

EMAGIN CORP
Form 10-K/A
October 11, 2011

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-K /A

Amendment No. 1

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

For the fiscal year ended December 31, 2009

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.)

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

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

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

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

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

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 R

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes R

No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 229.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). 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 Smaller Reporting Company

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, 2009, 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 National Association of Securities Dealers Inc. OTC Bulletin Board of \$1.09 was approximately \$12.1 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 February 28, 2010 was 17,073,558.

DOCUMENTS INCORPORATED BY REFERENCE – None

eMAGIN CORPORATION

FORM 10-K /A

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2009

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EXPLANATORY NOTE

This Amendment No. 1 hereby amends our Annual Report on Form 10-K (“Form 10-K/A”) for the year ended December 31, 2009 which was originally filed with the Securities and Exchange Commission on March 25, 2010 (the “Original 10-K”). This amendment is being filed mainly to include restated consolidated financial statements as described in Note 18, Restatement, of the Notes to the Consolidated Financial Statements. The consolidated financial statements are being restated to correct accounting errors as follows:

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

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

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

Part I – Item 1A – Risk Factors

Part II – Item 6 – Selected Financial Data

Part II – Item 7 – Management’s Discussion and Analysis of Financial Condition and Result of Operations

Part II – Item 8 – Financial Statements and Notes to the Consolidated Financial Statements

Part II – Item 9A – Controls and Procedures

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

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

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 of Financial Condition and Results of Operation," and "Risk Factors." They include statements concerning: our business strategy; expectations of market and customer response; liquidity and capital expenditures; future sources of revenues; expansion of our proposed product line; and trends in industry activity generally. In some cases, you can identify forward-looking statements by words such as "may," "will," "should," "expect," "plan," "could," "anticipate," "intend," "believe," "estimate," "predict," "potential," "goal," or "continue" or similar terminology. These statements are only predictions and involve known and unknown risks, uncertainties and other factors, including, but not limited to, the risks outlined under "Risk Factors," that may cause our 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 (“eMagin, “we,” “our,” or “us,”) is a leader in OLED (organic light emitting diode) technology. We design, develop, manufacture, and market OLED on silicon microdisplays, virtual imaging products which utilize OLED microdisplays, and related products. We also perform research in the OLED field. Our virtual imaging products 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 (“OEM”) customers to develop and market improved or new electronic products especially those that are mobile and highly portable. 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.

We believe our OLED microdisplays offer a number of significant advantages over other microdisplay options for near-to-eye applications including greatly increased power efficiency, less weight, and wider viewing angles. Using our active matrix OLED technology, many computer and electronic system functions can be built directly into the OLED microdisplay, resulting in compact, high resolution, power efficient systems. We have developed our own intellectual property and accumulated over 6 years of manufacturing know-how to create high performance OLED microdisplays.

As the first to exploit OLED technology for microdisplays, we believe that we enjoy a significant advantage in the commercialization of microdisplays for virtual imaging. We believe we are currently the only company to sell 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. Simultaneous with this merger, we changed our name to eMagin Corporation. eMagin is incorporated in the state of Delaware.

We derive the majority of our revenue from sales of our OLED microdisplay products. We also generate revenue from sales of optics, microdisplays combined with optics (“microviewers”), and virtual imaging systems (primarily our Z800 3DVisor™). In addition we earn revenue from non-recurring engineering (“NRE”) projects and under government contracts that support some of our research and development programs.

Using our active matrix OLED technology, many computer and video electronic system functions can be built directly into the OLED microdisplay, resulting in compact systems with expected lower overall system costs relative to alternative microdisplay technologies. Already proven in commercialized military and commercial systems, our portfolio of OLED microdisplays deliver high-resolution, flicker-free virtual images, working effectively even in extreme temperatures and high-vibration conditions with greatly increased system level power efficiency, less weight and wider viewing angles.

Our Technology Platforms

Small Molecule, Top-Emitting Active Matrix OLED Technology

There are two basic classes of OLED technology, dubbed single molecule or small molecule (monomer) and polymer. Our microdisplays are currently based upon active matrix small molecule OLED technology, which we refer to as active matrix OLED (“AMOLED”) because we build the displays directly on silicon chips. Our AMOLED 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. 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.

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 other technologies.

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 devices that enables OLED displays to be built on opaque silicon integrated circuits rather than only on glass. Our OLED devices emit full visible spectrum light that is isolated with color filters to create full color images. Our microdisplays 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, such as our recently developed OLED-XL™ technology, offer potential for even better performance for brightness, efficiency, and lifespan. In addition to our active matrix OLED 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.

We believe that our AMOLED technology provides significant advantages over other microdisplay technologies in our targeted microdisplay markets. We believe these key advantages include:

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

Prism Optics

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 molded plastic prism lenses which permit our AMOLED 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 Z800 3DVisor personal display systems.

Our Market Opportunities

The growth potential of our selected target market segments have been investigated using information gathered from key industry market research firms and resources, including Consumer Electronics Association, DisplaySearch, Mobile Display Report, Frost and Sullivan, McLaughlin Group, Nikkei, VisionGain 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 current and potential customers.

Most markets involve near-eye imaging applications for products such as viewfinders for digital cameras, or for head-wearable displays. These near-to-eye viewing products have been recently characterized by the McLaughlin Consulting Group as the Personal Viewer Market. The McLaughlin Group forecasts the total Personal Viewer Market to reach as much as 16.0 million units and \$5.7 billion in revenue by 2012.

Head-wearable display products 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. The virtual-imaging markets we are targeting broadly fall into the categories of military,

industrial/medical, and consumer though many products serve multiple markets (“dual use”). Within each of these market sectors, we believe that our OLED microdisplays, when combined with compact optic lenses, will become a key component for a number of mobile electronic products.

Military/First Responder

Properly implemented, we believe that head-mounted systems incorporating our microdisplays increases effectiveness by allowing hands-free operation and increasing situational awareness with enough brightness to be used in daylight, yet controllable for nighttime light security. As a COTS (commercial off the shelf) component, OLED microdisplays intrinsically demonstrate performance characteristics important to military and other demanding commercial and industrial applications, including high contrast, wide dimming range, 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. Most importantly, our OLED's very low power consumption reduces battery weight and increases allowed mission length. The OLED's inherent 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 SXGA OLED-XL™ microdisplay provides power advantages over other microdisplay technologies, particularly liquid crystal displays which require backlights and heaters and cannot provide instant-on capabilities at low temperatures.

Our products' military applications primarily fall into three broad areas: (1) helmet-mounted displays for situational awareness and data, (2) night vision/thermal imaging goggles and viewers, and (3) training and simulation devices. Similar systems are of interest for other military applications as well as for demanding operations such as urban security, homeland defense, fire and rescue.

Situational Awareness. Situational awareness products include head mounted displays which are used to display mapping, logistics and status and handheld imagers for border patrol and training. In certain situations these products are combined with a weapon system in order to give the user the capability of selecting targets without direct exposure. Our OLED microdisplays have already been commercially implemented into a number of military situational awareness programs including: US Army Land Warrior Program, U.S. Army Mounted Warrior Program, US Army Remote Viewer Program, FELIN Fantassin à Equipements et Liaisons Intégrés Program (French Infantryman with Networked Equipment), and Israeli Advanced Integrated Soldier System, among others. OEM products include Intevac Vision Systems' I-Port™ EX3, I-Port™, Night-Port™, and Binocular 50™.

Night Vision/Thermal Imaging. Night Vision Goggles allow the user to see in low light conditions. The most modern versions usually include two different technologies: infrared/thermal, and image intensification. Third and fourth generation military devices usually use some combination of the two modes. Thermal imagers detect infrared energy (heat) and convert it into an electronic signal. The resulting signal needs to be presented on a display. Heat sensed by an infrared camera can be very precisely quantified, or measured, allowing the user to not only monitor thermal performance, but also identify and evaluate the relative severity of heat-related problems. Thermal imaging systems can be stand-alone handheld systems or integrated as part of the aiming mechanism for a larger system. Our OLED microdisplays are typically targeted to uncooled systems, as opposed to systems that require external cooling in order to increase their sensitivity. Advances in sensor technology, both in sensitivity and resolution as well as economic efficiency, have been driving factors in the adoption of thermal technologies for military applications. The power efficiency and environmental ruggedness of our products are strong competitive advantages, particularly in these small hand-held non-cooled systems. Fielded products incorporating eMagin OLED microdisplays include Northrop Grumman's Lightweight Laser Designator Rangefinders (LLDR), Thales SOPHIE handheld thermal imagers, and Thales MINIE™, LUCIE™, and MONIE™ night vision goggles.

Training and Simulation. Our OLED microdisplays and our Z800 3DVisor have been acquired by OEMs for use with their simulation and training products. The Z800's capability to integrate 360 degree head tracking and stereo vision, as well as its wide field of view are attractive attributes for any simulation or virtual reality system. Examples of commercialized training and simulation products include: Cubic CombatRedi™ tactical man-worn system with wireless communication, Drive Square's portable in-vehicle simulator, NVIS' Virtual Binocular SV™ and Monoscope SV™, Quantum 3D ExpeditionDI™, Rockwell Collins' SimEye SX45™ and SimEye SX60™, and Sensics' xSight.™

Military Market Size. The McLaughlin Group reports that in 2012 sales of thermal weapons sights are forecast to reach \$525M and sales of enhanced night vision systems are projected to reach \$1.75B, propelled by both higher volumes and higher prices for added capabilities of color, higher resolution, and digital connectivity. Sales of helmet-mounted personal viewers for situational awareness are forecast to reach \$330M in 2012, with growth resulting from higher definition and color displays. Our displays have already been commercialized or prototyped for situational awareness and night vision/thermal imaging applications by military systems integrators including Elbit, Insight Technologies, Intevac Vision Systems, Nivisys, Oasys Technology, Qioptiq, Rockwell Collins, Saab, Sagem, and Thales, among many others. Night Vision Equipment Corporation's HelmetIR-50™, a lightweight, military helmet mounted thermal imager, which provides hands-free operation and allows viewers to see through total darkness, battlefield obscurants, and even foliage, is the first OLED-equipped product to be listed on the US Government's GSA schedule. Similar systems are of interest for other military applications as well as for related operations such as urban security, 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 potential 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. Current commercial products equipped with our OLED microdisplays in these sectors include those produced by Liteye, FLIR Systems, NordicNeuroLab, VRmagic GmbH, Sensics, and Total Fire Group, among others.

Consumer

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 mobile video Personal Viewer 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, portable DVD systems, electronic games, and other entertainment, and wearable computers.

As our OLED displays are manufactured in increasingly higher volumes at reduced costs, we believe that our OLED microdisplay products will be increasingly well positioned to compete with and displace liquid crystal displays in the rapidly growing consumer market as demand for higher-resolution, and better image quality evolves to meet the wish for more sophisticated Personal Viewers. Examples of potential applications for mobile Personal Viewers include handheld personal computers and mobile devices (such as smartphones, iPods™), whose small, direct view screens are often limitations, but which are now capable of running software applications that would benefit from a larger display accessory and entertainment and gaming video headset systems, which permit individuals to privately view television, including HDTV, video CDs, DVDs and video games on virtual large screens or stereovision.

Our Products

Our commercial microdisplay products based on our SVGA series OLED microdisplays, first introduced in 2001, have received award recognition including: SID Display of the Year and Electronic Products Magazine Product of the Year. In 2008 we introduced engineering samples of our SXGA OLED microdisplays. We are in the process of completing development of the SVGA 3DS (SVGA 3D shrink, a smaller format SVGA display with a new cell architecture with embedded features). We expect to begin selling significant quantities of the SXGA product in 2010. In 2006 we introduced our OLED-XL technology, which provides longer luminance half life and enhanced efficiency for all of our microdisplay product lines. These OLED and OLED-XL products are being applied or considered for near-eye and headset applications in products to be manufactured by OEM customers for a wide variety of military, medical, industrial, and consumer applications. We offer our products to OEMs and other 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 and offer design of customized displays with resolutions or features to meet special customer requirements.

SVGA+ OLED Microdisplay Series (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+ Rev3 OLED-XL microdisplay, the most power efficient OLED solution for near-eye personal viewer applications, uses less than 115 mW power in monochrome, such as for thermal imaging applications, and lower than 175 mW at 400 cd/m² (60Hz video at 70 cd/m²) for full color video. This new microdisplay has simpler calibration over temperature and is ideal for demanding binocular luminance and color matching. It also shares all the functional and design characteristics of eMagin's original SVGA OLEDs, responding instantly at temperatures as low as -40 degrees C.

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. The SVGA-3D OLED-XL is primarily used as components of our Z800 3DVisor.

SXGA OLED-XL (Super eXtended Graphics Array, 1280 x 1024). Our SXGA OLED microdisplay with 0.77 inch diagonal active area provides 3,932,160 sub-pixels in an active area that is only .15 inches larger than our SVGA+ microdisplay. The 1280 x 1024 triad pixel array comprises triads of vertical sub-pixels stacked side by side to make up each 12 x 12mm color pixel. The SXGA OLED-XL microdisplay offers both analog and digital signal processing, requiring less than 200mW under typical operation. The new SXGA microdisplays provide versatility and flexibility for OEM developers though a FPGA driver design available on a separate, lower power driver board, or as source code for integration into end product electronics for maximum power efficiency. The supported video formats are SXGA, 720p, DVGA (through 1280 x 960 pixel doubling), and both frame sequential and field sequential stereovision. Additional enhancements include increased pixel uniformity, improved color gamut, on-chip temperature sensor and compensation, and compatibility with both analog RGB and digital video signals. On-board circuitry ensures consistent color and brightness over a wide range of operating temperatures.

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.

Z800 3DVisor™ Our Z800 3DVisors™ 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. This product has received industry recognition including: Digital Living Class 2005 Innovators, Consumer Electronics Association's 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, and, was recognized as one of Advanced Imaging's Solutions of the Year, as integrated in Chatten Associates' head-aimed remote viewer.

Government Contract Funding

We derive a portion of our revenue from funding that we receive pursuant to research contracts or subcontracts funded by various agencies of the U.S. Government. The revenue that we recognize from these contracts represents reimbursement by various U.S. Government entities. Our recent contracts have been awarded for development of power efficient microdisplay for US Army Night Vision and development of ultra-high resolution display for US Army telemedicine. Our government contracts require us to conduct the research effort described in the statement of work section of the contract. These contracts may be modified or terminated at the discretion of the government and typically are subject to appropriation and allocation of the required funding on an annual basis. On contracts for which we are the prime contractor, we subcontract portions of the work to various entities and institutions.

Our Strategy

Our strategy is to strengthen our 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 experience and expertise in active matrix OLED technology. We aim to provide microdisplay and complementary 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:

Strengthen our technology leadership. As the first to exploit AMOLED microdisplays, we believe that we enjoy a significant advantage in bringing this technology to market. By continuing to invest in research and development, and protecting our intellectual property, we expect to further develop performance improvements and provide a competitive edge for our customers who integrate our displays into their end products.

Optimize microdisplay manufacturing efficiencies while protecting proprietary processes. We intend to reduce our production costs primarily through increasing manufacturing yield and lowering fixed costs through reduced cycle time and increased automation, as well as equipment upgrades. 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-related processes in-house, 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.

Build and maintain strong design capabilities. We employ in-house design capabilities supplemented by outsourced design services. Building and maintaining this capability 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.

