EMAGIN CORP
Form 424B3
August 31, 2006

Filed Pursuant to Rule 424(b)(3)
Registration No. 333-136748

eMagin Corporation

41,088,445 SHARES OF
COMMON STOCK

This prospectus fulfills our obligation to register shares within the time period specified in the related Note Purchase Agreements. This prospectus relates to the future resale by the selling stockholders of up 41,088,445 shares of our common stock, including up to 23,038,454 shares issuable upon conversion of our 6% senior secured convertible notes, and up to 18,049,991 issuable upon exercise of common stock purchase warrants that were sold in the July 2006 private placement of 6% senior secured convertible notes and common stock purchase warrants.

We will pay the expenses of registering these shares. We will not receive any proceeds from the sale of shares of common stock in this offering. All of the net proceeds from the sale of our common stock by the selling stockholders will go to the selling stockholders. However, we will receive the exercise price upon exercise of the warrants by the selling stockholders, if such warrants are exercised on a cash basis. Such proceeds, if any, will be used by us for working capital or general business purposes.

Our common stock is registered under Section 12(g) of the Securities Exchange Act of 1934, as amended, and is listed on the American Stock Exchange under the symbol "EMA". The last reported sales price per share of our common stock as reported by the American Stock Exchange on August 17, 2006, was $0.27 per share.

The securities offered in this prospectus involve a high degree of risk. See "Risk Factors" beginning on page 6 of this prospectus to read about factors you should consider before buying shares of our common stock.

The selling stockholders are offering these shares of common stock and may be deemed to be “underwriters” within the meaning of the Securities Act of 1933, as amended, of the shares of common stock, which they are offering. The selling stockholders may sell all or a portion of these shares from time to time in market transactions through any market on which our common stock is then traded, in negotiated transactions or otherwise, and at prices and on terms that may be determined by the then prevailing market price, at prices above or below the then prevailing market price, or at negotiated prices directly or through a broker or brokers, who may act as agent or as principal or by a combination of such methods of sale. The selling stockholders will receive all proceeds from the sale of the common stock. For additional information on the methods of sale, you should refer to the section entitled "Plan of Distribution."

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined whether this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this Prospectus is August 30, 2006

TABLE OF CONTENTS

You may only rely on the information contained in this prospectus or that we have referred you to. We have not authorized anyone to provide you with different information. This prospectus does not constitute an offer to sell or a solicitation of an offer to buy any securities other than the common stock offered by this prospectus. This prospectus does not constitute an offer to sell or a solicitation of an offer to buy any common stock in any circumstances in which such offer or solicitation is unlawful. Neither the delivery of this prospectus nor any sale made in connection with this prospectus shall, under any circumstances, create any implication that there has been no change in our affairs since the date of this prospectus or that the information contained by reference to this prospectus is correct as of any time after its date.

WHERE YOU CAN FIND MORE INFORMATION

We have filed a registration statement on Form S-3 under the Securities Act of 1933, as amended, relating to the shares of common stock being offered by this prospectus, and reference is made to such registration statement. This prospectus constitutes the prospectus of eMagin Corporation, filed as part of the registration statement, and it does not contain all information in the registration statement, as certain portions have been omitted in accordance with the rules and regulations of the Securities and Exchange Commission.

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended, that require us to file reports, proxy statements and other information with the Securities and Exchange Commission. Such reports, proxy statements and other information may be inspected at public reference facilities of the SEC at 100 F Street N.E. Washington, D.C. 20549. Copies of such material can be obtained from the Public Reference Section of the SEC at 100 F Street N.E. Washington, D.C. 20549 at prescribed rates. The public could obtain information on the operation of the public reference room by calling the Securities and Exchange Commission at 1-800-SEC-0330. Because we file documents electronically with the SEC, you may also obtain this information by visiting the SEC's Internet website at http://www.sec.gov.

