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and is required to be adopted by the Company in the first quarter of 2008. The Company is evaluating the effect that the adoption of SFAS 157 will have on its consolidated results of operations and financial condition and is not yet in a position to determine such effects.

Note 12 – COMMITMENTS AND CONTINGENCIES

Royalties

The Company, in accordance with a royalty agreement, is obligated to make minimum annual royalty payments to a corporation commencing January 1, 2001. The original minimum annual royalty due under this agreement was \$32 thousand per year and it increased to a \$125 thousand in 2005 and beyond. Under this agreement, the Company must pay a certain percentage of net sales of certain products, which percentages are defined in the agreement. The percentages are on a sliding scale depending on the amount of sales generated. Any minimum royalties paid may be credited against the amounts due based on the percentage of sales. The royalty agreement terminates upon the expiration of the last-to-expire issued patent.

For the years ended December 31, 2006, 2005, and 2004, royalty expense of approximately \$515 thousand, \$191 thousand and \$194 thousand, respectively, is included in cost of goods sold.

Operating leases

The Company leases office facilities and office, lab and factory equipment under operating leases expiring through 2009. The Company currently has lease commitments for space in Hopewell Junction, New York and Bellevue, Washington.

The Company's manufacturing facilities are leased from IBM in New York. eMagin leases approximately 40,000 square feet to house its equipment for OLED microdisplay fabrication and for research and development, an assembly area and administrative offices. In 2004, eMagin entered into an agreement to extend the term of the lease until 2009.

In July 2005, eMagin signed a sub-lease agreement for approximately 19,000 square feet in Bellevue Washington. The leased space is used as the Company's corporate headquarters. This lease will expire in 2009. The Company's lease at the Redmond Washington location expired in August 2005 and was not renewed.

The future minimum lease payments through 2009 are as follows:

2007	\$ 1,405
2008	1,444
2009	538
	<u>\$ 3,387</u>

Rent expense for the years ended December 31, 2006, 2005, and 2004 was approximately \$1.3 million, \$1.0 million, and \$0.8 million, respectively. The Redmond lease was paid in common stock valued at \$42 thousand and \$48 thousand for the 2005 and 2004 rent periods, respectively.

Employee benefit plans

eMagin has a defined contribution plan (the 401(k) 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 401(k) Plan, eMagin may match a portion of the participating employees' contributions. There was no matching contribution to the 401(k) Plan for the years ended December 31, 2006, 2005 and 2004.

Legal proceedings

On December 6, 2005, New York State Urban Development Corporation commenced action against eMagin in the Supreme Court of the State of New York, County of New York against eMagin, asserting breach of contract and seeking to recover a \$150 thousand grant which was made to eMagin based on goals set forth in the agreement for recruitment of employees. On July 13, 2006, eMagin agreed to a settlement with the New York State Urban Development Corporation to repay approximately \$112 thousand of the \$150 thousand grant. The settlement requires that repayments be made on a monthly basis in the amount of approximately \$3 thousand per month commencing August 1, 2006 and ending on July 1, 2009.

Note 13 – RELATED PARTY TRANSACTIONS

2006

On July 21, 2006, the Company entered into several Note Purchase Agreements for the sale of approximately \$5.99 million of senior secured debentures (the "Notes") and warrants to purchase approximately 1.8 million shares of common stock, par value \$.001 per share. The investors purchased \$5.99 million principal amount of Notes with conversion prices of \$2.60 per share that may convert into approximately 2.3 million shares of common stock and 5 year warrants exercisable at \$3.60 per share into approximately 1.6 million shares of common stock. If the Notes are not converted, 50% of the principal amount will be due on July 21, 2007 and the remaining 50% will be due on January 21, 2008. Commencing September 1, 2006, 6% interest is payable in quarterly installments on

outstanding notes.

In the Note Purchase transaction, two employees and two board members participated. Olivier Prache, Senior VP of Display Operations, purchased a \$30 thousand promissory note which may be converted into 11,539 shares and received 8,077 warrants which are exercisable at \$3.60 per share. Mr. Prache converted \$20 thousand of his promissory note and received 7,693 shares. John Atherly, CFO, purchased a \$40 thousand promissory note which may be converted into 15,385 shares and received 10,770 warrants exercisable at \$3.60 per share. David Gottfried, board member, purchased a \$250 thousand promissory note which may be converted into 96,154 shares and received 67,308 warrants exercisable at \$3.60 per share. Paul Cronson, board member, through Navacorp III, LLC purchased a \$200 thousand promissory note which may be converted into 76,923 shares and received 53,847 warrants exercisable at \$3.60 per share.