Leverage strategic relationships. 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 and solutions. In addition, we participate in industry associations such as Society Information Display, FlexTech Alliance (formerly known as United States Display Consortium), OLED Association, Consumer Electronics Association, and the Association of the United States Army, among others. Furthermore, we have established a CRADA (Cooperative Research and Development Agreement) with the US Army/RDECOM/NVESD for the purpose of evaluating and characterizing new and existing AMOLED microdisplay configurations. 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 satisfy our customers' evolving requirements.

Sales and Marketing

We primarily provide our OLED display and optics components for OEMs to incorporate into their branded products and sell through their own well-established distribution channels. We have traditionally marketed and sold our products to customers through targeted selling, promotions, select advertising and attendance at trade shows. We identify companies with end products and applications for which we believe our products will provide a key differentiator. Marketing efforts focus on identifying prospects and communicating the product performance attributes foremost in the minds of purchasing decision-makers. This approach is intended to ensure the highest possible return on investment for our marketing expense.

We market our products in North America, Asia, and Europe directly from our sales office located in our Bellevue, Washington facility. We also have distributors in China and Korea. We sell the Z800 3DVisor to individual buyers, OEM systems and equipment customers, through distributors, and through our e-commerce website, www.3dvisor.com. The contents of our e-commerce website are not part of this Report.

An OEM design cycle typically requires between 6 and 36 months, depending on the uniqueness of the market, the complexity of the end product, or in the case of military OEM customers, government procurement schedules. Because our microdisplays are the main functional component that defines many of our customers' end products, we work closely with customers to provide technical assistance throughout the product evaluation and integration process.

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 2009, 57% of our net revenue was to firms based in the United States and 43% was to international firms as compared to 61% domestic revenue and 39% international revenue during 2008. In 2009, we had 10 customers that accounted for more than 56% of our total revenue as compared to 10 customers that accounted for more than 63% of our total revenue in 2008. In 2009, we had 1 customer that accounted for more than 10% of our total revenue as compared to 2008 when we had 2 customers that each accounted for more than 10% of our total revenue.

Backlog

As of February 28, 2010, we had a backlog of approximately \$6.8 million for purchases through December 2010. This backlog primarily consists of non-binding purchase orders and purchase agreements but does not include expected revenue from R&D contracts or expected NRE (non-recurring engineering) programs under development.

The majority of our backlog consists of non-binding purchase orders or purchase agreements for delivery over the next six months. Most purchase orders are subject to rescheduling or cancellation by the customer with no or limited penalties. We believe that the backlog metric is of limited utility in predicting future sales because many of our OEM customers operate on a ship-to-order basis. Variations in the magnitude and duration of purchase orders and customer delivery requirements may result in substantial fluctuations in backlog from period to period.

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 37,000 square feet of space which houses our own equipment for OLED microdisplay fabrication and research and development, includes a 16,300 square foot class 10 clean room space, additional lower level clean room space, assembly space and administrative offices.

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 also lease a facility in Bellevue, Washington where we operate our Z800 3DVisor operations, finance function and business development activities. The facilities are well suited for designing and building limited volume prototypes and small quantity industrial or government products.

We believe manufacturing efficiency is an important factor for success, especially in the consumer markets. We currently have the equipment needed for profitable production in place. We plan to add equipment to increase capacity and yield over the next two years to meet expected demand for our microdisplays.

Competition

The industry in which we operate is highly competitive. We face competition from legacy technologies such as cathode ray tubes (CRTs), liquid crystal on silicon microdisplays (LCOS), and transmissive liquid crystal displays (LCDs) as well as from alternative flat panel display technologies such as field emission and virtual scanning retinal

displays. There are many large and small companies that manufacture or have in development products based on these technologies.

Currently, in the high resolution microdisplay market, we face competition from liquid crystal microdisplay manufacturers, such as those sold by Kopin Corporation. We are not aware of any current manufacturers of high resolution OLED microdisplays that compete with our microdisplay products.

In the future, we believe that our key competition will come from LCOS and small transmissive LCDs. While we believe that OLED technology has the capability to provide higher quality images, greater environmental ruggedness, reduced electronics cost and complexity, and improved power efficiency advantages over either type of liquid crystal based microdisplays, there is no assurance that these benefits will be fully realized or that liquid crystal manufacturers will not suitably improve these parameters to reduce these potential advantages of OLEDs.

To our knowledge, the only other companies that have publicly stated plans to commercially develop OLED microdisplays for near-eye applications are MicroEmissive Displays (MED) in Britain and MicroOLED in France. Though MED had raised substantial funds and created a new production facility, the company ceased business operations in 2008. We believe that one or more companies in Asia are investigating production of OLED microdisplays. We may also compete with potential licensees of Universal Display Corporation, Global OLED Technology LLC, or Cambridge Display Technology, among others, each of which potentially can license OLED technology portfolios. If other new OLED-based companies enter our markets with directly relevant display designs and without manufacturing and reliability issues, we will face competition, though we believe that our progress to date in this area gives us a substantial head start.

Intellectual Property

We believe we have developed a substantial intellectual property portfolio of patents, trade secrets and manufacturing know-how. It is important to protect our investment in technology by obtaining and enforcing intellectual property rights, including rights under patent, trademark, trade secret and copyright laws. We seek to protect inventions we consider significant by applying for patents in the United States and other countries when appropriate.

Our intellectual property covers a wide range of materials, device structures, processes, and fabrication techniques, primarily concentrated in the following areas:

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

We believe that, in addition to patent protection, our success is dependent upon non-patentable trade secrets and technical expertise. To protect this information and know-how from unauthorized use or disclosure, we use nondisclosure agreements and other measures to protect our proprietary rights, and we require all employees, and where appropriate, contractors, consultants, advisors and collaborators to enter into confidentiality and non-competition agreements. We believe that our intellectual property portfolio, coupled with our strategic relationships and accumulated manufacturing know-how in OLED, gives us a significant advantage over potential competitors.

Employees

As of February 28, 2010, we had a total of 64 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.

Available Information

Our website address is www.emagin.com. We make available free of charge through our website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, our Proxy Statements and all amendments to such reports filed under the Securities and Exchange Act after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission (SEC). These reports may be accessed from our website by following the links under "Investors," then "SEC Filings." The information found on our website is not part of this or any other report we file with or furnish to the SEC. We assume no obligation to update or revise any forward-looking statements in this Annual Report or in other reports filed with the SEC, whether as a result of new information, future events or otherwise, unless we are required to do so by law. A copy of this Annual Report and our other reports is available without charge upon written request to Investor Relations, eMagin Corporation, 3006 Northrup Way, Suite 103, Bellevue, WA 98004.

We also post on our website the charters of our Audit, Compensation, 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 SEC as they occur, as well as earnings press releases and other business-related press releases.

Our e-commerce site for sales of our Z800 3DVisor is www.3dvisor.com. The contents of this website are not part of this Report.

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. The following factors, as well as other factors affecting our operating results and financial condition, could cause our actual future results and financial condition to differ materially from those projected. 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 had losses in the past and may incur losses in the future.

Our accumulated deficit is approximately \$190 million as of December 31, 2009. We have not achieved profitability on a full year basis. We had one profitable quarter in 2009. We can give no assurances that we will continue to be profitable in the future. We cannot assure investors that we will sustain profitability or that we will not incur operating losses in the future.

We may not be able to execute our business plan due to a lack of cash from operations.

Prior to April 2008, we had not produced positive cash flows from operations. However, we have generated positive cash flows the past 7 quarters. We anticipate that our cash from operations will be sufficient to meet our requirements over the next twelve months. 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 may have 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. No assurance can be given that if additional financing is necessary, that it will be available, or if available, will be on acceptable terms.

Our operating results have significant fluctuations.

In addition to the variability resulting from the short-term nature of commitments from our customers, other factors contribute to significant periodic quarterly fluctuations in results of operations. These factors include, but are not limited to, the following:

- the receipt and timing of orders and the timing of delivery of orders;
- the inability to adjust expense levels or delays in adjusting expense levels, in either case in response to lower than expected revenues or gross margins;
- the volume of orders relative to our manufacturing capacity;
- product introductions and market acceptance of new products or new generations of products;
- changes in cost and availability of labor and components;
- product mix;
- variation in operating expenses; regulatory requirements, foreign currency fluctuations and changes in duties and tariffs;
- pricing and availability of competitive products and services; and
- changes, whether or not anticipated, in economic conditions.

Accordingly, the results of any past periods should not be relied upon as an indication of our future performance.

RISKS RELATED TO MANUFACTURING

The manufacture of active matrix OLED microdisplays is new and could result in manufacturing issues or delays.

Ours is an evolving technology and we are pioneers in this active matrix OLED microdisplay manufacturing technique. We cannot assure you that we will be able to produce our products in sufficient quantity and quality to maintain existing customers and attract new customers. In addition, we cannot assure you 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 rely on key sole source and limited source suppliers.

We depend on a number of sole source or limited source suppliers for certain raw materials, components, and services. These include circuit boards, graphic integrated circuits, passive components, materials and chemicals, and equipment support. We maintain several single-source supplier relationships, either because alternative sources are not available or because the relationship is advantageous due to performance, quality, support, delivery, capacity, or price considerations. 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 be detrimental to operating results. We do not manufacture the silicon integrated circuits on which we incorporate our OLED technology. Instead, we provide the design layouts to a sole semiconductor contract manufacturer who manufactures the integrated circuits on silicon wafers. Our inability to obtain sufficient quantities of components and other 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.

Our results of operations, financial condition, and business would be harmed if we were unable to balance customer demand and capacity.

As customer demand for our products, particularly new products, changes we must be able to ramp up or adjust our production capacity to meet demand. We are continually taking steps to address our manufacturing capacity needs for our products. If we are not able to increase our capacity or if we increase our capacity too quickly, our business and results of operations could be adversely impacted. If we experience delays or unforeseen costs associated with adjusting our capacity levels, we may not be able to achieve our financial targets. For some of our products, vendor lead times exceed our customers' required delivery time causing us to order to forecast rather than order based on actual demand. Ordering raw material and building finished goods based on forecasts exposes us to numerous risks including potential inability to service customer demand in an acceptable timeframe, holding excess inventory or having unabsorbed manufacturing overhead.

Variations in our production yields impact our ability to reduce costs and could cause our margins to decline and our operating results to suffer.

All of our products are manufactured using technologies that are highly complex. The number of usable items, or yield, from our production processes may fluctuate as a result of many factors, including but not limited to the following:

- variability in our process repeatability and control;
- contamination of the manufacturing environment or equipment;
- equipment failure, power outages, or variations in the manufacturing process;
- lack of consistency and adequate quality and quantity of piece parts and other raw materials;
- defects in packaging either within or without our control; and
- any transitions or changes in our production process, planned or unplanned.

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 because 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.

RISKS RELATED TO OUR INTELLECTUAL PROPERTY

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, and protection of our intellectual property rights may be limited in certain foreign countries. On April 30, 2007, the U.S. Supreme Court, in *KSR International Co. vs. Teleflex, Inc.*, mandated a more expansive and flexible approach towards a determination as to whether a patent is obvious and invalid, which may make it more difficult for patent holders to secure or maintain existing patents. 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.

In addition to patent protection, we also rely on trade secrets and other non-patented proprietary information relating to our product development and manufacturing activities. We try to protect this information through appropriate efforts to maintain its secrecy, including requiring employees and third parties to sign confidentiality agreements. We cannot be sure that these efforts will be successful or that the confidentiality agreements will not be breached. We also cannot be sure that we would have adequate remedies for any breach of such agreements or other misappropriation of our trade secrets or that our trade secrets and proprietary know-how will not otherwise become known or be independently discovered by others.

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 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 may be cyclical.

Our business strategy is dependent on OEM manufacturers building and selling products that incorporate our OLED displays as components into those products. Industry-wide fluctuations could cause significant harm to our business. 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.

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 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 often with a duration of between one and three years. 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, that we will have the resources to fund the expenditures necessary to implement certain cost-saving measures, or 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 attracting and retaining new personnel may have a materially adverse affect on our business and our operating results.

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 operating results are substantially dependent on the development and acceptance of new products and technology innovations.

Our future success may depend on our ability to develop new and lower cost solutions for existing and new markets and for customers to accept those solutions. We must introduce new products in a timely and cost-efficient manner, and we must secure production orders for those products from our customers. The development of new products is a highly complex process, and we historically have experienced delays in completing the development and introduction of new products. Some or all of those technologies or products may not successfully make the transition from the research and development lab. Even when we successfully complete a research and development effort with respect to a particular product or technology, it may fail to gain market acceptance. The successful development and introduction of these products depends on a number of factors, including the following:

- achievement of technology breakthroughs required to make commercially viable devices;
- the accuracy of our predictions of market requirements;
- acceptance of our new product designs;
- acceptance of new technology in certain markets;
- the availability of qualified research and development and product development personnel;

our timely completion of product designs and development;
our ability and available resources to expand sales;
our ability to develop repeatable processes to manufacture new products in sufficient quantities and at low enough costs for commercial sales;
our customers' ability to develop competitive products incorporating our products; and
acceptance of our customers' products by the market.

If any of these or other factors become problematic, we may not be able to develop and introduce these new products in a timely or cost-effective manner.

If government agencies discontinue or curtail their funding for our research and development programs our business may suffer.

Changes in federal budget priorities could adversely affect our contract revenue. Historically, government agencies have funded a significant part of our research and development activities. When the government changes budget priorities, such as in time of war or for other reasons, our funding has the risk of being redirected to other programs. Government contracts are also subject to the risk that the government agency may not appropriate and allocate all funding contemplated by the contract. In addition our government contracts generally permit the contracting authority to terminate the contract for the convenience of the government. The full value of the contracts would not be realized if they were prematurely terminated. We may be unable to incur sufficient allowable costs to generate the full estimated contract values. Furthermore, the research and development and product procurement contracts of the customers we supply may be similarly impacted. If the government funding is discontinued or reduced, our ability to develop or enhance products could be limited and our business results or operations and financial conditions could be adversely affected.

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 receive some longer term purchase agreements, 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 primarily on the basis of internally generated forecasts of demand based on communications with customers, and available industry data 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 active matrix OLED technology.

Our prospects could be significantly affected by our ability to develop strategic alliances with OEMs for incorporation of our active matrix OLED microdisplay 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 could 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 foreign entities. Some customers in other countries have longer receivable periods or warranty periods. In addition, many of the foreign OEMs that are the most likely

long-term purchasers of our microdisplays expose 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.

Current adverse economic conditions may adversely impact our business, operating results and financial condition.

The current economic conditions and market instability may affect our customers and suppliers. Any adverse financial or economic impact to our customers may impact their ability to pay timely, or result in their inability to pay. It may also impact their ability to fund future purchases, or increase the sales cycles which could lead to a reduction in revenue and accounts receivable. Our suppliers may increase their prices or may be unable to supply needed raw materials on a timely basis which could result in our inability to meet customers' demand or affect our gross margins. Our suppliers may, also, impose more stringent payment terms on us. The timing and nature of any recovery in the credit and financial markets remains uncertain, and there can be no assurance that market conditions will improve in the near future or that our results will not be materially and adversely affected.