INCORPORATION OF DOCUMENTS BY REFERENCE

The SEC allows us to 'incorporate by reference' the information contained in documents that we file with them into this prospectus. This means that we can disclose important information to you by referring you to another document filed separately with the SEC. The information that we incorporate by reference is considered to be part of this prospectus. Because we are incorporating by reference our future filings with the SEC, this prospectus is continually updated and those future filings may modify or supersede some or all of the information included or incorporated in this prospectus. This means that you must look at all of the SEC filings that we incorporate by reference to determine if any of the statements in this prospectus or in any document previously incorporated by reference have been modified or superseded. This prospectus incorporates by reference the documents listed below and any future filings we will make with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended, until the selling stockholders sell all of our common stock registered under this prospectus.

• our annual report on Form 10-K for the fiscal year ended December 31, 2005 filed with the SEC on April 17, 2006;

• our quarterly reports on Form 10-Q for the fiscal quarters ended March 31, 2006 and June 30, 2006 filed with the SEC on May 15, 2006 and August 14, 2006, respectively;

• our current reports on Form 8-K filed on August 18, 2006, August 14, 2006, August 11, 2006, July 25, 2006, June 21, 2006, May 15, 2006, March 28, 2006, February 1, 2006, and January 27, 2006; and

• the description of our common stock contained in Item 1 of our Registration Statement on Form 8-A, dated March 16, 2000.

The information about us contained in this prospectus should be read together with the information in the documents incorporated by reference. You may request a copy of any or all of these filings, at no cost, by writing or telephoning us at eMagin Corporation, 10500 N.E. 8th Street, Suite 1400, Bellevue, WA 98004, Telephone: (425) 749-3600.

SUMMARY

This summary highlights information contained elsewhere in this prospectus. You should read the entire prospectus carefully, including, the section entitled "Risk Factors" before deciding to invest in our common stock. eMagin Corporation is referred to throughout this prospectus as "eMagin," "we" or "us."

eMagin Corporation

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

Our first commercial product, the SVGA+ (Super Video Graphics Array of 800x600 plus 52 added columns of data) OLED microdisplay, was initially offered for sampling in 2001, and our first SVGA-3D (Super Video Graphics Array plus built-in stereovision capability) OLED microdisplay was shipped in early 2002. We are in the process of completing development of 2 additional OLED microdisplays, namely the SVGA 3DS (SVGA 3D shrink, a smaller format SVGA display with a new cell architecture with embedded features) and an SXGA (1280 x 1024).

In January 2005, we announced the world's first personal display system to combine OLED technology with head-tracking and 3D stereovision, the Z800 3DVisor(tm), which was first shipped in mid-2005. This product received a CES Design and Innovations Award for the electronic gaming category and also received the coveted Best of Innovation Awards for the entire display category. The product was also recognized as a Digital Living Class of 2005 Innovators.

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

July 2006 Note Purchase Agreements

On July 21, 2006, we entered into several Note Purchase Agreements (the “Purchase Agreements”) to sell to certain qualified institutional buyers and accredited investors up to $5,970,000 in principal amount 6% Senior Secured Convertible Notes Due 2007-2008, together with warrants to purchase 16,073,067 shares of our common stock, par value $0.001 per share. In addition, $20,000 of fees due to our investment banker was paid through participation in the notes transaction and convertible into 76,923 common shares with warrants to purchase 53,846 shares of our common stock.

50% of the aggregate principle amount of each Note matures 1 year after the date of issuance and the remaining 50% matures 18 months after the date of issuance. The Notes pay 6% interest quarterly, commencing on September 1, 2006, and are convertible into shares of common stock at a conversion price equal to $0.26 per share (the “Conversion Price”). In addition, we have the right to redeem all of the outstanding principal and accrued and unpaid interest due under the Notes upon certain conditions, including, but not limited to, that no event of default has occurred or is continuing and that there is an effective registration statement registering the shares underlying the Notes and the

Warrants.

The Warrants are exercisable into shares of our common stock until July 21, 2011 at an exercise price of $0.36 per share (the "Exercise Price"). The investors may exercise the Warrants on a cashless basis beginning one year after the date of issuance if the shares of common stock underlying the Warrants are not then registered pursuant to an effective registration statement or if an event of default, as defined in the Notes, has occurred and is continuing.