Stillwater is a beneficial owner of more than 5% of the Company's common stock. Rainbow Gate Corporation, a corporation in which its investment manager is the sole member of Stillwater LLC and its controlling shareholder is the same as Ginola Limited, purchased a \$700 thousand promissory note which may be converted into 269,231 shares and received 188,462 warrants exercisable at \$3.60 per share. Ginola Limited purchased an \$800 thousand promissory note which may be converted into 307,693 shares and received 215,385 warrants exercisable at \$3.60 per share. Stillwater LLC disclaims beneficial ownership of shares owned by Rainbow Gate Corporation.

A family member of an outside director of eMagin is the holder of a Series A warrant to purchase an aggregate of 4,286 shares of common stock. As a result of the Note Purchase transaction, the exercise price of all Series A warrants was reduced from \$5.50 to \$2.60 per share. Family members of an outside director of eMagin are holders of Series F warrants to purchase an aggregate of 10 thousand shares of common stock. As a result of the Note Purchase transaction, the exercise price of all Series F warrants was reduced from \$10.90 to \$8.60 per share.

eMagin has entered into a financial advisory agreement with Larkspur Capital Corporation. Paul Cronson, a director of eMagin, is a founder and shareholder of Larkspur Capital Corporation. The Company has agreed to pay a minimum fee of \$500 thousand to Larkspur Capital Corporation in the event certain transactions occur, i.e. sale of the Company's assets or change of control.

2005

On October 20, 2005, the Company entered into a Securities Purchase Agreement to sell to certain qualified institutional buyers and accredited investors an aggregate of 1,661,906 shares of eMagin's common stock, par value \$0.001 per share (the "Shares"), and warrants to purchase an additional 997,143 shares of common stock, for an aggregate purchase price of approximately \$9.1 million. The purchase price of the common stock and corresponding warrant was \$5.50 per share.

The warrants are exercisable at a price of \$10.00 per share and expire on October 20, 2010. Of the 997,143 warrants, 664,762 of the warrants are exercisable on or after May 20, 2006. The remaining 332,380 are exercisable after March 31, 2007. Both Stillwater and Ginola are beneficial owners of more than 5% of the Company's common stock.

Rainbow Gate Corporation, a corporation in which its investment manager is the sole member of Stillwater LLC and its controlling shareholder is the same as Ginola Limited, participated in the sale of equity pursuant to the Securities Purchase Agreement by investing \$500 thousand. Stillwater LLC disclaims beneficial ownership of shares owned by Rainbow Gate Corporation.

Chelsea Trust Company, as trustee of a trust with the same directors and/or controlling shareholders as Ginola Limited, participated in the sale of equity pursuant to the Securities Purchase Agreement by investing \$250 thousand. Ginola Limited disclaims beneficial ownership of shares owned by Chelsea Trust Company.

In connection with the issuance of the Shares and the warrants pursuant to the Securities Purchase Agreement, the Company was required to lower the exercise prices of existing Series A and F warrants from \$10.50 and \$12.10, respectively, to \$5.50 and \$10.90 per share, respectively, pursuant to the anti-dilution provisions of the Series A and F warrants.

A family member of an outside director of eMagin is the holder of a Series A warrant to purchase an aggregate of 4,286 shares of common stock. Accordingly, the exercise price of all Series A warrants was reduced from \$10.50 to \$5.50 per share.

2004

eMagin is party to a financial advisory and investment banking agreement with Larkspur Capital Corporation. Paul Cronson, a director of eMagin, is a founder and shareholder of Larkspur Capital Corporation. Larkspur Capital Corporation received as compensation for financial advisory and investment banking services in connection with the January 2004 private placement a cash fee of 6 3/4% of the funds raised and warrants to purchase eMagin shares of common stock equal to 2.5% of the cash netted to eMagin. Approximately \$284 thousand and 4,365 common stock purchase warrants exercisable at \$24.10 per share which expire in January 2009, were paid under the terms of the agreement. Paul Cronson was engaged as an advisor in connection with the sale of securities sold in October 2004 and received a fee of \$136 thousand.