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 February 28, 2010, we have outstanding common shares of 17,073,558 plus (i) options to purchase 2,798,711 shares, (ii) warrants to purchase 8,990,102 shares and (iii) convertible preferred stock to purchase 7,652,000 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.

Changes in internal controls or accounting guidance could cause volatility in our stock price.

Guidance regarding implementation and interpretation of the provisions of Section 404 continues to be issued by the standards-setting community. Smaller reporting companies are subject to the audit of internal controls for the first time in fiscal years that end on or after June 15, 2010. As a result of the ongoing interpretation of new guidance and the audit testing to be completed in the near future, our internal controls over financial reporting may include an unidentified material weakness which would result in receiving an adverse opinion on our internal controls over financial reporting from our independent registered public accounting firm. This could result in significant additional expenditures responding to the Section 404 internal control audit, heightened regulatory scrutiny and potentially an adverse effect to the price of our stock.

In addition, due to increased regulatory scrutiny surrounding publicly traded companies, the possibility exists that a restatement of past financial results could be necessitated by an alternative interpretation of present accounting guidance and practice. Although management does not currently anticipate that this will occur, a potential result of such interpretation could be an adverse effect on our stock price.

The market price of our common stock may be volatile.

The market price of our common stock has been subject to wide fluctuations. During our four most recently completed fiscal quarters, the closing price of our stock ranged from \$0.35 to \$1.95 and decreased to a low of \$0.35 on March 2, 2009. The market price of our common stock in the future is likely to continue to be subject to wide fluctuations in response to various factors, including, but not limited to, the following:

- variations in our operating results and financial conditions;
- actual or anticipated announcements of technical innovations, new product developments, or design wins by us or our competitors;
- general conditions in the semiconductor and flat panel display industries; and
- worldwide economic and financial conditions.

In addition, the public stock markets have experienced extreme price and volume fluctuations that have particularly affected the market price for many technology companies and that have often been unrelated to the operating performance of these companies. The broad market fluctuations and other factors may continue to adversely affect the market price of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

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 5,100 square feet. The lease expires in 2014. Our manufacturing facility is located in Hopewell Junction, New York, where we lease approximately 37,000 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 2014. We believe our facilities are adequate for our current and near-term needs. We believe we will be able to renew these leases or obtain alternative spaces under acceptable terms. See Note 13 to the Consolidated Financial Statements for more information about lease commitments.

ITEM 3. LEGAL PROCEEDINGS

A former employee ("plaintiff") of the Company commenced legal action in the United States District Court for the Southern District of New York, on or about October 12, 2007, alleging that the plaintiff was subject to gender based discrimination and retaliation in violation of Title VII of the Civil Rights Act of 1964 (Case No. 07-CV-8827 (KMK) . The plaintiff seeks unspecified compensatory damages, punitive damages and attorneys' fees. On November 26, 2007, the Company served and filed its Answer, in which it denied the material allegations of the Complaint and asserted numerous affirmative defenses. The Company and the plaintiff settled this action in May 2009. The settlement did not have a material effect on the Company's results of operations.

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, 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 required 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. As of December 31, 2009, the settlement was paid and \$37,800 was forgiven as a result of timely payments and was recorded in other income on the Company's consolidated statements of operations.

On March 17, 2010, Gary Jones, a former executive at the Company filed a complaint for damages in the Superior Court of the State of Washington for King County (the "Complaint") against the Company and the Company's Chief Financial Officer. The Complaint alleges unspecified damages for failure to pay contractual payments and wages under Washington law and includes, among other claims, breach of contract, breach of the duty of good faith and fair dealing, promissory estoppel and misrepresentation. The Company denies the allegations raised in the Complaint and intends to vigorously defend itself. There can be no assurance of the outcome of this matter.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITYHOLDERS

None.

PART II

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

Our common stock is traded on the OTC Bulletin Board under the symbol "EMAN". The following table sets forth the range of high and low prices per share of our common stock for each period indicated.

	2008		2009	
	High	Low	High	Low
First quarter	\$ 1.47	\$ 0.88	\$ 0.85	\$ 0.32
Second quarter	\$ 1.05	\$ 0.63	\$ 1.40	\$ 0.60
Third quarter	\$ 0.83	\$ 0.52	\$ 2.08	\$ 0.97
Fourth quarter	\$ 0.75	\$ 0.21	\$ 2.00	\$ 1.38

As of February 28, 2010, there were 504 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.

Equity Compensation Plan Information

The following table sets forth the aggregate information of our equity compensation plans in effect as of December 31, 2009:

Plan	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in first column)
Equity compensation plans approved by security holders –			
2003 Stock Option Plan	1,251,882	\$ 1.00	53,006
Equity compensation plans not approved by security holders –	1,565,692	\$ 1.47	222,626

2008 Incentive Stock Plan

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 consolidated statements of operations data for the years ended December 31, 2009 (Restated), 2008, and 2007 and the balance sheet data at December 31, 2009 (Restated) and 2008 are derived from our audited financial statements which are included elsewhere in this Form 10-K /A . The consolidated statements of operations data for the years ended December 31, 2006 and 2005 and the balance sheet data at December 31, 2007, 2006 and 2005 are derived from our audited financial statements which are not included in this Form 10-K /A . 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:

	2009 (Restated)	For the Year Ended December 31,			
		2008	2007	2006	2005
(In thousands, except per share data)					
Revenue	\$ 23,822	\$ 18,739	\$ 17,554	\$ 8,169	\$ 3,745
Cost of goods sold	10,175	10,673	12,628	11,359	10,219
Gross profit (loss)	13,647	8,066	4,926	(3,190)	(6,474)
Operating expenses:					
Research and development	1,996	2,081	2,949	4,406	4,020
Selling, general and administrative	6,900	6,254	6,591	8,860	6,316
Total operating expenses	8,896	8,335	9,540	13,266	10,336
Income (loss) from operations	4,751	(269)	(4,614)	(16,456)	(16,810)
Other (expense) income, net	(6,932)	(1,590)	(13,874)	1,190	282
Net loss prior to income tax provision	(2,181)	(1,859)	(18,488)	(15,266)	(16,528)
Net loss	\$ (2,271)	\$ (1,859)	\$ (18,488)	\$ (15,266)	\$ (16,528)
Loss per share, basic	\$ (0.14)	\$ (0.13)	\$ (1.59)	\$ (1.52)	\$ (1.94)
Loss per share, diluted	\$ (0.14)	\$ (0.13)	\$ (1.59)	\$ (1.52)	\$ (1.94)
Shares used in calculation of loss per share:					
Basic	16,344	14,175	11,633	10,058	8,541
Diluted	16,344	14,175	11,633	10,058	8,541

Consolidated Balance Sheet Data:
(in thousands)

	December 31,				
	2009 (Restated)	2008	2007	2006	2005
Cash and cash equivalents	\$ 5,295	\$ 2,404	\$ 713	\$ 1,415	\$ 6,727
Working capital (deficit)	\$ 8,581	\$ 3,300	\$ (4,708)	\$ (305)	\$ 8,868
Total assets	\$ 13,980	\$ 10,104	\$ 6,648	\$ 7,005	\$ 14,142
Long-term obligations	\$ 6,844	\$ —	\$ 60	\$ 2,229	\$ 56
Total shareholders’ equity (capital deficit)	\$ 2,893	\$ 3,661	\$ (4,170)	\$ (1,164)	\$ 10,401

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

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.

Restatement of Previously Issued Consolidated Financial Statements

In this Amendment No. 1 we have restated our previously issued management's discussion and analysis of financial condition and results of operations, consolidated financial statements and related disclosures for the year ended December 31, 2009 for the following:

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

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

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, 2009, we have recognized an aggregate of approximately \$74.2 million from sales of our products. As of February 28, 2010, we have a backlog of approximately \$6.8 million in products ordered for delivery through December 31, 2010 compared to a backlog of \$7.4 million in products ordered for delivery through December 31, 2009. This backlog consists of non-binding purchase orders and purchase agreements. These products are being applied or considered for near-eye and headset applications in products such as thermal imagers, night vision goggles, entertainment 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.

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

Company History

We began as 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 labor related and therefore semi-fixed. If we are unable to generate significant revenues, our net losses in any given period could be greater than expected.

Critical Accounting Policies

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

Revenue and Cost Recognition

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

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

Product Warranty

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

Use of Estimates

In accordance with accounting principles generally accepted in the United States of America, management utilizes certain estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. On an on-going basis, management evaluates its estimates and judgments. Management bases its estimates and judgments on historical

experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ from those estimates.

Fair Value of Financial Instruments - Restated

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

Stock-based Compensation

eMagin maintains several stock equity incentive plans. The 2005 Employee Stock Purchase Plan (the "ESPP") provides our employees with the opportunity to purchase common stock through payroll deductions. Employees purchase stock semi-annually at a price that is 85% of the fair market value at certain plan-defined dates. As of December 31, 2009, the number of shares of common stock available for issuance was 300,000. As of December 31, 2009, 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 in common stock available for issuance by 3% of the diluted shares outstanding on January 1 of each year for a period of 9 years which commenced January 1, 2005. In 2009, no options were issued from the 2003 Plan.

The 2008 Incentive Stock Plan (“the 2008 Plan”) adopted and approved by the Board of Directors on November 5, 2008 provides for shares of common stock and options to purchase shares of common stock to employees, officers, directors and consultants. As of December 31, 2009, there were 498,533 shares of common stock issued to consultants and there were 1,278,841 options granted from this plan.

The Company accounts for the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors by estimating the fair value of stock awards at the date of grant using the Black-Scholes option valuation model. Stock-based compensation expense is reduced for estimated forfeitures and is amortized over the vesting period using the straight-line method.

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		
	2009 (Restated)	2008	2007
Consolidated Statements of Operations Data:			
Revenue	100%	100%	100%
Cost of goods sold	43	57	72
Gross profit	57	43	28
Operating expenses:			
Research and development	8	11	17
Selling, general and administrative	29	33	38
Total operating expenses	37	44	55
Income (loss) from operations	20	(1)	(27)
Other expense	(29)	(9)	(78)
Loss before provision for income taxes	(9)	(10)	(105)
Provision for income taxes	—	—	—
Net loss	(9)%	(10)%	(105)%

Year Ended December 31, 2009 Compared to Year Ended December 31, 2008

Revenues

Revenues increased by approximately \$5.1 million to a total of approximately \$23.8 million for the year ended December 31, 2009 from approximately \$18.7 million for the year ended December 31, 2008, representing an increase of 27%. The increase in revenue was due to increased customer demand.

For the year ended December 31, 2009, product revenue increased approximately \$4.0 million as compared to the year ended December 31, 2008. The 26% increase was due to higher customer demand and product availability for our OLED displays and z800s. For the year ended December 31, 2009, contract revenue increased 34% or approximately \$1.0 million as compared to the year ended December 31, 2008. The increase was a result of an increase in the

research and development projects in 2009 as compared to 2008.

Cost of Goods Sold

Cost of goods sold includes direct and indirect costs associated with production. Cost of goods sold for the year ended December 31, 2009 were approximately \$10.2 million as compared to approximately \$10.7 million for the year ended December 31, 2008, a decrease of approximately \$0.5 million. Cost of goods sold as a percentage of revenues improved to 43% for the year ended December 31, 2009 from 57% for the year ended December 31, 2008. Cost of goods is comprised primarily of material and labor cost with the labor portion of cost of goods mostly fixed. Improved manufacturing yield and lower royalty expense resulted in a lower cost of goods sold.

The following table outlines product, contract and total gross profit and related gross margins for the years ended December 31, 2009 and 2008 (dollars in thousands):

	For the Year ended December 31,			
	2009		2008	
Product revenue gross profit	\$11,910		\$6,644	
Product revenue gross margin	60	%	42	%
Contract revenue gross profit	\$1,737		\$1,422	
Contract revenue gross margin	43	%	47	%
Total gross profit	\$13,647		\$8,066	
Total gross margin	57	%	43	%

The gross profit for the year ended December 31, 2009 was approximately \$13.6 million as compared to approximately \$8.1 million for the year ended December 31, 2008, an increase of \$5.6 million. Gross margin was 57% for the year ended December 31, 2009 up from 43% for the year ended December 31, 2008. The increase was mainly attributable to our increase in product gross margin of 18% offset by a reduction in the contract gross margin of 4%.

The product gross profit for the year ended December 31, 2009 was approximately \$11.9 million as compared to approximately \$6.6 million for the year ended December 31, 2008, an increase of \$5.3 million. Product gross margin was 60% for the year ended December 31, 2009 up from 42% for the year ended December 31, 2008. The increase was attributed to the fuller utilization of our fixed production overhead due to improved yields and a reduction in royalty expense. See Note 13 of the Consolidated Financial Statements - Commitments and Contingencies for further discussion on the royalty expense.

The contract gross profit for the year ended December 31, 2009 was approximately \$1.7 million as compared to approximately \$1.4 million for the year ended December 31, 2008, an increase of \$0.3 million. Contract gross margin was 43% for the year ended December 31, 2009 down from 47% for the year ended December 31, 2008. The contract gross margin is dependent upon the mix of costs, internal versus external third party costs, with the external third party costs causing a lower gross margin and reducing the contract gross profit.

Research and Development Expenses

Research and development expenses include salaries, development materials and other costs specifically allocated to the development of new microdisplay products, OLED materials and subsystems. Research and development expenses for the year ended December 31, 2009 were relatively unchanged at approximately \$2.0 million as compared to approximately \$2.1 million for the year ended December 31, 2008, a decrease of approximately \$0.1 million. The decrease was primarily due to an increase in the allocation of research and development resources and expenses related to contracts to cost of goods sold and a reduction of expense due to the streamlining of the research and development effort in the subsystems area offset by an increase in internal product development costs.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist principally of salaries, fees for professional services including legal fees, as well as other marketing and administrative expenses. Selling, general and administrative expenses for the year ended December 31, 2009 were approximately \$6.9 million as compared to approximately \$6.3 million for the year ended December 31, 2008, an increase of approximately \$0.6 million. The increase is primarily related to an

increase in personnel costs, shareholder related costs, professional fees and tradeshow costs offset by a decrease in reserve for allowance for bad debts and rent expense.

Other (Expense) Income

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

For the year ended December 31, 2009, interest expense was approximately \$466 thousand as compared to approximately \$2.0 million, respectively, for the year ended December 31, 2008. For the year ended December 31, 2009, the interest expense associated with debt was approximately \$63 thousand, loan fees associated with the new line of credit was approximately \$13 thousand, interest on liquidated damages of approximately \$28 thousand and the amortization of the deferred costs associated with the debt was approximately \$362 thousand. Interest expense for the year ended December 31, 2008 was comprised of interest associated with debt of approximately \$0.7 million; the amortization of the deferred costs associated with debt of approximately \$1.3 million; the amortization of the debt discount associated with debt of approximately \$25 thousand; and other expenses of approximately \$2 thousand. The decrease in interest expense was primarily a result of carrying a lower balance on our line of credit, the repayment and conversion of the 8% Senior Secured Convertible Notes in December 2008, and lower amortization of deferred debt issuance costs.