The Conversion Price and the Exercise Price are subject to adjustment for certain events, including the payment of dividends, distributions or split of our common stock, or in the event of our consolidation, merger or reorganization. In addition, the Conversion Price and the Exercise Price are also subject to adjustment in the event that our Chief Executive Officer, Chief Financial Officer or Chief Strategy Officer sells, transfers or disposes of shares of common stock or securities convertible into our common stock, other than 50,000 shares of common stock in any fiscal quarter which our Chief Financial Officer is permitted to sell on or after January 1, 2007. In such event the Conversion and Exercise Prices shall be reduced, if applicable, to a price equal to the average of the daily volume weighted average prices for each of the three trading days following the date such sale, transfer or disposition is reported, or required to be reported, on a Form 4 filing with the Securities and Exchange Commission (the "Commission"); provided, that, if such an adjustment would require us to seek stockholder approval of the transactions in accordance with Rule 713 of the American Stock Exchange Company Guide, then such adjustment shall not reduce the Conversion Price or Exercise Price to a price lower than the Conversion Price until such time as stockholder approval is obtained.

Our obligations under the Purchase Agreements and the Notes are secured by substantially all of our assets, and the assets of our wholly owned subsidiary, Virtual Vision, Inc., pursuant to a Pledge and Security Agreement and a Patent and Trademark Security Agreement, each dated as of July 21, 2006. In addition, we entered into a Lockbox Agreement in favor of the investors which provides that, in the event of a default of our obligations under the definitive agreements, we shall direct our accounts and contract debtors to pay funds owed to us to an interest bearing account to be held on behalf of the investors, and to be paid to the investors as set forth therein.

Under the Purchase Agreements, we are obligated to file a registration statement with the Commission registering the common stock issuable upon conversion of the Notes and exercise of the Warrants. We are obligated to use our best efforts to cause the registration statement to be filed no later than 30 days after the closing date and to insure that the registration statement remains in effect until all of the shares of common stock issuable upon conversion of the Notes and exercise of the Warrants have been sold. In the event of a default of our registration obligations under the Purchase Agreements, including our agreement to file the registration statement with the Commission no later than 30 days after the closing date, or if the registration statement is not declared effective within 90 days after the closing date (120 days if the registration statement is reviewed by the Commission), we are required to pay to the investors, as partial liquidated damages, for each month that the registration statement has not been filed or declared effective, as the case may be, a cash amount equal to 1% of the liquidated value of the Notes.

In addition, to further strengthen our management team we intend to add two new directors recommended by the new investors and to recruit additional senior management. Further, we agreed to form a management committee to oversee our business, with one member to be recommended by the investors. Our Chief Executive Officer and Chief Strategy Officer have agreed to defer 10% of their compensation until such time as we realize an EBITDA positive quarter or until the occurrence of certain other events. In addition, no later than 90 days after the closing date, we agreed to hold a meeting of our stockholders to seek the requisite vote to approve the private placement as well as a reverse stock split of our outstanding shares of common stock at a ratio of not less than one for each ten shares of common stock.

Paul Cronson, a Director, John Atherly, Chief Financial Officer, and Olivier Prache, Senior Vice President of Display Manufacturing and Development Operations of our company participated in the private placement through the purchase of an aggregate of $270,000 in principal amount of Notes, together with Warrants to purchase an aggregate of 726,921 shares of common stock, each on the same terms and conditions as the other investors.