A family member of an outside director of eMagin participated in the Securities Purchase Agreement in January 2004's private placement in the amount of \$90 thousand.

Stillwater LLC, a limited liability company and a beneficial owner of more than five percent of the outstanding shares of eMagin's common stock, held an aggregate of \$4 million of the notes converted in February 2004. Ginola Limited, a beneficial owner of more than five percent of the outstanding shares of eMagin's common stock, held an aggregate of \$1.3 million of the notes which were converted. An outside director of eMagin held \$250 thousand of the notes converted.

A family member of an outside director of eMagin participated in the re-pricing of the Securities Purchase Agreement in August. 209,989 warrants were re-priced and exercised. The family member re-priced and exercised 2,586 B warrants and 2,368 C warrants.

Note 14 – EMPLOYMENT AGREEMENTS

On January 24, 2006, pursuant to actions taken by the Compensation Committee of the Board of Directors of eMagin Corporation (the "Company"), Gary Jones entered into a revised executive employment agreement, to conform to the recently established Sarbanes-Oxley requirements, in connection with his service as Chief Executive Officer and President of the Company. Additionally, Susan Jones entered into a revised executive employment agreement, to conform to the recently established Sarbanes-Oxley requirements, in connection with her service as the Company's Chief Marketing and Strategy Officer, Executive Vice President and Corporate Secretary.

Each agreement is effective for an initial term of three years, effective January 1, 2006. The agreement provides for an annual salary, benefits made available by the Company to its employees and eligibility for an incentive bonus pursuant to one or more incentive compensation plans established by the Company from time to time. The Company may terminate the employment of Executive at any time with or without notice and with or without cause (as such term is defined in the agreement). If the Executive's employment is terminated without cause, or if Executive resigns with good reason (as such term is defined in the agreement), or if Executive's position is terminated or significantly changed as result of change of control (as such term is defined in the agreement), Executive shall be entitled to receive salary until the end of the agreement's full term or twelve months, whichever is greater, payment for accrued vacation, and bonuses which would have been accrued during the term of the agreement. If Executive voluntarily terminates employment with the Company, other than for good reason or is terminated with cause (as such term is defined in the agreement), Executive shall cease to accrue salary, vacation, benefits, and other compensation on the date of the voluntary or with cause termination. The Executive Employment Agreement includes other conventional terms and also contains invention assignment, non-competition, non-solicitation and non-disclosure provisions.

On April 17, 2006, the parties entered into amendments to the employment agreements pursuant to which the parties clarified that the Company has agreed to pay for health benefits equivalent to medical and dental benefits provided during the executive's full time employment until the end of the agreement's full term or twenty-four (24) months, whichever is greater.

On January 11, 2007, Gary Jones resigned as the President, Chief Executive Officer, and as a Director of the Company. Mr. Jones and the Company entered into an Executive Separation and Consulting Agreement. See Note 16 – Subsequent Events for additional information.

In addition, on January 11, 2007, Dr. K.C. Park was appointed Interim Chief Executive Office, President, and a Director of the Company. Dr. Park entered into a Compensation Agreement with the Company on February 12, 2007. See Note 16 – Subsequent Events for additional information.

Note 15 – CONCENTRATIONS

In 2006 eMagin had one customer that accounted for 13% of its total revenues. In 2005 eMagin had no customers that accounted for more than 10% of its total revenues. In 2004 eMagin had two customers that individually accounted for 17% and 15% of net revenues.

For the year ended December 31, 2006, approximately 59% of the Company's net revenues were made to customers in the United States and approximately 41% of the Company's net revenues were made to international customers. For the year ended December 31, 2005, approximately 49% of the Company's net revenues were made to customers in the United States and approximately 51% of the Company's net revenues were made to international customers. For the year ended December 31, 2004, approximately 78% of the Company's net revenues were made to customers in the United States and approximately 22% of the Company's net revenues were made to international customers.

At December 31, 2006, there were 5 customers which comprised 69% of the outstanding accounts receivable. At December 31, 2005, there were 2 customers which comprised 31% of the outstanding accounts receivable. At December 31, 2004, there were 3 customers which comprised 50% of the outstanding accounts receivable.