Other income for the year ended December 31, 2009 was approximately \$67 thousand as compared to approximately \$400 thousand for the year ended December 31, 2008. The other income for the year ended December 31, 2009 was interest income of approximately \$6 thousand; approximately \$4 thousand of miscellaneous income; and approximately \$57 thousand for a settlement of a liability. Other income for the year ended December 31, 2008 was interest income of approximately \$11 thousand; approximately \$18 thousand of income from equipment salvage; gain on the license of intangibles of approximately \$557 thousand (see Note 13 of the Consolidated Financial Statements - Commitments and Contingencies); and offset by approximately \$186 thousand of liquidated damages expense related to registration payment arrangements.

Change in Fair Value of Warrant Liability. In accordance with ASC 815, adopted January 1, 2009, certain warrants previously classified within equity are reclassified as liabilities. As a result of this reclassification, the accounting guidance requires revaluation of this liability every reporting period. The fair value of the liability at December 31, 2009 was measured by using the Monte Carlo Simulation model. The revaluation resulted in a charge of \$6.5 million for the year ended December 31, 2009. This revaluation is a non-cash item and had no impact on our cash balances, operations, or operating income.

Off-Balance Sheet Arrangements

We have no 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, 2008 Compared to Year Ended December 31, 2007

Revenues

Revenues increased by approximately \$1.1 million to a total of approximately \$18.7 million for the year ended December 31, 2008 from approximately \$17.6 million for the year ended December 31, 2007, representing an increase of 7%. This increase was primarily due to increased contract revenue from research and development projects. Our contract revenue increased approximately \$1.6 million while our product revenue decreased approximately \$0.5 million.

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, 2008 and 2007 was approximately \$10.7 million and \$12.6, respectively, a decrease of \$1.9 million. The decrease included an inventory write-off of approximately \$0.4 million in 2007 related to a non-recurring production issue that occurred during the fourth quarter of 2007. An increase in yield in 2008 accounted for the remaining difference. Cost of goods sold as a percentage of revenues improved from 72% in 2007 to 57% in 2008. Cost of goods is comprised primarily of material and labor cost. The labor portion of cost of goods is mostly fixed. Increased display production output volume and improved manufacturing yield results in a lower cost of goods sold percentage.

The following table outlines product, contract and total gross profit and related gross margins for the years ended December 31, 2008 and 2007 (dollars in thousands):

	For the Year ended December 31,			
	2008		2007	
Product revenue gross profit	\$6,644		\$4,280	
Product revenue gross margin	42	%	26	%
Contract revenue gross profit	\$1,422		\$646	

Contract revenue gross margin	47	%	47	%
Total gross profit	\$8,066		\$4,926	
Total gross margin	43	%	28	%

The gross profit was approximately \$8.1 million for the year ended December 31, 2008 and the gross profit was approximately \$4.9 million for the year ended December 31, 2007. The gross margin was 43% for the year ended December 31, 2008 up from 28% for the year ended December 31, 2007. The gross margin improvement was attributed primarily to improved manufacturing yield.

The product gross profit for the year ended December 31, 2008 was approximately \$6.6 million as compared to approximately \$4.3 million for the year ended December 31, 2007, an increase of \$2.3 million. Product gross margin was 42% for the year ended December 31, 2008 up from 26% for the year ended December 31, 2007. The increase was attributed to the fuller utilization of our fixed production overhead due to improved yields and the 2007 inventory write-off related to a non-recurring production issue.

The contract gross profit for the year ended December 31, 2008 was approximately \$1.4 million as compared to approximately \$0.6 million for the year ended December 31, 2007, an increase of \$0.8 million. Contract gross margin was 47% for each of the years ended December 31, 2008 and 2007.

Research and Development Expenses

Research and development expenses include salaries, development materials and other costs specifically allocated to the development of new microdisplay products, OLED materials and subsystems. Research and development expenses for the year ended December 31, 2008 were approximately \$2.1 million as compared to approximately \$2.9 million for the year ended December 31, 2007, a decrease of \$0.8 million. The 29% decrease was due to the re-deployment of research and development personnel to production contract services which are included in cost of goods sold and to a streamlining of the research and development effort in the subsystems area which resulted in expense reductions.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of salaries and related expenses for employees in the functional areas of business development, finance, information technology, quality assurance and other corporate expenses. This includes fees for professional services, such as audit and legal fees associated with audit, SEC filings, and other public company related matters, as well as other marketing and administrative expenses. General and administrative expenses decreased by approximately \$0.3 million to a total of approximately \$6.3 million for the year ended December 31, 2008 from \$6.6 million for the year ended December 31, 2007. The 5% decrease was primarily related to a reduction of marketing expenses, personnel costs and other cost reductions.

Other (Expense) Income

Other (expense) income, net consists primarily of interest income earned on investments, interest expense related to the secured debt, loss from the change in the derivative liability, loss on the extinguishment of debt and other income from the licensing of intangible assets.

For the year ended December 31, 2008, interest expense was approximately \$2.0 million as compared to \$3.1 million for the year ended December 31, 2007. Interest expense for the year ended December 31, 2008 was comprised of interest associated with debt of approximately \$0.7 million; the amortization of the deferred costs associated with debt of approximately \$1.3 million; the amortization of the debt discount associated with debt of \$25 thousand; and other expenses of approximately \$2 thousand. Interest expense for 2007 consisted of interest expense associated with debt of approximately \$744 thousand; the amortization of the deferred costs associated with debt of approximately \$418 thousand; and the amortization of the debt discount associated with the debt of approximately \$1.9 million. The majority of the decrease in interest expense in 2008 as compared to 2007 was a reduction in the amortization of debt discount associated with debt of \$1.9 million offset by an increase in the amortization of deferred costs associated with debt of \$0.9 million.

For the year ended December 31, 2008, the change in the derivative liability was \$0 compared to a loss of approximately \$853 thousand for the year ended December 31, 2007. The loss on extinguishment of debt was \$0 for the year ended December 31, 2008 as compared to a loss of \$10.7 million for the year ended December 31, 2007.

Other income for the year ended December 31, 2008 was approximately \$400 thousand which consisted of interest income of approximately \$11 thousand; approximately \$18 thousand of income from equipment salvage; gain on the license of intangibles of \$557 thousand; and offset by approximately \$186 thousand of liquidated damages expense related to registration payment arrangements as compared to approximately \$815 thousand for the year ended December 31, 2007 which consisted of interest income of approximately \$43 thousand, a gain on the license of intangible assets of \$869 thousand, offset by a write-off of a miscellaneous receivable of \$103 thousand, and other income of \$7 thousand. See Note 13 to the Consolidated Financial Statements - Commitments and Contingencies.

Liquidity and Capital Resources

As of December 31, 2009, we had approximately \$5.3 million of cash as compared to approximately \$2.4 million as of December 31, 2008. The increase of approximately \$2.9 million was due to cash provided by operations of approximately \$5.3 million offset by cash used for financing and investing activities of approximately \$2.4 million.

For the year ended December 31, 2009, net cash provided by operating activities was approximately \$5.3 million, attributable to our net loss of approximately \$ 2.3 million and approximately \$0.5 million from the change in operating assets and liabilities and offset by non-cash expenses of approximately \$8.1 million. Net cash provided by operating activities for the year ended December 31, 2008 was approximately \$138 thousand, attributable to improved net loss of approximately \$1.9 million, approximately \$1.1 million from the change in operating assets and liabilities and offset by non cash expenses of approximately \$3.0 million.

For the year ended December 31, 2009, net cash used in investing activities was approximately \$721 thousand primarily related to the purchase of equipment. Net cash used in investing activities for the year ended December 31, 2008 was approximately \$311 thousand primarily related to the purchase of equipment.

Net cash used by financing activities for the year ended December 31, 2009 was approximately \$1.7 million primarily to pay down the line of credit. Net cash provided by financing activities during the year ended December 31, 2008 was approximately \$1.9 million and was comprised of approximately \$5.5 million from proceeds of sale of common and preferred stock, net of issuance costs and approximately \$1.9 million from proceeds from the line of credit offset by the payments of long-term debt of approximately \$5.5 million.

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

Contractual Obligations

The following chart describes the outstanding contractual obligations of eMagin as of December 31, 2009 (in thousands):

	Total	Payments due by period		
		1 Year	2-3 Years	4-5 Years
Operating lease obligations	\$ 4,913	\$ 1,094	\$ 2,276	\$ 1,543
Line of credit	40	40	—	—
Purchase obligations (a)	3,066	3,066	—	—
Total	\$ 8,019	\$ 4,200	\$ 2,276	\$ 1,543

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

Effect of Recently Issued Accounting Pronouncements

See Note 3 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

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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 (the "Company") as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in shareholders' equity (capital deficit) and cash flows for each of the years in the three-year period ended December 31, 2009. Our audits also included the financial statement schedule - Valuation and Qualifying Accounts - listed in the index at item 15. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits include consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. 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 as of December 31, 2009 and 2008, and the consolidated results of their operations and their consolidated cash flows for each of the years in the three-year period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the financial statement schedule referred to above, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

The accompanying financial statements as of and for the year ended December 31, 2009 have been restated to classify certain warrants as liabilities and to reflect the change in fair value of these warrants in the statement of operations, as more fully described in Note 18 to the financial statements.

EisnerAmper LLP

New York, New York
October 6, 2011

eMAGIN CORPORATION
CONSOLIDATED BALANCE SHEETS

	December 31, 2009 (Restated) See Note 18 2008 (In thousands, except share and per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,295	\$ 2,404
Investments – held to maturity	100	97
Accounts receivable, net	4,563	3,643
Inventory	2,179	2,374
Prepaid expenses and other current assets	687	796
Total current assets	12,824	9,314
Equipment, furniture and leasehold improvements, net	1,021	381
Intangible assets, net	43	47
Other assets	92	—
Deferred financing costs, net	—	362
Total assets	\$ 13,980	\$ 10,104
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,122	\$ 1,026
Accrued compensation	956	837
Other accrued expenses	791	804
Advance payments	211	694
Deferred revenue	238	164
Current portion of debt	—	1,691
Warrant liability	34	—
Other current liabilities	891	798
Total current liabilities	4,243	6,014
Warrant liability	6,844	—
Total liabilities	11,087	6,014
Commitments and contingencies (Note 13)		
Redeemable common stock: 522,500 shares redeemable as of December 31, 2008	—	429
Shareholders' equity:		

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Preferred stock, \$.001 par value: authorized 10,000,000 shares:

Series B Convertible Preferred stock, (liquidation preference of \$5,739,000) stated value \$1,000 per share, \$.001 par value: 10,000 shares designated and 5,739 issued and outstanding as of December 31, 2009 and 2008

Common stock, \$.001 par value: authorized 200,000,000 shares, issued and outstanding, -----16,967,244 shares in 2009 and 15,213,959 shares, net of redeemable

common stock, in 2008	17	15
Additional paid in capital	193,358	204,818
Accumulated deficit	(190,482)	(201,172)
Total shareholders' equity	2,893	3,661
Total liabilities and shareholders' equity	\$ 13,980	\$ 10,104

See notes to Consolidated Financial Statements.

eMAGIN CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

	For the Year Ended December 31, 2009		
	(Restated)		
	See Note		
	18	2008	2007
	(In thousands, except per share data)		
Revenue:			
Product	\$ 19,775	\$ 15,730	\$ 16,169
Contract	4,047	3,009	1,385
Total revenue, net	23,822	18,739	17,554
Cost of goods sold:			
Product	7,865	9,086	11,889
Contract	2,310	1,587	739
Cost of goods sold	10,175	10,673	12,628
Gross profit	13,647	8,066	4,926
Operating expenses:			
Research and development	1,996	2,081	2,949
Selling, general and administrative	6,900	6,254	6,591
Total operating expenses	8,896	8,335	9,540
Income (loss) from operations	4,751	(269)	(4,614)
Other expense:			
Interest expense	(466)	(1,990)	(3,087)
Loss on extinguishment of debt	—	—	(10,749)

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Section 4.04 No Conflict; Required Filings and Consents.

(a) The execution and delivery of this Agreement by Parent and Merger Sub do not, and the performance of this Agreement by Parent and Merger Sub and the consummation by Parent and Merger Sub of the Transactions will not, (i) conflict with or violate the Articles of Incorporation or Bylaws of Parent or Merger Sub, (ii) conflict with or violate any Law applicable to Parent or Merger Sub or by which any property or asset of either of them is bound or affected, or (iii) result in any breach or violation of, or constitute a default (or an event which, with notice or lapse of time or both, would become a default) under, or give to others any rights of termination, amendment, acceleration or cancellation of, or result in the creation of a Lien on any property or asset of Parent or Merger Sub pursuant to, any contract to which Parent or Merger Sub is a party or by which Parent or Merger Sub or any property or asset of either of them is bound or affected, except, with respect to clauses (ii) and (iii), for any such conflicts, violations, breaches, defaults or other occurrences which would not, individually or in the aggregate, prevent or materially delay consummation of any of the Transactions or otherwise prevent or materially delay Parent and Merger Sub from performing their obligations under this Agreement.

(b) The execution and delivery of this Agreement by Parent and Merger Sub do not, and the performance of this Agreement by Parent and Merger Sub and the consummation by Parent and Merger Sub of the Transactions will not, require any consent, approval, authorization or permit of, or filing with or notification to, any Governmental Authority, except for (i) applicable requirements, if any, of the Exchange Act, (ii) the filing and recordation of appropriate merger documents as required by the FBCA and appropriate documents with the relevant authorities of other states in which the Company or any of the Subsidiaries is qualified to do business, (iii) the notification requirements of the HSR Act, and (iv) where the failure to obtain such consents, approvals, authorizations or permits, or to make such filings or notifications, would not, individually or in the aggregate, prevent or materially delay consummation of any of the Transactions or otherwise prevent Parent or Merger Sub from performing their material obligations under this Agreement.

Section 4.05 Absence of Litigation.

As of the date of this Agreement, there is no Action pending or, to the knowledge of the officers of Parent, threatened, against Parent or any of its affiliates before any Governmental Authority that would or seeks to delay or prevent the consummation of any of the Transactions. As of the date of this Agreement, neither Parent nor any of its affiliates is subject to any continuing order of, consent decree, settlement agreement or other similar written agreement with, or, to the knowledge of the officers of Parent, continuing investigation by, any Governmental Authority, or any order, writ, judgment, injunction, decree, determination or award of any Governmental Authority that would or seeks to delay or prevent the consummation of any of the Transactions.

Section 4.06 Operations of Merger Sub.

Merger Sub is as of the date hereof a direct, wholly owned subsidiary of Parent, and will be as of the Effective Time a direct wholly owned subsidiary of Parent, was formed solely for the purpose of engaging in the Transactions, has engaged in no other business activities and has conducted its operations only as contemplated by this Agreement, and has no liabilities nor obligations other than as set forth in this Agreement.

Section 4.07 Brokers.

No broker, finder or investment banker, financial advisor, or other Person, is entitled to any brokerage, finder's or other fee or commission in connection with the Transactions based upon arrangements made by or on behalf of Parent or Merger Sub. The Company will not be responsible for any brokerage, finder's or other fee or commission to any broker, finder or investment banker in connection with the Transactions based upon arrangements made by or on behalf of Parent or Merger Sub.

Section 4.08 Information Supplied.

To Parent's and Merger Sub's knowledge none of the information provided or to be provided by Parent or Merger Sub for inclusion or incorporation by reference in the proxy statement to be mailed by the Company pursuant to Section 6.01 hereof will at the time the proxy statement is mailed to the Company's shareholders, or at the time of any amendment or supplement thereto, contain any untrue statement of a material fact or omit to state any material fact required to be stated therein or necessary

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in order to make the statements therein, in light of the circumstances under which they are made, not misleading.