In addition to the foregoing, on the same date, we entered into an additional Note Purchase Agreement with Stillwater LLC which provides for the purchase and sale of an additional Note in the principal amount of up to $500,000 (the “Stillwater Note”), together with a warrant (the “Stillwater Warrant”) to purchase 70% of the number of shares issuable upon conversion of the Stillwater Note, at our sole discretion by delivery of a notice to Stillwater on December 14, 2006 for the completion of the purchase and sale to occur on December 29, 2006 (the "Closing Date"). Our ability to require Stillwater to purchase and pay for the Stillwater Note and Stillwater Warrant shall be reduced by the sum of (i) the additional financing raised by us prior to the Closing Date, and (ii) the aggregate exercise price paid by Stillwater to us upon exercise of all or a portion of any of our common stock purchase warrants owned by Stillwater prior to the Closing Date, including a warrant to purchase 1,923,077 shares of our common stock which we issued to Stillwater on July 21, 2006 (the “July Warrant”) on similar terms and conditions as the Warrants set forth above, with an exercise price of $0.26. We are registering the shares of common stock underlying the July Warrant in this prospectus. The conversion price of the Stillwater Note shall be equal to 100% of the market price of the common stock on December 13, 2006 and the exercise price of the Stillwater Warrant will be equal to 100% of the market price of the common stock on December 13, 2006, plus $0.10. Further, we are obligated to use our best efforts to register the shares underlying the Stillwater Note, and the Stillwater Warrant no later than 90 days after the Closing Date. In the event of a default of our registration obligations, including our agreement to file the registration statement with the Commission no later than 90 days after the closing date, or if the registration statement is not declared effective within 150 days after the closing date (180 days if the registration statement is reviewed by the Commission), we are required to pay to Stillwater, as partial liquidated damages, for each month that the registration statement has not been filed or

declared effective, as the case may be, a cash amount equal to 1% of the liquidated value of the Stillwater Note.

The aggregate commissions and expenses payable in connection with the private placement were approximately $590,000, which includes an aggregate of $399,000 in sales commissions. Of this $20,000 was paid by us through the issuance of a $20,000 principal amount of 6% senior secured convertible note, together with warrants to purchase 53,846 shares of our common stock at $0.36 per share, the same terms as the notes' warrants.

We claim an exemption from the registration requirements of the Securities Act for the private placement of these securities pursuant to Section 4(2) of the Act and/or Regulation D promulgated there under since, among other things, the transaction did not involve a public offering, the investors are accredited investors and/or qualified institutional buyers, the investors had access to information about us and their investment, the investors took the securities for investment and not resale absent a registration statement covering their resale or pursuant to an exemption from registration, and we took appropriate measures to restrict the transfer of the securities.

RISK FACTORS

This investment has a high degree of risk. Before you invest you should carefully consider the risks and uncertainties described below and the other information in this prospectus. If any of the following risks actually occur, our business, operating results and financial condition could be harmed and the value of our stock could go down. This means you could lose all or a part of your investment.

RISKS RELATED TO OUR FINANCIAL RESULTS

WE HAVE A HISTORY OF LOSSES SINCE OUR INCEPTION AND MAY INCUR LOSSES FOR THE FORESEEABLE FUTURE.

Accumulated losses excluding non-cash transactions as of June 30, 2006 were $74 million and acquisition related non-cash transactions were $102 million, which resulted in an accumulated net loss of $176 million. We have not yet achieved profitability and we can give no assurances that we will achieve profitability within the foreseeable future as we fund operating and capital expenditures in areas such as establishment and expansion of markets, sales and marketing, operating equipment and research and development. We cannot assure investors that we will ever achieve or sustain profitability or that our operating losses will not increase in the future.

WE MAY NOT BE ABLE TO EXECUTE OUR BUSINESS PLAN AND MAY NOT GENERATE CASH FROM OPERATIONS

In the event that cash flow from operations is less than anticipated and we are unable to secure additional funding to cover our expenses, in order to preserve cash, we would be required to reduce expenditures and effect reductions in our corporate infrastructure, either of which could have a material adverse effect on our ability to continue our current level of operations. To the extent that operating expenses increase or we need additional funds to make acquisitions, develop new technologies or acquire strategic assets, the need for additional funding may be accelerated and there can be no assurances that any such additional funding can be obtained on terms acceptable to us, if at all. If we were not able to generate sufficient capital, either from operations or through additional debt or equity financing, to fund our current operations, we would be forced to significantly reduce or delay our plans for continued research and development and expansion. This could significantly reduce the value of our securities.