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

Note 16 – SUBSEQUENT EVENTS

Executive Separation and Consulting Agreement

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

Compensation Agreement

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

AMEX Delisting

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

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

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

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

Note 17 – QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Summarized quarterly financial information for 2006 and 2005 are as follows (in thousands except per share data):

	Quarters Ended			
	March 31, 2006	June 30, 2006	September 30, 2006	December 31, 2006
Revenues	\$ 1,641	\$ 1,674	\$ 2,292	\$ 2,562
Gross margin (loss)	\$ (1,388)	\$ (1,291)	\$ (648)	\$ 137
Net loss	\$ (5,160)	\$ (4,838)	\$ (3,769)	\$ (1,499)
Net loss per share – basic and diluted	\$ (0.52)	\$ (0.48)	\$ (0.37)	\$ (0.15)
Shares used in per share calculation – basic and diluted	10,004	10,011	10,077	10,196

	Quarters Ended			
	March 31, 2005	June 30, 2005	September 30, 2005	December 31, 2005
Revenues	\$ 690	\$ 652	\$ 1,131	\$ 1,272
Gross loss	\$ (1,267)	\$ (1,737)	\$ (1,555)	\$ (1,915)
Net loss	\$ (3,469)	\$ (4,498)	\$ (3,763)	\$ (4,798)
Net loss per share – basic and diluted	\$ (0.43)	\$ (0.55)	\$ (0.47)	\$ (0.52)
Shares used in per share calculation – basic and diluted	8,143	8,245	8,304	9,476

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

None.

ITEM 9A. CONTROLS AND PROCEDURES

(a) *Evaluation of Disclosure Controls and Procedures*

Based on an evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) required by paragraph (b) of Rule 13a-15 or Rule 15d-15, as of December 31, 2006, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Our Chief Executive Officer and Chief Financial Officer also concluded that, as of December 31, 2006, our disclosure controls and procedures were effective in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

(b) *Changes in Internal Controls*

During the period ended December 31, 2006, there were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Rule 13a-15 or Rule 15d-15 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS, AND CORPORATE GOVERNANCE

The information required by this item is incorporated by reference to eMagin's Proxy Statement for its 2007 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year ended December 31, 2006.

The information required by this item concerning our executive officers is set forth under the heading "Executive Officers" in Part I of this Annual Report on Form 10-K.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is incorporated by reference to eMagin's Proxy Statement for its 2007 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year ended December 31, 2006.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The information required by this item is incorporated by reference to eMagin's Proxy Statement for its 2007 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year ended December 31, 2006.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this item is incorporated by reference to eMagin's Proxy Statement for its 2007 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year ended December 31, 2006.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

The information required by this item is incorporated by reference to eMagin's Proxy Statement for its 2007 Annual Meeting of Stockholders to be filed with the SEC within 120 days after the end of the fiscal year ended December 31, 2006.

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) Financial Statements and Schedules

1. *Financial Statements*

The following consolidated financial statements are filed as part of this report under Item 8 of Part II "Financial Statements and Supplementary Data.:

- A. Consolidated Balance Sheets at December 31, 2006 and 2005.
- B. Consolidated Statements of Operations for the Years Ended December 31, 2006, 2005, and 2004.
- C. Consolidated Statements of Changes in Shareholders' Equity (Deficit) for the Years Ended December 31, 2006, 2005, and 2004.
- D. Consolidated Statements of Cash Flows for the Years Ended December 31, 2006, 2005, and 2004.

2. *Financial Statement Schedules*

The following financial statement schedule is filed as part of this report:

- A. Schedule II – Valuation and Qualifying Accounts

Financial statement schedules not included herein have been omitted because they are either not required, not applicable, or the information is otherwise included herein.

(b) Exhibits

The exhibits listed in the accompanying Index to Exhibits on pages 57 to 59 are filed or incorporated by reference as part of this Annual Report on Form 10-K.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on this 2nd day of April, 2007.

eMAGIN CORPORATION

By: /s/ K.C. Park

K. C. Park
Interim Chief Executive Officer

In accordance with the Exchange Act, this report has been signed below by the following persons on April 2nd, 2007, on behalf of the registrant and in the capacities indicated.