Section 4.09 Board and Shareholder Determinations.

The Board of Directors of Parent, at a meeting duly called and held, adopted resolutions approving this Agreement and the Transactions, and the Parent, as sole shareholder of Merger Sub, has duly adopted resolutions approving this Agreement and the Transactions.

Section 4.10 No Parent Stockholder Vote.

No vote of the holders of shares of Parent capital stock is necessary to approve this Agreement, the Merger or the Transactions.

Section 4.11 Financing Letters.

Parent has provided to the Company a true, complete and correct copy of the financing commitment letters subject only to their terms (the Financing Letters) and all amendments thereto, executed by AEA Mezzanine Management, LP, SunTrust Bank and M&I Marshall and Ilsley Bank or such other credible, nationally recognized lender of significant financial worth (the Lenders) and addressed to the Parent. Parent will provide to the Company any amendments to the Financing Letters, or any notices given in connection therewith, as promptly as possible (but in any event within twenty-four (24) hours). The terms and conditions of any amendments thereto (or in the case of any substitute Lenders, any financing letters or amendments thereto) shall be satisfactory to the Company in its sole discretion; provided, however the Parent can obtain an extension to the Financial Letters without the approval of the Company but will provide to the Company a copy of any such extensions as promptly as possible (but, in any event, within twenty-four (24) hours).

ARTICLE V

CONDUCT OF BUSINESS PENDING THE MERGER

Section 5.01 Conduct of Business by the Company Pending the Merger.

The Company agrees that, between the date of this Agreement and the Effective Time, except as expressly contemplated by this Agreement, as set forth in Section 5.01 of the Company Disclosure Schedule or otherwise consented to in writing by Parent, the businesses of the Company and the Subsidiaries shall be conducted only in, and the Company and the Subsidiaries shall not take any action except in, the ordinary course of business and in a manner consistent with past practice and in compliance in all material respects with applicable Law, and the Company shall, and shall cause each of the Subsidiaries to, use its reasonable best efforts to preserve substantially intact the business organization of the Company and the Subsidiaries, to preserve the assets and properties of the Company and the Subsidiaries in good repair and condition, in each case in the ordinary course of business and in a manner consistent with past practice. By way of amplification and not limitation, except as expressly contemplated by any other provision of this Agreement or as set forth in Section 5.01 of the Company Disclosure Schedule, the Company agrees that neither the Company nor any Subsidiary shall, between the date of this Agreement and the Effective Time, directly or indirectly, do, or propose to do, any of the following without the prior written consent of Parent, which shall respond to a request for consent promptly but not later than five (5) days after receipt of a request, (provided, however, that with respect to Sections 5.01(h) pertaining to settlements or compromises, 5.01(i), 5.01(j), 5.01(k) and 5.01(l) such written consent shall not be unreasonably withheld):

(a) amend or otherwise change its Articles of Incorporation, Bylaws or other similar organizational documents;

(b) issue, sell, pledge, dispose of, grant, encumber, or otherwise subject to any Lien, or authorize such issuance, sale, pledge, disposition, grant or encumbrance of or subjection to such Lien, (i) any shares of any class of capital stock of the Company or any Subsidiary, or any options, warrants, convertible securities or other rights of any kind to acquire

any shares of such capital stock, or any other ownership interest (including any phantom interest), of the Company or any Subsidiary except for (A) the issuance of shares of Common Stock upon the exercise of Company Stock Options outstanding on the date of this Agreement; (B) the issuance of shares of Common Stock upon the exercise of Company Warrants outstanding on the date of this Agreement; or (ii) any Personal Property or other assets of the Company

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or any Subsidiary, except assets (other than Leased Properties) that are not material in the ordinary course of business and in a manner consistent with past practice;

(c) declare, set aside, make or pay any dividend or other distribution, payable in cash, stock, property or otherwise, with respect to any of its capital stock, except for dividends or other distributions by any Subsidiary only to the Company or any direct or indirect wholly owned Subsidiary;

(d) reclassify, combine, split, subdivide or redeem, or purchase or otherwise acquire, directly or indirectly, any capital stock of the Company or any Subsidiary;

(e) (i) acquire (including by merger, consolidation, or acquisition of stock or assets or any other business combination) any corporation, partnership, other business organization (or any division thereof) or any property or asset, except assets (including assets or accounts from suppliers, vendors or dealers) in the ordinary course of business and in a manner consistent with past practice; (ii) authorize, or make any commitment with respect to, any capital expenditure, other than maintenance expenditures at existing Leased Properties in the ordinary course of business and consistent with past practice; (iii) enter into any new line of business; or (iv) make investments in persons other than existing Subsidiaries;

(f) (i) increase the compensation payable or to become payable or the benefits provided to its current or former directors, officers or employees, except for increases in compensation for employees in the ordinary course of business and in a manner consistent with past practice, except for the payment of bonuses to employees relating to bonus, incentive plans or employment agreements as in effect on the date hereof, copies of which have been previously provided to Parent, and except for the renewal of such bonus or incentive plans in the ordinary course of business consistent with past practices if such plans can be terminated without penalty at the Effective Time (other than for the payment of incentive compensation or bonus compensation earned as of the time of such termination); provided, however, in no event shall bonuses of stock, stock options, stock appreciation rights or any items whose value is tied to the stock price of the Company be awarded pursuant to such plans; (ii) grant any retention, severance or termination pay (other than pursuant to the severance policy of the Company or its Subsidiaries as in effect on the date hereof, copies of which are set forth in Section 5.01(f) of the Company Disclosure Schedule) to, or enter into any employment, bonus, change of control or severance agreement with, any current or former director, officer or other employee of the Company or of any Subsidiary; (iii) establish, adopt, enter into, terminate or amend any Plan or establish, adopt or enter into any plan, agreement, program, policy, trust, fund or other arrangement that would be a Plan if it were in existence as of the date of this Agreement for the benefit of any director, officer or employee except as required by Law; or (iv) loan or advance any money or other property to any current or former director, officer or employee of the Company or the Subsidiaries;

(g) make any change (or file for such change) in any method of Tax accounting;

(h) make, change or rescind any material Tax election, file any amended Tax Return, except as described in Section 3.13(a) and as required by applicable Law, enter into any closing agreement relating to Taxes, waive or extend the statute of limitations in respect of Taxes (other than pursuant to extensions of time to file Tax Returns obtained in the ordinary course of business) or settle or compromise any material United States federal, state or local income Tax liability, audit, claim or assessment, or surrender any right to claim for a Tax Refund;

(i) pay, discharge, waive, settle or satisfy any claim, liability or obligation that is not an Action, other than the payment, discharge, waiver, settlement or satisfaction, in the ordinary course of business and consistent with past practice;

(j) waive, release, assign, settle or compromise any pending or threatened Action;

(k) other than in the ordinary course of business and in a manner consistent with past practice, (i) enter into, amend, modify or consent to the termination of (other than a termination in accordance with its terms) any Material Contract, or (ii) amend, waive, modify or consent to the termination of (other than a termination in accordance with its terms) the Company's or any Subsidiary's rights thereunder;

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provided, however, in no event shall the management services agreement between the Company and RPC Financial Advisors, LLC be amended or modified, even if such amendment or modification is in the ordinary course of business and consistent with past practice;

(l) make any expenditure in connection with any advertising or marketing, other than in the ordinary course of business and in a manner consistent with past practice;

(m) fail to maintain in full force and effect the existing insurance policies covering the Company and the Subsidiaries and their respective properties, assets and businesses;

(n) enter into, amend, modify or consent to the termination of any Contract that would be a Material Contract or transaction that would be required to be set forth in Section 3.15(a) of the Company Disclosure Schedule if in effect on the date of this Agreement;

(o) effectuate a plant closing or mass layoff, as those terms are defined in the Worker Adjustment and Retraining Notification Act of 1988;

(p) repurchase, repay or incur any Indebtedness (other than in connection with the lease of new vehicles or letters of credit in the ordinary course of business), or issue any debt securities or assume or endorse, or otherwise become responsible for, the obligations of any Person, or make any loans or advances, or grant any security interest in any of its assets, except for repayments of Indebtedness, in amounts and at times determined by the Company in its discretion, under that certain Credit Agreement dated as of June 7, 2005, as amended, among the Company and Wachovia Bank, National Association (the Credit Agreement), and except in the ordinary course of business and consistent with past practice;

(q) file any insurance claim except in the ordinary course of business and consistent with past practice; or

(r) announce an intention, enter into any formal or informal agreement or otherwise make a commitment, to do any of the foregoing.

Section 5.02 Conduct of Business by Parent and Merger Sub Pending the Merger.

Each of Parent and Merger Sub agrees that, between the date of this Agreement and the Effective Time, it shall not, directly or indirectly, (a) take any action to cause its representations and warranties set forth in Article IV to be untrue in any material respect; or (b) take any action that would reasonably be likely to materially delay the consummation of the Transactions.

ARTICLE VI

ADDITIONAL AGREEMENTS

Section 6.01 Preparation of Proxy Statement: Company Shareholders Meeting.

(a) The Company shall prepare and file with the SEC a proxy statement that has been reviewed by Parent, in preliminary form (the Proxy Statement), as soon as practicable following execution of this Agreement (with a goal of three (3) business days after execution of this Agreement) and the Company shall respond after notification and approval by the Parent of such response, as promptly as practical (with a goal of no later than three (3) business days) after receipt of any comments of the SEC with respect thereto. Parent and Merger Sub shall cooperate with the Company in connection with the preparation of the Proxy Statement, including, but not limited to, furnishing to the Company any and all information regarding Parent and Merger Sub and their respective Affiliates as may be required

to be disclosed therein as promptly as possible after the date hereof. The parties shall notify each other within one (1) business day of the receipt of any comments from the SEC or its staff and of any request by the SEC or its staff for amendments or supplements to the Proxy Statement or for additional information and shall supply each other with copies of all correspondence between such or any of its representatives, on the one hand, and the SEC or its staff, on the other hand, with respect to the Proxy Statement or the Merger.

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(b) If, at any time prior Shareholder Approval, any event occurs with respect to the Company, any Subsidiary, Parent or Merger Sub, or any change occurs with respect to other information to be included in the Proxy Statement, which is required to be described in an amendment of, or a supplement to, the Proxy Statement, the Company or Parent, as the case may be, shall within one business day notify the other party of such event and the Company shall promptly file, with Parent's cooperation, any necessary amendment or supplement to the Proxy Statement.

(c) The record date for determining the shareholders entitled to notice of or to vote at the Shareholders' Meeting (as defined below) shall be the date twelve (12) business days after execution of this Agreement (the Record Date). The Company shall notify the American Stock Exchange (AMEX) of the Record Date the day after execution of this Agreement. In the event the SEC has not cleared the Proxy Statement within fifty five (55) days of the Record Date then the Company's Board of Directors shall set a new record date, within one business day, which such new Record Date shall be twelve (12) business days later. The Company shall notify the AMEX within one business day of the setting of a new Record Date.

(d) The Company shall utilize its best efforts to on the next business day after the execution of this Agreement, mail written notice of this Transaction to all the holders of the Company Warrants in compliance with all warrant agreements.

(e) The Company shall utilize its best efforts to promptly following the receipt of the SEC's clearance of the Proxy Statement (with a goal of no later than three (3) business days after receipt of clearance), mail or otherwise deliver notice of a meeting of the holders of the Company Common Stock to all of such holders of Company Common Stock entitled to vote as of the Record Date (the Shareholders' Meeting) for the purpose of seeking the Shareholder Approval. The notice to Shareholders shall duly call a Shareholders' Meeting within twenty (20) days after the date the notice is mailed or otherwise delivered to the Shareholders. The notice shall also contain the cleared Proxy Statement. The Company shall, through the Company Board, recommend to holders of the Company Common Stock that they give the Shareholder Approval (the Company Recommendation), except to the extent that the Company Board shall have withdrawn or modified such recommendation, as permitted by and determined in accordance with Section 6.02.

(f) If the Parent determines in its sole discretion that any of the above timelines cannot be met then the Parent shall have the sole discretion to permit any one or more of the above time frames to be extended.

Section 6.02 No Solicitation of Transactions.

(a) The Company agrees that neither it nor any Subsidiary shall, nor shall it authorize or permit the Representatives of the Company or its Subsidiaries to, directly or indirectly: (i) initiate, solicit or encourage (including by way of furnishing information or assistance) any inquiries or the making of any proposal that constitutes, or may reasonably be expected to lead to, any Competing Transaction Proposal (as defined below), (ii) enter into discussions or negotiate with any Person or entity in furtherance of such inquiries or to obtain a Competing Transaction Proposal, (iii) enter into any agreement with respect to a Competing Acquisition Proposal, (iv) agree to or endorse any Competing Transaction Proposal, or (v) authorize any of the officers or directors of the Company or any of its Subsidiaries to take any such action, and the Company shall use its reasonable efforts to cause the directors, officers, employees, agents and representatives of the Company and its Subsidiaries (including, without limitation, any investment banker, financial advisor, attorney or accountant retained by the Company) not to take any such action. Nothing contained in this Section 6.02 shall prohibit the Board of Directors of the Company from furnishing information to, or entering into discussions or negotiations with, any Person or entity that makes an unsolicited, bona fide expression of interest in writing to enter into a Competing Transaction Proposal if: (A) the Board of Directors of the Company, after consultation with and advice from Akerman Senterfitt (or other outside counsel of recognized reputation), determines in good faith that the failure to do so is reasonably likely to result in a violation by the Board of Directors of its fiduciary duties to the Company's shareholders under applicable Law, (B) the Board of Directors of the Company has

no reason

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to believe that the expression of interest is not made in good faith, and (C) promptly after furnishing such information to, or entering into discussions or negotiations with, such Person or entity, the Company provides verbal notice within 48 hours and written notice within 72 hours to Parent to the effect that it plans to furnish information to, or enter into discussions or negotiations with, such Person or entity.

(b) For purposes of this Agreement, Competing Transaction Proposal shall mean any of the following involving the Company or any of its Subsidiaries (other than the transactions contemplated by this Agreement): (i) any merger, consolidation, share exchange, business combination, or other similar transaction; (ii) any direct or indirect sale, lease, exchange, mortgage, pledge, transfer or other disposition of substantially all of the assets of the Company and its Subsidiaries, taken as a whole, in a single transaction or a series of related transactions; or (iii) any tender offer (including a self-tender offer) or exchange offer for fifty (50%) or more of the outstanding shares of Common Stock of the Company or the filing of a registration statement under the Securities Act, in connection therewith.

(c) Notwithstanding any other provision of this Agreement, if the Board of Directors of the Company determines, in its good faith judgment, that a Competing Transaction Proposal is a Superior Acquisition Proposal (as defined below), the Board of Directors of the Company may terminate this Agreement; provided, that: (A) the Company provides at least five (5) business days prior written notice to the Parent of its intention to terminate this Agreement; (B) during such five (5) business day period (or longer period if extended by the Company and the Parent) (the Negotiation Period), the Company agrees to negotiate in good faith with the Parent regarding such changes as the Parent may propose to the terms of this Agreement, with the intent of enabling the Company to agree to a modification of this Agreement so that the transactions contemplated hereby may be consummated; and (C) after expiration of the Negotiation Period, the Competing Transaction Proposal remains a Superior Acquisition Proposal (taking into account any modifications to the terms hereof proposed by the Parent) and the Board of Directors of the Company confirms its determination (after consultation with outside legal counsel and its outside financial advisors) that such Competing Transaction Proposal is a Superior Acquisition Proposal; and (D) pay termination fee as provided in Section 8.02 of this Agreement. If the party making the Superior Acquisition Proposal comes forth with a further proposal, further notice pursuant to this Section shall be provided to Parent and there shall be an additional Negotiation Period pursuant to this Section.