OUR INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM HAS EXPRESSED DOUBT ABOUT OUR ABILITY TO CONTINUE AS A GOING CONCERN, WHICH MAY HINDER OUR ABILITY TO OBTAIN FUTURE FINANCING

Our consolidated financial statements as of June 30, 2006 have been prepared under the assumption that we will continue as a going concern for the year ending December 31, 2006. Our independent registered public accounting firm have issued their report dated March 15, 2006 in connection with the audit of our financial statements as of December 31, 2005 and 2004 and for the three year period ended December 31, 2005, that included an explanatory paragraph expressing substantial doubt about our ability to continue as a going concern without additional capital becoming available. Our ability to continue as a going concern is dependent upon our ability to obtain additional equity or debt financing, attain further operating efficiencies and, ultimately, to achieve profitable operations. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

RISKS RELATED TO MANUFACTURING

THE MANUFACTURE OF OLED-ON-SILICON IS NEW AND OLED MICRODISPLAYS HAVE NOT BEEN PRODUCED IN SIGNIFICANT QUANTITIES.

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

WE ARE DEPENDENT ON A SINGLE MANUFACTURING LINE.

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

WE COULD EXPERIENCE MANUFACTURING INTERRUPTIONS, DELAYS, OR INEFFICIENCIES IF WE ARE UNABLE TO TIMELY AND RELIABLY PROCURE COMPONENTS FROM SINGLE-SOURCED SUPPLIERS.

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

WE EXPECT TO DEPEND ON SEMICONDUCTOR CONTRACT MANUFACTURERS TO SUPPLY OUR SILICON INTEGRATED CIRCUITS AND OTHER SUPPLIERS OF KEY COMPONENTS, MATERIALS AND SERVICES.

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

RISKS RELATED TO OUR INTELLECTUAL PROPERTY

WE RELY ON OUR LICENSE AGREEMENT WITH EASTMAN KODAK FOR THE DEVELOPMENT OF OUR PRODUCTS.

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

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

WE MAY NOT BE SUCCESSFUL IN PROTECTING OUR INTELLECTUAL PROPERTY AND PROPRIETARY RIGHTS.

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

RISKS RELATED TO THE MICRODISPLAY INDUSTRY

THE COMMERCIAL SUCCESS OF THE MICRODISPLAY INDUSTRY DEPENDS ON THE WIDESPREAD MARKET ACCEPTANCE OF MICRODISPLAY SYSTEMS PRODUCTS.

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

THE MICRODISPLAY SYSTEMS BUSINESS IS INTENSELY COMPETITIVE.

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

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

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

THE DISPLAY INDUSTRY IS CYCLICAL.

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

COMPETING PRODUCTS MAY GET TO MARKET SOONER THAN OURS.

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

OUR COMPETITORS HAVE MANY ADVANTAGES OVER US.

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

OUR PRODUCTS ARE SUBJECT TO LENGTHY OEM DEVELOPMENT PERIODS.

We plan to sell most of our microdisplays to OEMs who will incorporate them into products they sell. OEMs determine during their product development phase whether they will incorporate our products. The time elapsed between initial sampling of our products by OEMs, the custom design of our products to meet specific OEM product requirements, and the ultimate incorporation of our products into OEM consumer products is significant. If our products fail to meet our OEM customers' cost, performance or technical requirements or if unexpected technical

challenges arise in the integration of our products into OEM consumer products, our operating results could be significantly and adversely affected. Long delays in achieving customer qualification and incorporation of our products could adversely affect our business.

OUR PRODUCTS WILL LIKELY EXPERIENCE RAPIDLY DECLINING UNIT PRICES.

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

RISKS RELATED TO OUR BUSINESS

OUR SUCCESS DEPENDS ON ATTRACTING AND RETAINING HIGHLY SKILLED AND QUALIFIED TECHNICAL AND CONSULTING PERSONNEL.

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

OUR SUCCESS DEPENDS IN A LARGE PART ON THE CONTINUING SERVICE OF KEY PERSONNEL.

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

OUR BUSINESS DEPENDS ON NEW PRODUCTS AND TECHNOLOGIES.

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

WE GENERALLY DO NOT HAVE LONG-TERM CONTRACTS WITH OUR CUSTOMERS.

Our business has primarily operated on the basis of short-term purchase orders. We are now receiving 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 on the basis of internally generated forecasts of demand. If we fail to accurately forecast demand for our products, operating results of our business may suffer and the value of your investment in our company may decline.