<u>Signature</u>	<u>Title</u>
<u>/s/ K.C. Park</u> K.C. Park	Interim President and Chief Executive Officer, Director (Principal Executive Officer)
<u>/s/ John Atherly</u> John Atherly	Chief Financial Officer (Principal Financial and Accounting Officer)
<u>/s/ Adm. Thomas Paulsen</u> Adm. Thomas Paulsen	Chairman of the Board, Director
<u>/s/ Claude Charles</u> Claude Charles	Director
<u>/s/ Paul Cronson</u> Paul Cronson	Director
<u>/s/ Irwin Engelman</u> Irwin Engelman	Director
<u>/s/ Dr. Jacob E. Goldman</u> Dr. Jacob E. Goldman	Director
<u>/s/ David Gottfried</u> David Gottfried	Director
<u>/s/ Brig. Gen. Stephen Seay</u> Brig. Gen. Stephen Seay	Director

eMAGIN CORPORATION
SCHEDULE II – VALUATION AND QUALIFYING ACCOUNTS

Allowance for doubtful accounts

<u>Year Ended</u>	<u>Beginning Balance</u>	<u>Charged to Expenses</u>	<u>Amounts Written Off</u>	<u>Ending Balance</u>
		(In thousands)		
December 31, 2004	\$ (304)	\$ (488)	\$ 21	\$ (771)
December 31, 2005	\$ (771)	\$ 164	\$ 120	\$ (487)
December 31, 2006	\$ (487)	\$ —	\$ 44	\$ (443)

eMAGIN CORPORATION
INDEX TO EXHIBITS

<u>Exhibit Number</u>	<u>Description</u>
2.1	Agreement and Plan of Merger between Fashion Dynamics Corp., FED Capital Acquisition Corporation and FED Corporation dated March 13, 2000 (incorporated by reference to exhibit 2.1 to the Registrant's Current Report on Form 8-K/A filed on March 17, 2000).
3.1	Amended and Restated Articles of Incorporation (incorporated by reference to exhibit 99.2 to the Registrant's Definitive Proxy Statement filed on June 14, 2001).
3.2	Amended Articles of Incorporation (incorporated by reference to exhibit A to the Registrant's Definitive Proxy Statement filed on June 13, 2003).
3.3	Bylaws of the Registrant (incorporated by reference to exhibit 99.3 to the Registrant's Definitive Proxy Statement filed on June 14, 2001).
4.1	Form of Warrant dated as of April 25, 2003 (incorporated by reference to exhibit 4.3 to the Registrant's Current Report on Form 8-K filed on April 28, 2003).
4.2	Form of Series A Common Stock Purchase Warrant dated as of January 9, 2004 (incorporated by reference to exhibit 4.1 to the Registrant's Current Report on Form 8-K filed on January 9, 2004).
4.3	Form of Series B Common Stock Purchase Warrant dated as of January 9, 2004 (incorporated by reference to exhibit 4.2 to the Registrant's Current Report on Form 8-K filed on January 9, 2004).
4.4	Form of Series C Common Stock Purchase Warrant dated as of January 9, 2004 (incorporated by reference to exhibit 4.3 to the Registrant's Current Report on Form 8-K filed on January 9, 2004).
4.5	Form of Series D Warrant (incorporated by reference to exhibit 4.1 to the Registrant's current report on Form 8-K filed on March 4, 2004).
4.6	Form of Series E Warrant (incorporated by reference to exhibit 4.2 to the Registrant's current report on Form 8-K filed on March 4, 2004).
10.1	2000 Stock Option Plan, (incorporated by reference to exhibit 99.1 to the Registrant's Registration Statement on Form S-8 filed on March 14, 2000).*
10.2	Form of Agreement for Stock Option Grant pursuant to 2003 Stock Option Plan (incorporated by reference to exhibit 99.2 to the Registrant's Registration Statement on Form S-8 filed on March 14, 2000).*
4.7	Form of Series F Warrant (incorporated by reference to exhibit 4.1 to the Registrant's current report on Form 8-K filed on October 26, 2004).
4.8	Form of Common Stock Purchase Warrant dated October 20, 2005, filed October 31, 2005, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.3	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 (incorporated by reference to exhibit 10.6 to the Registrant's Annual Report on Form 10-K/A for the year ended December 31, 2000 filed on April 30, 2001).
10.4	Amendment Number 1 to the Nonexclusive Field of Use License Agreement relating to the LED Technology for miniature, high resolution displays between the Eastman Kodak Company and FED Corporation dated March 16, 2000 (incorporated by reference to exhibit 10.7 to the Registrant's Annual Report on Form 10-K/A for the year ended December 31, 2000 filed on April 30, 2001).
10.5	Lease between International Business Machines Corporation and FED Corporation dated May 28, 1999 (incorporated by reference to exhibit 10.9 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000 filed on March 30, 2001).