(d) For purposes of this Agreement, Superior Acquisition Proposal means any bona fide, written Competing Transaction Proposal made by a third party, not solicited in violation of subsection 6.02(a), that is on terms that the Board of Directors of the Company reasonably determines in good faith (after consulting with its outside financial advisors) would after taking into account all the terms and conditions of the Competing Transaction Proposal including any breakup fees, expenses, reimbursement provisions and conditions (including but not limited to financial, legal or regulatory conditions) to consummate the transaction (A) result in a transaction that is more favorable, from a financial point of view, to the Company Shareholders than the transactions contemplated hereby if such Competing Transaction Proposal were to be consummated, (B) the Board of Directors reasonably believes that the Competing Transaction Proposal has a substantial likelihood of being consummated, and (C) for which financing, to the extent required, is evidenced by a financing commitment letter subject only to its terms, executed by a credible, nationally recognized lender of significant financial worth, or is from a person which, in the good faith reasonable judgment of the Board of Directors (after consultation with its outside financial advisors) is financially capable of consummating the proposal.

Section 6.03 Directors and Officers Indemnification.

(a) From and for six (6) years after the Effective Time, Parent shall indemnify, defend and hold harmless the present and former officers, directors and employees of the Company and its Subsidiaries (collectively, the Indemnified Parties) against all losses, expenses (including attorneys' fees and other expenses of investigation or litigation, including on appeal), claims, damages or liabilities arising out of actions or omissions occurring at or prior to the

Effective Time (including, without limitation, the transactions contemplated by this Agreement) in their capacity as present and former officers, directors and employees to the full extent permitted or required under the FBCA (including Section 607.0850 and

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subsection (7) thereof) or other applicable state Law and shall also advance expenses as incurred to the fullest extent permitted under the FBCA (including Section 607.0850 and subsection (7) thereof) or other applicable state Law, provided that the Person to whom expenses are advanced provides, if requested, the undertaking to repay such advances under the circumstances contemplated by the FBCA. Parent and Merger Sub agree that all rights to indemnification, including provisions relating to advances of expenses incurred in defense of any claim, action, suit, proceeding or investigation (a Claim), existing in favor of the Indemnified Parties as provided in the Company's or any Subsidiary's Articles of Incorporation, Bylaws or resolutions of their Boards of Directors, as in effect as of the date hereof, with respect to matters occurring prior to and through the Effective Time, shall survive the Merger and shall continue in full force and effect. Parent shall cause the Surviving Corporation to fulfill and honor in all respects such indemnification obligations in accordance with their terms. Subject to any limitation imposed from time to time under applicable Law, the provisions with respect to indemnification set forth in the Articles of Incorporation and Bylaws of the Surviving Corporation shall not be amended, repealed or otherwise modified for a period of six (6) years after the Effective Time in any manner that would adversely affect the rights thereunder of any Indemnified Person.

(b) Without limiting the foregoing, in the event any claim is brought against any Indemnified Party (whether arising before or after the Effective Time) after the Effective Time (i) such Indemnified Party may retain counsel satisfactory to it (subject to approval by Parent and the Surviving Corporation, which approval will not be unreasonably withheld), (ii) Parent and the Surviving Corporation shall pay all reasonable fees and expenses of such counsel for such Indemnified Party promptly as statements therefor are received, and (iii) Parent and the Surviving Corporation will use all reasonable efforts to assist in the vigorous defense of any such matter, provided that neither Parent nor the Surviving Corporation shall be liable for any settlement of any Claim effected without its written consent, which consent, however, shall not be unreasonably withheld. Any Indemnified Party wishing to claim indemnification under this Section 6.03, upon learning of any such Claim, shall notify Parent (but the failure so to notify Parent shall not relieve it from any liability for indemnification under this Section 6.03 which it may have except to the extent such failure materially prejudices Parent), and shall deliver to Parent, upon request, the undertaking, if any, contemplated by the FBCA in connection with the advance of expenses. To the extent that a Claim is brought against more than one Indemnified Party, such Indemnified Parties as a group may retain only one law firm to represent them with respect to each such matter unless there is, in the opinion of counsel to an Indemnified Party, under applicable standards of professional conduct, a conflict on any significant issue between the positions of any two or more Indemnified Parties.

(c) Immediately prior to the Effective Time the Company shall, at the direction of the Parent, purchase a non-cancelable extended reporting period endorsement under the Company's existing directors' and officers' liability insurance coverage for the Company's officers and directors (the Tail Policy) in the same form as presently maintained by the Company, which shall provide such officers and directors with coverage until the sixth anniversary of the Effective Time (the Tail Period) with not less than the existing coverage under, and have other terms not less favorable to the coverage presently maintained by the Company; provided, however, that Parent shall have the right to shop the insurance policy through their own insurance agent and cause the Company to purchase the insurance policy through the Parent's insurance agent if the policy can be purchased at a lower cost to the Company; provided, however, that Company may engage a qualified insurance consultant to confirm that such Tail Policy satisfies the above criteria; and, provided further, that Parent shall not be required to pay for the Tail Period, if the aggregate annual premium for the Tail Policy is in excess of two hundred fifty percent (250%) of the annual premium for the existing policy. In the event the premium for the Tail Policy exceeds two hundred and fifty percent (250%) of the annual premium for the existing policy the amount of coverage of the Tail Policy shall be reduced to the greatest amount of coverage that can be obtained for any annual premium for the existing policy. A copy of the proposed policy shall be provided to the Parent by the Company at least five (5) business days prior to Closing. A copy of a binder for such policy shall be provided to the Company prior to Closing.

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(d) This Section 6.03 shall survive the consummation of the Merger at the Effective Time, shall not be terminated or modified in such a manner as to adversely affect the Indemnified Parties, is intended to benefit the Company, the Surviving Corporation, the Indemnified Parties and their respective heirs, personal representatives, successors and assigns and shall be binding upon all successors and assigns of Parent, Merger Sub, the Company and the Surviving Corporation.

Section 6.04 Further Action; Reasonable Best Efforts.

(a) Upon the terms and subject to the conditions of this Agreement, each of the parties hereto agrees to use its reasonable best efforts to as soon as practicably possible (i) take, or cause to be taken, all appropriate action, and to do, or cause to be done, all things necessary, proper or advisable under applicable Law or otherwise to consummate and make effective the Transactions, and (ii) obtain from Governmental Authorities and third parties any consents, licenses, permits, waivers, approvals, authorizations or orders required to be obtained by Parent or the Company or any of their respective subsidiaries in connection with the authorization, execution and delivery of this Agreement.

(b) Subject to appropriate confidentiality protections, each of Parent and the Company shall have the right to review and approve in advance drafts of all applications, notices, petitions, filings and other documents made or prepared in connection with the items described in clauses (a) and (b) above, which approval shall not be unreasonably withheld or delayed, shall cooperate with each other in connection with the making of all such filings, shall furnish to the other party such necessary information and assistance as such other party may reasonably request with respect to the foregoing and shall provide the other party with copies of all filings made by such party with any applicable Government Authority, and, upon request, any other information supplied by such party to a Governmental Authority in connection with this Agreement and the Transactions.

(c) Merger Sub, the Company, and Parent shall use their respective reasonable best efforts to obtain any third party consents (i) necessary, proper or advisable to consummate the Transactions, (ii) disclosed in the Company Disclosure Schedule or (iii) required to prevent a Company Material Adverse Effect from occurring prior to the Effective Time. In the event that the Company shall fail to obtain any third party consent described above, the Company shall use its reasonable best efforts, and shall take such actions as are reasonably requested by Parent, to minimize any adverse effect upon the Company and Parent and their respective businesses resulting, or which could reasonably be expected to result, after the Effective Time, from the failure to obtain such consent. In addition, at the request of Parent, the Company shall use its reasonable best efforts to assist Parent in obtaining any estoppel certificates from any ground lessor under the ground leases underlying the Leased Properties.

(d) Notwithstanding anything to the contrary in this Agreement, in connection with obtaining any approval or consent from any Person (other than a Governmental Authority) with respect to the Merger or any other Transaction, (i) without the prior written consent of Parent which shall not be unreasonably withheld, none of the Company or any of its Subsidiaries shall pay or commit to pay to such Person whose approval or consent is being solicited any cash or other consideration, make any commitment or incur any liability or other obligation due to such Person and (ii) none of Parent, Merger Sub or their respective affiliates shall be required to pay or commit to pay to such Person whose approval or consent is being solicited any cash or other consideration, make any commitment or to incur any liability or other obligation.

(e) The Company and the Subsidiaries will (i) permit Parent and Lenders and their respective representatives to have reasonable access, during normal business hours and upon at least twenty-four (24) hours prior written notice describing the type of access requested, to the Company and the Subsidiaries (with the goal of minimizing disruptions to Company's operations); (ii) shall provide copies of any documents, books, records, contracts, policies etc. requested by Parent or Lender within two (2) business days, if reasonably practical to do so, and (iii) shall provide to Parent, the Lenders and their respective representatives (x) within thirty (30) days following the end of each fiscal month during

the period beginning on the execution of this Agreement and ending at the Effective Time, Middleton Pest Control Inc. s unaudited balance sheet, related statements of operations and income (loss) and cash flow

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statement with respect to such prior fiscal month and (y) such other information or documents ordinarily produced by the Company (financial or otherwise) with respect to the Company and its Subsidiaries as Parent and the Lenders may reasonably request, including, without limitation, any weekly operating metrics and other key financial measures used to operate the business of the Company and its Subsidiaries in the ordinary course.

Section 6.05 Obligations of Parent and Merger Sub.

Parent shall take all action necessary to cause Merger Sub to perform its obligations under this Agreement and to consummate the Transactions on the terms and subject to the conditions set forth in this Agreement.

Section 6.06 Public Announcements.

The initial press release relating to this Agreement shall be a joint press release the text of which has been agreed to by each of Parent and the Company. Thereafter, each of Parent and the Company shall consult in good faith with each other before issuing any press release or otherwise making any public statements with respect to this Agreement or any of the Transactions and shall not issue any such press release or make any such public statement, except, in the opinion of counsel for Parent or the Company (as the case may be) as may be required by applicable Law or the requirements of any applicable securities exchange, in which case the issuing party shall use its reasonable best efforts to consult with the other party before issuing any press release or making any such public statements.

Section 6.07 Transfer Taxes.

The Company and Parent shall cooperate in the preparation, execution and filing of all returns, questionnaires, applications or other documents regarding any sales, transfer, stamp, stock transfer, value added, use, real property transfer or gains and any similar Taxes which become payable in connection with the transactions contemplated by this Agreement. Each of Parent and the Surviving Corporation agrees to assume liability for and pay any sales, transfer, stamp, stock transfer, value added, use, real property transfer or gains and any similar Taxes, as well as any transfer, recording, registration and other fees that may be imposed upon, payable or incurred in connection with this Agreement and the Transactions.

Section 6.08 Resignations.

The Company shall use its reasonable best efforts to obtain and deliver to Parent at the Closing evidence reasonably satisfactory to Parent of the resignation effective as of the Effective Time, of the directors and such officers of the Company and the Subsidiary selected for resignation by Parent. To the extent any officer of the Company and/or Subsidiary has an employment, severance, termination or stay bonus agreement, and is selected for resignation by Parent such resignations shall be deemed under each of such agreements to be a termination by the Company without Good Cause (as that term is defined in the agreements listed as items 1 and 2 of Section 3.10(b) of the Company Disclosure Schedule) and in accordance with Section 5 of such agreements, notice of termination shall be deemed given to such officer on the Effective Date, or a termination other than for Cause (as defined in the agreement listed as item 3 of Section 3.10(b) of the Company Disclosure Schedule) and any and all amounts due for salary, reimbursements, vacation pay, severance or other amounts due pursuant to such agreements to any such officer shall be paid in cash by Parent to such officer at Closing if such officer waives the sixty (60) day notice requirement for termination under his employment or severance agreement, otherwise such payments shall be made post Closing in accordance with the terms of such employment or severance agreement. In the event the Parent does not select an officer of the Company or the Subsidiary for resignation or such officer does not waive any such notice provisions, Parent shall and shall cause the Surviving Corporation to honor such agreements and the terms thereof.

Section 6.09 Employment and Benefit Arrangements.

(a) Parent agrees that individuals who are employed by the Company or any of Subsidiaries immediately prior to the Closing Date (each such employee, an Affected Employee) shall remain employees of the Surviving Corporation or such Subsidiaries as of the Effective Time, except to the extent such individuals voluntarily terminate their

employment or terminate on account of death, retirement or disability; provided, however, that nothing contained herein shall confer upon any Affected Employee the right to continued employment by the Surviving Corporation or any of its Subsidiaries for any period of time after the Effective Time which is not otherwise required by Law or Contract.

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(b) From and after the Effective Time, Parent shall cause the Surviving Corporation to honor all employment, collective bargaining, severance, termination and retirement agreements to which the Company or a Subsidiary is a party, as such agreements are in effect on the date hereof and shall take no steps to breach or not honor the terms of such agreements.

(c) For a one year period following the Effective Time, Parent shall cause the Surviving Corporation to provide those Affected Employees who are employees of the Surviving Corporation or a Subsidiary at the Effective Time with benefits that are, in the aggregate, substantially comparable and no less favorable to such employees as are the benefits of the Company available to such employees immediately prior to the Effective Time (collectively the Continuing Benefits). Parent shall cause any eligible expenses incurred by any Affected Employee and his or her covered dependents to be taken into account in connection with Continuing Benefits for purposes of satisfying all applicable deductible, coinsurance and maximum out-of-pocket requirements applicable to such Affected Employee and his or her covered dependents for the applicable plan year as if such amounts had been paid in accordance with such Continuing Benefits. In addition, Parent shall cause all pre-existing condition exclusions and actively-at-work requirements to be waived for such Affected Employee and his or her covered dependents, to the extent such conditions were inapplicable or waived with respect to Affected Employee participated immediately prior to the Effective Time.

(d) Parent shall take all actions required so that eligible employees of the Company or any Subsidiary shall receive service credit for purposes of Continuing Benefits and under Parent's vacation, severance programs, pension plans and post-retirement welfare benefit plans, for the duration of their service with the Company and any Subsidiary (including, where applicable, past service credit with other entities recognized by the Company or its Subsidiaries prior to the date of this Agreement).

ARTICLE VII

CONDITIONS TO THE MERGER

Section 7.01 Conditions to the Obligations of Each Party.

Subject to waiver as set forth in Section 8.04, the respective obligations of the Company, Parent and Merger Sub to consummate the Merger are subject to the satisfaction at or prior to the Closing Date of the following conditions:

(a) Company Shareholder Approval. This Agreement shall have received Shareholder Approval.