OUR BUSINESS STRATEGY MAY FAIL IF WE CANNOT CONTINUE TO FORM STRATEGIC RELATIONSHIPS WITH COMPANIES THAT MANUFACTURE AND USE PRODUCTS THAT COULD INCORPORATE OUR OLED-ON-SILICON TECHNOLOGY.

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

OUR BUSINESS DEPENDS TO SOME EXTENT ON INTERNATIONAL TRANSACTIONS.

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

OUR BUSINESS MAY EXPOSE US TO PRODUCT LIABILITY CLAIMS.

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

OUR BUSINESS IS SUBJECT TO ENVIRONMENTAL REGULATIONS AND POSSIBLE LIABILITY ARISING FROM POTENTIAL EMPLOYEE CLAIMS OF EXPOSURE TO HARMFUL SUBSTANCES USED IN THE DEVELOPMENT AND MANUFACTURE OF OUR PRODUCTS.

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

RISKS RELATED TO OUR CURRENT FINANCING ARRANGEMENT

THERE ARE A LARGE NUMBER OF SHARES UNDERLYING OUR SECURED CONVERTIBLE NOTES AND WARRANTS THAT MAY BE AVAILABLE FOR FUTURE SALE AND THE SALE OF THESE SHARES MAY DEPRESS THE MARKET PRICE OF OUR COMMON STOCK.

As of August 1, 2006, we had 100,522,492 shares of common stock issued and outstanding, senior secured convertible notes outstanding that may be converted into an estimated 23,038,454 shares of common stock and outstanding warrants to purchase 18,049,991 shares of common stock. In addition, as of August 1, 2006, we have outstanding (i) options to purchase 11,715,754 shares and (ii) warrants to purchase 19,354,471 shares of common stock. All of the shares issuable upon conversion of the secured convertible notes and upon exercise of our warrants and options, may be sold without restriction. 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.

THE ISSUANCE OF SHARES UPON CONVERSION OF THE SECURED CONVERTIBLE NOTES AND EXERCISE OF OUTSTANDING WARRANTS MAY CAUSE IMMEDIATE AND SUBSTANTIAL DILUTION TO OUR EXISTING STOCKHOLDERS.

The issuance of shares upon conversion of the secured convertible notes and exercise of warrants may result in substantial dilution to the interests of other stockholders. Although certain of the selling stockholders may not convert their secured convertible notes and/or exercise their warrants if such conversion or exercise would cause such stockholder to own more than 9.99% of our outstanding common stock, this restriction does not prevent each of such selling stockholders from converting and/or exercising and selling some of its holdings and then converting the rest of its holdings. In this way, such selling stockholders could sell more than this limit while never holding more than this limit.

IF WE ARE REQUIRED FOR ANY REASON TO REPAY OUR OUTSTANDING SECURED CONVERTIBLE NOTES, WE WOULD BE REQUIRED TO DEPLETE OUR WORKING CAPITAL, IF AVAILABLE, OR RAISE ADDITIONAL FUNDS. OUR FAILURE TO REPAY THE SECURED CONVERTIBLE NOTES, IF REQUIRED, COULD RESULT IN LEGAL ACTION AGAINST US, WHICH COULD REQUIRE THE SALE OF SUBSTANTIAL ASSETS.

In July 2006, we entered into Note Purchase Agreements for the sale of an aggregate of $5,970,000 principal amount of secured convertible notes. 50% of the aggregate principle amount of each secured convertible note matures 1 year after the date of issuance and the remaining 50% matures 18 months after the date of issuance, unless sooner converted into shares of our common stock. In addition, the secured convertible notes pay 6% interest per annum. Any event of default such as our failure to repay the principal or interest when due, our failure to issue shares of common

stock upon conversion by the holder, our failure to timely file a registration statement or have such registration statement declared effective, breach of any covenant, representation or warranty in the Note Purchase Agreements or related convertible note, the assignment or appointment of a receiver to control a substantial part of our property or business, the commencement of a bankruptcy, insolvency, reorganization or liquidation proceeding against our company and the delisting of our common stock could require the early repayment of the secured convertible notes, including a default interest rate of 12% on the outstanding principal balance of the notes if the default is not cured within the specified grace period. We anticipate that the full amount of the secured convertible notes will be converted into shares of our common stock, in accordance with the terms of the secured convertible notes. If we were required to repay the secured convertible notes, we would be required to use our limited working capital and raise additional funds. If we were unable to repay the notes when required, the note holders could commence legal action against us and foreclose on all of our assets to recover the amounts due. Any such action would require us to curtail or cease operations.