10.6	Amendment Number 1 to the Lease between International Business Machines Corporation and FED Corporation dated July 9, 1999 (incorporated by reference to exhibit 10.8 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000 filed on March 30, 2001).
10.7	Amendment Number 2 to the Lease between International Business Machines Corporation and FED Corporation dated January 29, 2001 (incorporated by reference to exhibit 10.11 to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000 filed on March 30, 2001).
10.8	Amendment Number 3 to Lease between International Business Machines Corporation and FED Corporation dated May 28, 2002.
10.9	Amendment Number 4 to Lease between International Business Machines Corporation and FED Corporation dated December 14, 2004.
10.10	Registration Rights Agreement dated as of April 25, 2003 by and among eMagin and certain initial investors identified on the signature pages thereto (incorporated by reference to exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on April 28, 2003).
10.11	Securities Purchase Agreement dated as of January 9, 2004 by and among eMagin and the investors identified on the signature pages thereto (incorporated by reference to exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on January 9, 2004).
10.12	Registration Rights Agreement dated as of January 9, 2004 by and among eMagin and certain initial investors identified on the signature pages thereto (incorporated by reference to exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on January 9, 2004).
10.13	Master Amendment Agreement dated as of February 17, 2004 by and among eMagin and the investors identified on the signature pages thereto (incorporated by reference to exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on March 4, 2004).
10.14	Registration Rights Agreement dated as of February 17, 2004 by and among eMagin and certain initial investors identified on the signature pages thereto (incorporated by reference to exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on March 4, 2004).
10.15	Letter Agreement amending the Master Amendment Agreement dated as of March 1, 2004 by and among eMagin and the parties to the Master Amendment Agreement (incorporated by reference to exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on March 4, 2004).
10.16	Lease between International Business Machines Corporation and FED Corporation dated May 28, 1999, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein.
10.17	Amendment Number 2 to the Lease between International Business Machines Corporation and FED Corporation dated January 29, 2001, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein.
10.18	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.
10.19	Securities Purchase Agreement dated as of April 25, 2003 by and among eMagin and the investors identified on the signature pages thereto, filed April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.20	Registration Rights Agreement dated as of April 25, 2003 by and among eMagin and certain initial investors identified on the signature pages thereto filed April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.21	Securities Purchase Agreement dated as of January 9, 2004 by and among eMagin and the investors identified on the signature pages thereto, filed January 9, 2004, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.22	Registration Rights Agreement dated as of January 9, 2004 by and among eMagin and certain initial investors identified on the signature pages thereto. Incorporated herein by reference to our January 9, 2004 Form 8-K.
10.23	Master Amendment Agreement dated as of February 17, 2004 by and among eMagin and the investors identified on the signature pages thereto, filed March 4, 2004, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.24	Registration Rights Agreement dated as of February 17, 2004 by and among eMagin and certain initial investors identified on the signature pages thereto, filed March 4, 2004, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.25	

Letter Agreement amending the Master Amendment Agreement dated as of March 1, 2004 by and among eMagin and the parties to the Master Amendment Agreement, filed March 4, 2004, as filed in the Registrant's Form 8-K incorporated herein by reference.

23.1	Consent of Independent Registered Public Accounting Firm.
31.1	Certification by Chief Executive Officer pursuant to Sarbanes Oxley Section 302.
31.2	Certification by Chief Financial Officer pursuant to Sarbanes Oxley Section 302.
32.1	Certification by Chief Executive Officer pursuant to 18 U.S. C. Section 1350.
32.2	Certification by Chief Financial Officer pursuant to 18 U.S. C. Section 1350.