(b) No Order. No Governmental Authority shall have enacted, issued, promulgated, enforced or entered any Law, rule, regulation, judgment, decree, executive order or award which is then in effect and has the effect of making the Merger illegal or otherwise prohibiting consummation of the Merger.

(c) Other Government Approvals or Notices. All consents, waivers, approvals and authorizations required to be obtained, and all filings or notices required to be made, by Parent and Merger Sub and the Company or any Subsidiary prior to the Closing (other than the filing and recordation of merger documents in accordance with the FBCA) shall have been obtained from and made with all required Governmental Authorities, except for such consents, waivers, approvals or authorizations which the failure to obtain, or such filings or notices which the failure to make, would not have a Company Material Adverse Effect prior to or after the Effective Time or be reasonably likely to subject the Company, Parent, Merger Sub or any of their respective Subsidiaries or any of their respective officers or directors to any penalties or criminal liability.

Section 7.02 Conditions to the Obligations of Parent and Merger Sub.

Subject to waiver as set forth in Section 8.04, the obligations of Parent and Merger Sub to consummate the Merger are also subject to the satisfaction at or prior to the Closing Date of the following conditions:

(a) Representations and Warranties. (i) The representations and warranties of the Company contained in this Agreement not qualified by a materiality or Company Material Adverse Effect qualifier shall be true and correct in all material respects, and (ii) the representations and warranties of the Company contained in this Agreement qualified by a materiality or Company Material Adverse Effect qualifier

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shall be true and correct in all respects, in the case of both (i) and (ii) above as of the date of this Agreement and as of the Closing Date, as though made on and as of the Closing Date or, to the extent representations and warranties speak as of an earlier date as of such earlier date. In addition, the representations and warranties set forth in Section 3.03 (Capitalization) shall be true and correct in all respects as of the Closing Date, as though made on and as of the Closing Date, except for changes to capitalization due to the exercise or termination of Company Stock Options listed on Schedule 3.03(b).

(b) Agreements and Covenants. The Company shall have performed or complied in all material respects with all agreements and covenants required by this Agreement to be performed or complied with by it on or prior to the Closing Date; provided, however the Company shall have performed in all respects with respect to the timelines set forth in Section 6.01.

(c) Officer's Certificate. The Company shall have delivered to Parent a certificate, dated the date of the Closing, signed by an officer of the Company and certifying as to the satisfaction of the conditions specified in Sections 7.02(a) and 7.02(b).

Section 7.03 Conditions to the Obligations of the Company.

Subject to waiver as set forth in Section 8.04, the obligations of the Company to effect the Merger are also subject to the satisfaction at or prior to the Closing Date of the following conditions:

(a) Representations and Warranties. Each of the representations and warranties of Parent and Merger Sub that are qualified by materiality shall be true and correct in all respects, and the representations and warranties of Parent and Merger Sub contained in this Agreement that are not so qualified shall be true and correct in all material respects, in each case as of the date of this Agreement and as of the Closing Date, as though made on and as of the Closing Date, except to the extent expressly made as of an earlier date, in which case as of such earlier date.

(b) Agreements and Covenants. Parent and Merger Sub shall have performed or complied in all material respects with all agreements and covenants required by this Agreement to be performed or complied with by it on or prior to the Closing Date.

(c) Officer's Certificate. Parent and Merger Sub each shall have delivered to the Company a certificate, dated the date of the Closing, signed by an officer, certifying as to the satisfaction of the conditions specified in Sections 7.03(a) and 7.03(b).

(d) Available Funds. Parent has or will have sufficient funds at the Closing (a) to satisfy any and all of Parent's and Merger Sub's obligations arising under or out of the Agreement, including without limitation the obligations of Article II, (b) to the extent necessary, refinance the outstanding indebtedness of the Company, and (c) pay any and all of its fees and expenses in connection with the Merger or the financing thereof.

ARTICLE VIII

TERMINATION, AMENDMENT AND WAIVER

Section 8.01 Termination.

This Agreement may be terminated and the Merger and the other Transactions may be abandoned at any time prior to the Effective Time by action taken or authorized by the Board of Directors of the terminating party or parties, notwithstanding any Shareholder Approval, and whether before or after the shareholders of the Company have approved this Agreement at the Company Shareholders' Meeting, as follows:

(a) by mutual written consent of Parent and the Company;

(b) by either Parent or the Company if the Effective Time shall not have occurred on or before 150 days after the date of this Agreement, provided, however, that the right to terminate this Agreement under this Section 8.01(b) shall not be available to any party whose failure to fulfill any obligation under this Agreement has been the cause of, or resulted in, the failure of the Effective Time to occur on or before such date;

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(c) by either Parent or the Company if any Governmental Authority shall have enacted, issued, promulgated, enforced or entered any injunction, order, decree or ruling (whether temporary, preliminary or permanent) or taken any other action (including the failure to have taken an action) which has become final and non-appealable and has the effect of making consummation of the Merger illegal or otherwise preventing or prohibiting consummation of the Merger;

(d) by Parent, if neither Parent nor Merger Sub is in material breach of its obligations under this Agreement, and if (i) any of the representations and warranties of the Company herein become untrue or inaccurate such that Section 7.02(a) would not be satisfied, or (ii) there has been a breach on the part of the Company of any of its covenants or agreements herein such that Section 7.02(b) would not be satisfied, and, in either such case, such breach (if curable) has not been cured within 30 days after written notice to the Company; provided, however, the cure period shall not apply to the timelines specified in Section 6.01;

(e) by the Company if the Company is not in material breach of its obligations under this Agreement, and if (i) any of the representations and warranties of Parent or Merger Sub herein become untrue or inaccurate such that Section 7.03(a) would not be satisfied, or (ii) there has been a breach on the part of Parent or Merger Sub of any of its covenants or agreements herein such that Section 7.03(b) would not be satisfied, and, in either such case, such breach (if curable) has not been cured within 30 days after written notice to Parent;

(f) by either Parent or the Company if this Agreement shall fail to receive the requisite vote for approval by the Shareholders of the Company at the Shareholders Meeting; or

(g) by the Company in accordance, and in compliance, with the termination rights set forth in Section 6.02(c).

The party desiring to terminate this Agreement pursuant to Section 8.01 shall give notice of such termination and the provisions of Section 8.01 being relied on to terminate this Agreement to the other party.

Section 8.02 Effect of Termination.

In the event of the termination of this Agreement pursuant to Section 8.01, except as provided in Section 2.07, there shall be no liability under this Agreement on the part of any party hereto; provided, however, in the event any party willfully breaches any representations, warranties, covenants or agreements as set forth in this Agreement, the non-breaching party shall be entitled to pursue any of its remedies at law or in equity. Notwithstanding the foregoing, in the event that this Agreement is terminated, pursuant to the provisions of Section 8.01(g), the Company shall pay to the Parent \$2,750,000, if terminated on or before November 15, 2009 and shall pay to the Parent up to \$3,500,000 if terminated after November 15, 2009, which payment shall be made within six (6) months from the date of such termination, in full satisfaction of all costs, expenses, damages and claims that the Parent would have under the terms of this Agreement or the Confidentiality Agreement and shall be Parent's and Merger Sub's sole and exclusive remedy for Company's termination of this Agreement pursuant to Section 8.01(g), and thereafter the parties shall be released from all further obligations under or pursuant to the terms of this Agreement. In the event this Agreement is terminated pursuant to Section 8.01(g) after November 15, 2009, the amount paid to Parent shall be equal to the sum of \$2,750,000 plus the actual cost of Lender's fees paid by Parent to extend the termination date of the Financing Letters beyond November 15, 2009, or to close such financing up to \$3,500,000.

Section 8.03 Amendment.

This Agreement may be amended by the parties hereto by action taken by or on behalf of their respective Boards of Directors at any time prior to the Effective Time; provided, however, that, after the adoption of this Agreement and the Transactions by the shareholders of the Company, no amendment shall be made except as allowed under applicable Law. This Agreement may not be amended except by an instrument in writing signed by each of the parties hereto.

Section 8.04 Waiver.

At any time prior to the Closing Date, any party hereto may (a) extend the time for the performance of any obligation or other act of any other party to be performed for the benefit of the waiving party, (b) waive any inaccuracy in the representations and warranties of any other party contained herein or in any document delivered pursuant hereto and (c) waive compliance by any other party with any

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agreements or conditions compliance with which is for the benefit of the waiving party contained in this Agreement (to the extent permitted by Law). Any such extension or waiver shall be valid if set forth in an instrument in writing signed by the party or parties to be bound thereby. The failure of any party to assert any of its rights under this Agreement or otherwise shall not constitute a waiver of those rights.

Section 8.05 Fees and Expenses.

(a) All Expenses incurred by the parties shall be paid at Closing by Parent.

(b) Expenses as used in this Agreement shall include all reasonable out-of-pocket expenses (including without limitation, all fees and expenses of counsel, investment bankers, accountants, financial advisors, experts and consultants to a party and its affiliates) incurred by a party or on its behalf in connection with or related to the authorization, preparation, negotiation, execution and performance of this Agreement, the solicitation of shareholder approvals and all other matters related to the closing of the Transactions.

ARTICLE IX

GENERAL PROVISIONS

Section 9.01 Nonsurvival of Representations and Warranties: Disclosure Schedule.

None of the representations, warranties, covenants and agreements in this Agreement or in any instrument delivered pursuant to this Agreement, nor any rights arising out of any breach of such representations, warranties, covenants and agreements, shall survive the Effective Time, except for those covenants and agreements contained herein that by their terms apply or are to be performed in whole or in part after the Effective Time. The inclusion of any information in the Company Disclosure Schedule shall not be deemed to be an admission or acknowledgment, in and of itself, that such information is required by the terms hereof to be disclosed, is material, has resulted in or is reasonably likely to result in a Material Adverse Effect on the applicable party or is outside the ordinary and usual course of business.

Section 9.02 Notices. All notices, requests, claims, demands and other communications hereunder shall be in writing and shall be given (a) on the date of delivery if delivered personally, (b) on the first business day following the date of dispatch if delivered by a nationally recognized next day courier service, (c) on the fifth business day following the date of mailing if delivered by registered or certified mail (postage prepaid, return receipt requested) or (d) if sent by facsimile or email transmission, when transmitted and receipt is confirmed. All notices hereunder shall be delivered to the respective parties at the following addresses (or at such other address for a party as shall be specified in a notice given in accordance with this Section 9.02):

If to Parent or Merger Sub:
Massey Services, Inc
315 Groveland Street
Orlando, FL 32804
Attn: Harvey Massey, Chairman

with a copy to:
Shuffield, Lowman & Wilson, P.A.
1000 Legion Place, Suite 1700
Orlando, FL 32801
Attn: William R. Lowman, Jr.

if to the Company:

Sunair Services Corporation
1350 Newport Center Drive, Suite 201
Deerfield Beach, FL 33442
Attn: President

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with a copy to:

Akerman Senterfitt
1 SE Third Avenue, Suite 2800
Miami, Florida 33131
Attn: Stephen K. Roddenberry

Section 9.03 Certain Definitions.

(a) For purposes of this Agreement:

Affiliate of a specified Person means a Person who, directly or indirectly through one or more intermediaries, controls, is controlled by, or is under common control with, such specified Person.

Business day means any day on which the principal offices of the SEC in Washington, D.C. are open to accept filings, or, in the case of determining a date when any payment is due, any day on which banks are not required or authorized to close in The City of New York.

Closing Payment Amount means \$36,007,367

Company Material Adverse Effect means any event, circumstance, development, change or effect that, individually or in the aggregate with all other events, circumstances, developments, changes and effects, is materially adverse to the business, assets, financial condition, or results of operations of the Company and the Subsidiaries taken as a whole or would reasonably be expected to prevent or materially delay the consummation of the Transactions or prevent or materially impair or delay the ability of the Company to perform its obligations hereunder, other than (i) the occurrence of any or all of the changes or events described in Section 3.08 of the Company Disclosure Schedule, and (ii) those reasonably resulting solely from the execution of this Agreement, the observance of its terms, or the announcement of the consummation of the Transactions, including but not limited to any adjustments to the Company's intangible assets.

Control (including the terms controlled by and under common control with) means the possession, directly or indirectly, or as trustee or executor, of the power to direct or cause the direction of the management and policies of a Person, whether through the ownership of voting securities, as trustee or executor, by contract or credit arrangement or otherwise.

Debt means the Indebtedness of the Company as of the Closing Date, including but not limited to, indebtedness pursuant to (i) the Credit Agreement and any prepayment penalty due thereunder; (ii) Company acquisition subordinated debt liability; (iii) vehicle leases; or (iv) professional fees and other Expenses (other than as otherwise provided for in this Agreement) including, without limitation, legal fees and expenses, and investment banking fees (whether or not any of the foregoing are paid as of the Closing Date).

Exchange Act means the Securities and Exchange Act of 1934, as amended.

Indebtedness means (A) indebtedness for borrowed money (excluding any interest thereon), secured or unsecured, (B) obligations under conditional sale or other title retention Contracts relating to purchased property, (C) capitalized lease obligations, (D) obligations under interest rate cap, swap, collar or similar transactions or currency hedging transactions (valued at the termination value thereof), and (E) guarantees of any of the foregoing of any other Person.

Knowledge of the Company or Company's knowledge means the actual knowledge of the Chairman of the Board, President, Chief Executive Officer, Chief Operating Officer, or Chief Financial Officer of the Company and

Subsidiary, in each case after review of such Person's own files and inquiry of those executives of the Company and Subsidiary who would reasonably be expected to have knowledge of the specific matter at issue.

Lien means any mortgage, pledge, lien, encumbrance, charge or other security interest.

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Material Contracts shall mean with respect to any Person, all contracts, agreements and understandings that are material within the meaning set forth in Item 601(b)(10) of Regulation S-K of Title 17, Part 229 of the Code of Federal Regulations and are still in effect and shall also include (i) any contract or agreement that provides for payment to the Company or Subsidiaries for the performance of services in an amount in excess of \$150,000 annually; (ii) any contract or agreement requiring payments by the Company or Subsidiaries in excess of \$150,000 annually; (iii) any guarantee in respect of any Indebtedness or obligation of the Company or Subsidiaries; (iv) any contract or agreement limiting the ability of the Company or Subsidiaries to engage in any line of business or to compete with any Person; (v) any contract or agreement limiting the ability of any Person to engage in any line of business or to compete with the Company or Subsidiaries (vi) any contract or agreement under which the Company or Subsidiaries has borrowed or loaned money in excess of \$150,000, or any mortgage, note, bond, indenture or other evidence of Indebtedness (excluding advances, deposits, trade payables in the ordinary course of business); (vii) any joint venture, partnership or other similar joint ownership agreements; (viii) any contract, agreement or consent decree of Governmental Authority to which the Company or Subsidiaries are bound; (ix) any employment, severance, change of control or golden parachute contract of an Employee of the Company or Subsidiaries; and (x) any contract or agreement (A) granting or obtaining any right to use any material Intellectual Property rights (other than contracts granting rights to use readily available commercial software available to consumers for a combined license and maintenance fee of less than \$150,000 per year or subject to shrink wrap or click through license agreements) or (B) restricting the right of the Company or permitting any third Person to use any material intellectual property rights.

Permitted Investment means any obligation of investment grade status.