IF AN EVENT OF DEFAULT OCCURS UNDER THE NOTE PURCHASE AGREEMENTS, SECURED CONVERTIBLE NOTES, WARRANTS, SECURITY AGREEMENT OR PATENT AND TRADEMARK SECURITY AGREEMENT, THE INVESTORS COULD TAKE POSSESSION OF ALL OUR GOODS, INVENTORY, CONTRACTUAL RIGHTS AND GENERAL INTANGIBLES, RECEIVABLES, DOCUMENTS, INSTRUMENTS, CHATTEL PAPER, AND INTELLECTUAL PROPERTY.

In connection with the Note Purchase Agreements we entered into in July 2006, we executed a Security Agreement, a Patent and Trademark Security Agreement and a Lockbox Agreement, each in favor of the investors granting them a first priority security interest in all of our goods, inventory, contractual rights and general intangibles, receivables, documents, instruments, chattel paper, and intellectual property. The Security Agreement, Patent and Trademark Security Agreement and Lockbox Agreement state that if an event of default occurs under the Note Purchase Agreements, Secured Convertible Notes, Warrants, Security Agreement, Patent and Trademark Security Agreement or Lockbox Agreement, the investors have the right to take possession of the collateral, to operate our business using the collateral, and have the right to assign, sell, lease or otherwise dispose of and deliver all or any part of the collateral, at public or private sale or otherwise to satisfy our obligations under these agreements.

RISKS RELATED TO OUR 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 the company. Some of the provisions of our certificate of incorporation, our bylaws and Delaware law could, together or separately, discourage potential acquisition proposals or delay or prevent a change in control. In particular, our board of directors is authorized to issue up to 10,000,000 shares of preferred stock (less any outstanding shares of preferred stock) with rights and privileges that might be senior to our common stock, without the consent of the holders of the common stock.

FORWARD-LOOKING STATEMENTS

We and our representatives may from time to time make written or oral statements that are "forward-looking," including statements contained in this prospectus and other filings with the Securities and Exchange Commission, reports to our stockholders and news releases. All statements that express expectations, estimates, forecasts or projections are forward-looking statements within the meaning of the Act. In addition, other written or oral statements which constitute forward-looking statements may be made by us or on our behalf. Words such as "expects," "anticipates," "intends," "plans," "believes," "seeks," "estimates," "projects," "forecasts," "may," "should," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in or suggested by such forward-looking statements. We undertake no obligation to update publicly any forward-looking statements, whether as a result of new information, future events or otherwise.

USE OF PROCEEDS

This prospectus relates to shares of our common stock that may be offered and sold from time to time by the selling stockholders. We will not receive any proceeds from the sale of shares of common stock in this offering. Proceeds, if any, received on the exercise of currently outstanding warrants will be use for general working capital purposes.

SELLING STOCKHOLDERS

The table below sets forth information concerning the resale of the shares of common stock by the selling stockholders. We will not receive any proceeds from the resale of the common stock by the selling stockholders. If the warrants are exercised by the payment of cash, however, we will receive proceeds from the exercise of the warrants. However, the warrants have a cashless exercise provision that allows the holder in certain circumstances to receive a reduced number of shares of our common stock, without paying the exercise price in cash. To the extent any of the warrants are exercised in this manner, we will not receive any additional proceeds from such exercise.

The following table also sets forth, as of the date of this prospectus, the name of each selling stockholder for whom we are registering shares of common stock for the future resale to the public pursuant to this prospectus, the number of shares of common stock beneficially owned by each selling stockholder, the number of shares of common stock that may be sold in this offering and the number of shares of common stock each selling stockholder will own after the offering, assuming they sell all of the shares offered.