10.26	2004 Non–Employee Compensation Plan, filed July 7, 2004, as filed in the Registrant's Form S–8, incorporated herein by reference.*
10.27	Form of Letter Agreement by and among eMagin and the holders of the Class A, Class B and Class C common stock purchase warrants, filed August 9, 2004, as filed in the Registrant's Form 8–K incorporated herein by reference.
10.28	Securities Purchase Agreement dated as of October 21, 2004 by and among eMagin and the purchasers listed on the signature pages thereto, filed October 26, 2004, as filed in the Registrant's Form 8–K incorporated herein by reference.
10.29	Placement Agency Agreement dated as of October 21, 2004 by and among eMagin and W.R. Hambrecht & Co., LLC, filed October 26, 2004, as filed in the Registrant's Form 8–K incorporated herein by reference.
10.30	Agreement, dated as of June 29, 2004, by and between eMagin and Larkspur Capital Corporation, filed October 26, 2004, as filed in the Registrant's Form 8–K incorporated herein by reference.
10.31	Amendment No. 4 to Lease by and between eMagin and International Business Machines Corporation, filed December 20, 2004, as filed in the Registrant's Form 8–K incorporated herein by reference.
10.32	Sublease Agreement dated as of July 14, 2005 by and between eMagin and Capgemini U.S., LLC, filed August 2, 2005, as filed in the Registrant's Form 8–K incorporated herein by reference.
10.33	Amended and Restated 2003 Stock Option Plan, filed September 1, 2005, as filed in the Registrant's Definitive Proxy Statement, incorporated herein by reference.*
10.34	Amended and Restated 2004 Non–Employee Compensation Plan, filed September 1, 2005, as filed in the Registrant's Definitive Proxy Statement, incorporated herein by reference.*
10.35	2005 Employee Stock Purchase Plan, filed September 1, 2005, as filed in the Registrant's Definitive Proxy Statement, incorporated herein by reference.*
10.36	Securities Purchase Agreement dated as of October 20, 2005, by and among eMagin and the purchasers listed on the signature pages thereto, filed October 31, 2005, as filed in the Registrant's Form 8–K incorporated herein by reference.
10.37	Registration Rights Agreement dated as of October 20, 2005, by and among eMagin and the purchasers listed on the signature pages thereto, filed October 31, 2005, as filed in the Registrant's Form 8–K incorporated herein by reference.

10.38	Employment Agreement effective as of January 1, 2006 by and between eMagin and Gary Jones, filed January 27, 2006, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.39	Employment Agreement effective as of January 1, 2006 by and between eMagin and Susan Jones, filed January 27, 2006, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.40	Amendment to Employment Agreement as of April 17, 2006 by and between eMagin and Gary Jones.
10.41	Amendment to Employment Agreement as of April 17, 2006 by and between eMagin and Susan Jones.
10.42	Form of Note Purchase Agreement dated July 21, 2006, by and among the Company and the investors named on the signature pages thereto, filed July 25, 2006, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.43	Form of 6% Senior Secured Convertible Note Due 2007-2008 of the Company dated July 21, 2006, filed July 25, 2006, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.44	Form of Common Stock Purchase Warrant of the Company dated July 21, 2006, filed July 25, 2006, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.45	Pledge and Security Agreement dated as of July 21, 2006 by and between the Company and Alexandra Global Master Fund Ltd., as collateral agent, filed July 25, 2006, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.46	Patent and Trademark Security Agreement dated as of July 21, 2006 by and between the Company and Alexandra Global Master Fund Ltd., as collateral agent, filed July 25, 2006, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.47	Lockbox Agreement dated as of July 21, 2006 by and between the Company and Alexandra Global Master Fund Ltd., as collateral agent, filed July 25, 2006, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.48	Form of Note Purchase Agreement dated July 21, 2006, by and between the Company and Stillwater LLC, filed July 25, 2006, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.49*	2004 Amended and Restated Non-Employee Compensation Plan, filed September 21, 2006, as filed in the Registrant's Definitive Proxy Statement incorporated herein by reference.
10.50	Executive Separation and Consulting Agreement dated as of January 11, 2007 by and between eMagin Corporation and Gary W. Jones, filed January 19, 2007, as filed in the Registrant's Form 8-K/A incorporated herein by reference.
10.51	Letter Agreement dated as of February 12, 2007 by and between eMagin Corporation and Dr. K.C. Park, filed February 16, 2007, as filed in the Registrant's Form 8-K incorporated herein by reference.
10.52	Allonge to the 6% Senior Secured Convertible Notes Due 2007-2008 of eMagin Corporation dated as of March 9, 2007, filed March 13, 2007, as filed in the Registrant's Form 8-K incorporated herein by reference
23.1	Consent of Independent Registered Public Accounting Firm.
31.1	Certification by Chief Executive Officer pursuant to Sarbanes Oxley Section 302.
31.2	Certification by Chief Financial Officer pursuant to Sarbanes Oxley Section 302.
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350.
32.2	Certification by Chief Financial Officer pursuant to 18 U.S.C. Section 1350.