Permitted Liens means with respect to any assets of the Company (i) mechanic's, materialmen's and similar liens with respect to amounts not past due, (ii) liens for income Taxes or other Taxes not yet due and payable or for income Taxes or other Taxes that the taxpayer is contesting in good faith pursuant to proceedings disclosed on the Company Disclosure Schedule, (iii) purchase money liens arising by operation of law (including liens on inventory and other assets in favor of vendors of the Company) and (iv) liens securing rental payments under capital lease arrangements disclosed on the Company Disclosure Schedule.

Person means an individual, corporation, partnership, limited partnership, limited liability company, syndicate, person (including a person as defined in Section 13(d)(3) of the Exchange Act), trust, association, entity, government, or political subdivision, agency or instrumentality of a government.

Representatives means any officer, director, investment banker, attorney, accountant, consultant or advisor.

SEC means the Securities and Exchange Commission.

Securities Act means the Securities Act of 1933, as amended.

Subsidiary or Subsidiaries of a Person means an entity controlled by such Person, directly or indirectly, through one or more intermediaries, and, without limiting the foregoing, includes any entity in respect of which such Person, directly or indirectly, beneficially owns 50% or more of the voting securities or equity. Unless otherwise indicated Subsidiary means subsidiary of the Company.

Termination Date means, the date this Agreement is terminated pursuant to Section 8.01.

Total Common Shares Outstanding means, as of the Closing Date, all issued and outstanding shares of Common Stock plus all shares of Common Stock to be issued or deemed issued upon exercise of any Common Stock Option or Company Warrant by virtue of Section 2.06 as of the Effective Time, minus any shares of Common Stock to be cancelled pursuant to Section 2.01(b).

Transactions means the Merger and the other transactions contemplated by this Agreement.

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(b) The following terms have the meaning set forth in the Sections set forth below:

Defined Term	Location of Definition
Action	ss. 3.09
Affected Employee	ss. 6.09(a)
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(c) When a reference is made in this Agreement to Sections, Schedules or Exhibits, such reference shall be to a Section, Schedule or Exhibit of this Agreement, respectively, unless otherwise indicated. Whenever the words include, includes or including are used in this Agreement, they shall be deemed to be followed by the words without limitation. The words hereof, herein and hereunder and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not any particular provision of this Agreement. The term or is not exclusive. The definitions contained in this Agreement are applicable to the singular as well as the plural forms of such terms. References to a Person are also to its permitted successors and assigns. Whenever the context may require, any pronoun shall include the corresponding masculine, feminine and neuter forms.

Section 9.04 Severability.

If any term or other provision of this Agreement is finally adjudicated by a court of competent jurisdiction to be invalid, illegal or incapable of being enforced by any rule of Law, or public policy, all other conditions and provisions of this Agreement shall nevertheless remain in full force and effect so long as the economic or legal substance of the Transactions is not affected in any manner materially adverse to any party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in a mutually acceptable

manner in order that the Transactions be consummated as originally contemplated to the fullest extent possible.

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Section 9.05 Disclaimer of Other Representations and Warranties.

Parent, Merger Sub and the Company each acknowledges and agrees that, except for the representations and warranties expressly set forth in this Agreement (a) no party makes, and has not made, any representations or warranties relating to itself or its businesses or otherwise in connection with the Transactions, (b) no Person has been authorized by any party to make any representation or warranty relating to itself or its businesses or otherwise in connection with the Transactions and, if made, such representation or warranty must not be relied upon as having been authorized by such party, and (c) any estimates, projections, predictions, data, financial information, memoranda, presentations or any other materials or information provided or addressed to any party or any of its Representatives are not and shall not be deemed to be or to include representations or warranties unless any such materials or information is the subject of any representation or warranty set forth in this Agreement.

Section 9.06 Entire Agreement: Assignment.

This Agreement (together with the Confidentiality Agreement, Company Disclosure Schedule, and the other documents delivered pursuant hereto), constitutes the entire agreement among the parties hereto with respect to the subject matter hereof and thereof and supersedes all prior agreements and undertakings, both written and oral, among the parties hereto, or any of them, with respect to the subject matter hereof and thereof. This Agreement shall not be assigned (whether pursuant to a merger, by operation of law or otherwise) without the prior written consent of the other parties hereto, except that Parent and Merger Sub may assign all or any of their rights, but not their obligations, hereunder to any direct or indirect wholly owned subsidiary of Parent.

Section 9.07 Parties in Interest.

This Agreement shall be binding upon and inure solely to the benefit of each party hereto, and nothing in this Agreement, express or implied, is intended to or shall confer upon any other Person any right, benefit or remedy of any nature whatsoever under or by reason of this Agreement, other than (i) Section 6.03 which is intended to be for the benefit of the persons covered thereby and may be enforced by such persons, and (ii) Article II which is intended to be for the benefit of those persons entitled to receive the Merger Consideration, to the extent that their right to receive such payment may be enforced by such persons after the Closing Date.

Section 9.08 Remedies: Specific Performance.

The parties hereto agree that upon a breach of any of the terms or provisions of this Agreement then in addition to any remedies available at law or equity the Parent, Merger Sub and Company shall have the right to seek specific performance of the terms hereof, to the extent available under applicable Law.

Section 9.09 Governing Law.

This Agreement shall be governed by, and construed in accordance with, the laws of the State of Florida applicable to contracts executed in and to be performed in that State, regardless of the laws that might otherwise govern under applicable principles of conflicts of law. All Actions arising out of or relating to this Agreement shall be heard and determined exclusively in the Circuit Court of Orange County, Florida. The parties hereto hereby (a) submit to the exclusive jurisdiction of the Circuit Court of Orange County, Florida for the purpose of any Action arising out of or relating to this Agreement brought by any party hereto, and (b) irrevocably waive, and agree not to assert by way of motion, defense, or otherwise, in any such Action, any claim that it is not subject personally to the jurisdiction of the above-named court, that its property is exempt or immune from attachment or execution, that the Action is brought in an inconvenient forum, that the venue of the Action is improper, or that this Agreement or the Transactions may not be enforced in or by the above-named court.

Section 9.10 Headings.

The descriptive headings contained in this Agreement are included for convenience of reference only and shall not affect in any way the meaning or interpretation of this Agreement.

Section 9.11 Counterparts.

This Agreement may be executed and delivered (including by facsimile transmission) in one or more counterparts, and by the different parties hereto in separate counterparts, each of which when executed shall be deemed to be an original but all of which taken together shall constitute one and the same agreement.

[SIGNATURES ON NEXT PAGE]

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IN WITNESS WHEREOF, Parent, Merger Sub and the Company have caused this Agreement to be executed as of the date first written above by their respective officers thereunto duly authorized.

SUNAIR SERVICES CORPORATION

By /s/ Jack I. Ruff

Jack I. Ruff,
President and Chief Executive Officer

MASSEY SERVICES, INC.

By /s/ Harry L. Massey

Name: Harry L. Massey

Title: Chairman and CEO

BUYER ACQUISITION COMPANY, INC.

By /s/ Harry L. Massey

Name: Harry L. Massey

Title: Chairman and CEO

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Annex B

[Letterhead of Hyde Park Capital]

September 28, 2009

Special Committee of the Board of Directors
Sunair Services Corporation
1350 E. Newport Center Drive
Suite 201
Deerfield Beach, FL 33442

Members of the Special Committee of the Board:

You have asked us for our opinion as to the fairness, from a financial point of view, to the holders of the common stock, par value \$0.10 per share (Sunair Common Stock), of Sunair Services Corporation (Sunair or the Company), of the Consideration (as defined below) to be received by such holders pursuant to the terms of the draft Agreement and Plan of Merger, dated as of September 28, 2009 (the Agreement), among Massey Services, Inc. (Massey or Acquiror), Buyer Acquisition Company, Inc. (Merger Sub) and Sunair Services Corporation. The Agreement provides for, among other things, the merger of Merger Sub with and into the Company upon which the Company would become a wholly owned subsidiary of Massey (the Merger), pursuant to which each outstanding share of Sunair Common Stock will be converted into the right to receive \$2.75 in cash (the Consideration).

In arriving at our opinion, we have:

1. reviewed the Agreement;
2. reviewed certain publicly available business and financial information relating to Sunair;
3. reviewed certain other information relating to Sunair provided to or discussed with us by the Company, including (i) financial forecasts relating to the Company and (ii) certain industry and business information thereto prepared by the management of the Company;
4. discussed the past and present operations and financial condition and the prospects of the Company with senior executives of Sunair;
5. reviewed and compared the historical stock prices, multiples, margins, growth rates and trading history for the shares of Sunair, and compared that data with similar data for other publicly held companies in businesses we deemed relevant in evaluating Sunair;
6. considered, to the extent publicly available, the financial terms of certain other merger or acquisition transactions, including premiums paid for public companies, which we deemed to be relevant, which have been effected or announced;
7. considered our experience in connection with marketing the Company for sale to a large group of potential strategic and financial buyers;
8. considered such other information, financial studies, analyses and investigations and financial, economic and market criteria which we deemed relevant.

In connection with our review, we have not independently verified any of the foregoing information and we have assumed and relied upon such information being complete and accurate in all material respects. With respect to the financial forecasts for Sunair that we have used in our analyses, the management of Sunair has advised us, and we have assumed, with your consent, that such forecasts have been reasonably prepared on bases reflecting the best currently available estimates and judgments of the management of Sunair as to the future financial performance of the Company both before and after giving effect to certain industry and business information referred to above. We also have assumed, with your consent, that, in the course of obtaining any regulatory or third party consents, approvals or agreements in connection with the Merger, no delay, limitation, restriction or condition will be imposed that would have an adverse effect on Sunair or the

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Merger and that the Merger will be consummated in accordance with the terms of the Agreement without waiver, modification or amendment of any material term, condition or agreement thereof. In addition, we have not been requested to make, and have not made, an independent appraisal of the assets or liabilities (contingent or otherwise) of Sunair, nor have we been furnished with any such evaluations or appraisals.

Our opinion addresses only the fairness, from a financial point of view and as of the date hereof, to the holders of Sunair Common Stock of the Consideration to be received in the Merger and does not address any other aspect or implication of the Merger or any other agreement, arrangement or understanding entered into in connection with the Merger or otherwise or the fairness of the amount or nature of, or any other aspect relating to, any compensation to any officers, directors or employees of any party to the Merger, or class of such persons, relative to the Consideration or otherwise. The issuance of this opinion was approved by our authorized internal committee.

Our opinion is necessarily based upon information made available to us as of the date hereof and financial, economic, market and other conditions as they exist and can be evaluated on the date hereof. These conditions have been and remain subject to extraordinary levels of volatility and uncertainty and we express no view as to the impact of such volatility and uncertainty on Sunair or the Merger. Our opinion does not address the relative merits of the Merger as compared to alternative transactions or strategies that might be available to Sunair, nor does it address the underlying business decision of Sunair to proceed with the Merger.

We have acted as financial advisor to Sunair in connection with the Merger and will receive a fee for our services, a significant portion of which is contingent upon the consummation of the Merger. We also will receive a fee upon the rendering of our opinion. In addition, Sunair has agreed to indemnify us for certain liabilities and other items arising out of or related to our engagement. We may in the future provide financial advice and services, to Sunair, Massey and their respective affiliates for which we would expect to receive compensation. We have no previous business agreements or relationships with either Sunair or Massey.

In arriving at this opinion, we did not attribute any particular weight to any analysis or factor considered, but rather made the qualitative judgments as to the significance and relevance of each analysis and factor. Accordingly, we believe that our analysis must be considered as a whole and that selecting portions of the analyses, without considering all analyses, would create an incomplete view of the process underlying this opinion.

It is understood that this letter is for the information of the Special Committee of the Board of Directors of Sunair in connection with its evaluation of the Merger and does not constitute advice or a recommendation to any shareholder as to how such shareholder should vote or act on any matter relating to the proposed Merger. Furthermore, this letter should not be construed as creating any fiduciary duty on the part of Hyde Park Capital Advisors, LLC to any such party. This opinion is not to be quoted or referred to, in whole or in part, without our prior written consent, which will not be unreasonably withheld.

Based upon and subject to the foregoing, it is our opinion that, as of the date hereof, the Consideration to be received in the Merger by the holders of Sunair Common Stock is fair, from a financial point of view, to such holders.

Very truly yours,

/s/ HYDE PARK CAPITAL ADVISORS LLC

HYDE PARK CAPITAL ADVISORS LLC

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Exhibit 99.1

(front)

SUNAIR SERVICES CORPORATION

Special Meeting of Shareholders [date]

This Proxy is solicited on behalf of the Board of Directors

The undersigned hereby appoints Jack I. Ruff and Edward M. Carriero, Jr., with full power of substitution, proxies of the undersigned to represent the undersigned and to vote all shares of common stock of Sunair Services Corporation which the undersigned would be entitled to vote if personally present at the Special Meeting of Shareholders of Sunair Services Corporation to be held on _____ at the Hilton Hotel, 100 Fairway Drive, Deerfield Beach, Florida 33441 at 11:00 a.m., local time, and any and all adjournments or postponements thereof, subject to the directions indicated on the reverse side.

If no directions are given, the shares will be voted FOR the approval of the Merger Agreement and FOR the approval to adjourn or postpone the meeting if necessary or appropriate, to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the Merger Agreement. This Proxy also delegates discretionary authority to vote with respect to any other matters that may properly come before the special meeting or any adjournment or postponement thereof.

THE UNDERSIGNED HEREBY ACKNOWLEDGES RECEIPT OF THE NOTICE OF SPECIAL MEETING AND PROXY STATEMENT OF SUNAIR SERVICES CORPORATION.

Note: THIS PROXY MUST BE SIGNED AND DATED ON THE REVERSE SIDE

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(reverse)

Special Meeting of Shareholders of
Sunair Services Corporation

Please date, sign and mail your
proxy card back in the envelope provided
as soon as possible.

Please detach along perforated line and mail in the envelope provided.

**THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR PROPOSAL 1 AND
PROPOSAL 2.**

**PLEASE SIGN, DATE AND RETURN PROMPTLY IN THE ENCLOSED ENVELOPE.
PLEASE MARK YOUR VOTE IN BLUE OR BLACK INK AS SHOWN HERE**

- | | | | |
|---|----------|--------------|--------------|
| 1. Proposal to approve the Agreement and Plan of Merger (Merger Agreement), dated as of September 28, 2009 by and among Massey Services, Inc. Inc., Buyer Acquisition Company, Inc. and Sunair Services Corporation | FOR
o | AGAINST
o | ABSTAIN
o |
| 2. Proposal to approve to the adjournment or postponement of the meeting if necessary or appropriate, to solicit additional proxies if there are insufficient votes at the time of the special meeting to approve the Merger Agreement. | FOR
o | AGAINST
o | ABSTAIN
o |
| 3. To vote on such other matters that may properly come before the meeting. | | | |

To change the address on your account, please check the box at right and indicate your new address in the address space above. Please note that changes to the registered name(s) on the account may not be submitted via this method o

Signature of Shareholder _____ Date ___, 2009

Signature of Shareholder _____ Date ___, 2009

NOTE: Please sign exactly as your name or names appear on this Proxy. When shares are held jointly, each holder should sign. When signing as executor, administrator, attorney, trustee or guardian, please give full title as such. If the signer is a corporation, please sign full corporate name by duly authorized officer, giving full title as such. If signer is a partnership, please sign in partnership name by authorized person.