* Each of the Exhibits noted by an asterisk is a management compensatory plan or arrangement.

Exhibit 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (Nos. 333-134526 and 333-138879) on Form S-8 and the Registration Statement (No. 333 - 136748) on Form S-3, of our report dated March 27, 2007, which include explanatory paragraphs as to the Company's ability to continue as a going concern and the Company's change in its method of accounting for Stock-based compensation, with respect to the consolidated financial statements of eMagin Corporation included in this Annual Report on Form 10-K for the year ended December 31, 2006.

We also consent to the reference to us as "Experts" in the Registration Statement on Form S-3.

/s/ Eisner
New York, New York
March 27, 2007

EXHIBIT 31.1

CERTIFICATION

**eMAGIN CORPORATION
CERTIFICATION PURSUANT TO SARBANES–OXLEY SECTION 302**

I, K.C. Park, certify that:

1. I have reviewed this annual report on Form 10–K 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 were made, not misleading with respect to the period covered by this annual 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 issuer as of, and for, the periods presented in this quarterly report;
4. The issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a–15(e) and 15d–15(e)) for the issuer and have:
 - a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the issuer including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and
 - b) Evaluated the effectiveness of the issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent fiscal quarter (the issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting;
5. The issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the issuer's auditors and the audit committee of the issuer's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the issuer's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls over financial reporting.

Date: April 2, 2007

By: /s/ K.C. Park

K.C. Park
Interim Chief Executive Officer

EXHIBIT 31.2

CERTIFICATION

eMAGIN CORPORATION CERTIFICATION PURSUANT TO SARBANES–OXLEY SECTION 302

I, John Atherly, certify that:

1. I have reviewed this annual report on Form 10–K 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 were made, not misleading with respect to the period covered by this annual 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 issuer as of, and for, the periods presented in this annual report;
4. The issuer's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a–15(e) and 15d–15(e)) for the issuer and have:
 - a) Designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the issuer including its consolidated subsidiary, is made known to us by others within those entities, particularly during the period in which this report is being prepared; and
 - b) Evaluated the effectiveness of the issuer's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - c) Disclosed in this report any change in the issuer's internal control over financial reporting that occurred during the issuer's most recent fiscal quarter (the issuer's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the issuer's internal control over financial reporting;
5. The issuer's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the issuer's auditors and the audit committee of the issuer's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the issuer's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the issuer's internal controls over financial reporting.

Date: April 2, 2007

By: /s/ John Atherly

John Atherly
Chief Financial Officer

EXHIBIT 32.1

**eMAGIN CORPORATION
CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES–OXLEY ACT OF 2002**

I, K. C. Park, the Chief Executive Officer of eMagin Corporation (the "Company"), certify, pursuant to Section 906 of the Sarbanes–Oxley Act of 2002, 18 U.S.C. Section 1350, that to the best of my knowledge:

- (1) the Annual Report on Form 10–K of the Company for the fiscal year ended December 31, 2006 (the "Report") fully complies with the requirements of Section 13 (a) or 15 (d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to eMagin Corporation and will be retained by eMagin Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

Date: April 2, 2007

By: /s/ K.C. Park

K. C. Park
Interim Chief Executive Officer

EXHIBIT 32.2

**eMAGIN CORPORATION
CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED
PURSUANT TO SECTION 906 OF THE SARBANES–OXLEY ACT OF 2002**

I, John Atherly, the Chief Financial Officer of eMagin Corporation (the "Company"), certify, pursuant to Section 906 of the Sarbanes–Oxley Act of 2002, 18 U.S.C. Section 1350, that to the best of my knowledge:

- (1) the Annual Report on Form 10–K of the Company for the fiscal year ended December 31, 2006 (the "Report") fully complies with the requirements of Section 13 (a) or 15 (d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m or 78o(d)); and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement required by Section 906 has been provided to eMagin Corporation and will be retained by eMagin Corporation and furnished to the Securities and Exchange Commission or its staff upon request.

Date: April 2, 2007

By: /s/ John Atherly

John Atherly
Chief Financial Officer

Created by 10KWizard www.10KWizard.com