	Shares Beneficially Owned Prior to the Offering			Shares Beneficially Owned After the Offering	
Name	Number**	Percent(1)	Total Shares Registered in this Prospectus	Number	Percent
Alexandra Global Master Fund Ltd. (2)	10,753,136	9.9%(17)	19,615,383	5,818,180	4.1%
Rainbow Gate Corporation (3)	8,048,212	5.47%	4,576,922	3,471,290	2.4%
Ginola Limited (4)	8,835,799	6.00%	5,230,769	3,605,030	2.5%
David Gottfried (5)	3,426,714	2.38%(17)	1,634,614	1,792,100	1.3%
Iroquois Master Fund Ltd. (6)	1,307,691	*(17)	1,307,691	- 0 -	0.0%
Nite Capital, LP (7)	1,580,418	1.10%(17)	1,307,691	272,727	*
HU Investments, LLC (8)	4,438,645	3.09%(17)	1,307,691	3,130,954	2.2%
Navacorp III, LLC (9)	1,815,348	1.27%(17)	1,307,691	507,657	*
	1,307,691	*(17)	1,307,691	- 0 -	0.0%

BTG Investments, LLC (10)					
David Kincade (11)	1,153,845	*(17)	653,845	500,000	*
Thomas Wales (12)	1,284,921	*(17)	326,921	958,000	1.0%
John Atherly (13)	564,575	*(17)	261,538	303,037	*
Olivier Prache (14)	434,467	*(17)	196,152	238,315	*
Stillwater LLC (15)	10,347,655	7.17%	1,923,077	8,424,579	5.91%
Roth Capital Partners, LLC (16)	130,769	*(17)	130,769	- 0 -	0.0%
	54,718,945	36.38%	41,088,445	23,203,689	15.3%

* Less than 1%

**The actual number of shares of common stock offered in this prospectus, and included in the registration statement of which this prospectus is a part, includes such additional number of shares of common stock as may be issued or issuable upon conversion of our senior secured convertible notes and the exercise of the warrants by reason of any stock split, stock dividend or similar transaction involving the common stock, in accordance with Rule 416 under the Securities Act of 1933, as amended. In addition, certain of the selling stockholders have contractually agreed to restrict their ability to convert their senior secured convertible notes and exercise their warrants and receive shares of our common stock such that the number of shares of common stock held by such selling stockholder in the aggregate and its affiliates after such conversion or exercise does not exceed 9.9% of the then issued and outstanding shares of common stock as determined in accordance with Section 13(d) of the Exchange Act. Accordingly, the number of shares of common stock set forth in the table for certain of the selling stockholders exceeds the number of shares of common stock that the selling stockholders could own beneficially at any given time through their ownership of the notes and warrants (see footnote (17) below). In that regard, the beneficial ownership of the common stock by the selling stockholder set forth in the table is not determined in accordance with Rule 13d-3 under the Securities Exchange Act of 1934, as amended.

(1) Based upon 100,522,492 shares of common stock issued and outstanding as of August 1, 2006 and assumes the increase in the number of shares outstanding by reason of the conversion of notes or exercise of warrants pursuant to which the shares of common stock listed in this table may have been issued.

(2) Represents (i) 3,636,636 shares of common stock and 2,181,817 shares underlying warrants owned by the selling stockholder prior to the July 2006 private placement which are not being registered in this prospectus, (ii) 11,538,461 shares of common stock underlying a 6% senior secured convertible note and (iii) 8,076,922 shares of common stock issuable upon exercise of a common stock purchase warrant. Alexandra Investment Management, LLC, a Delaware limited liability company ("AIM"), serves as investment adviser to Alexandra Global Master Fund Ltd., a British Virgin Islands international business company ("Alexandra"). By reason of such relationship, AIM may be deemed to share dispositive power over the shares of common stock stated as beneficially owned by Alexandra. AIM disclaims beneficial ownership of such shares of common stock. Mr. Mikhail A. Filimonov is a managing member and the Chairman, Chief Executive Officer and Chief Investment Officer of AIM. By reason of such relationship, Filimonov may be deemed to share dispositive power over the shares of common stock stated as beneficially owned by Alexandra. Filimonov disclaims beneficial ownership of such shares of common stock. The selling stockholder has notified us that they are not broker-dealers and/or affiliates of broker-dealers.

(3) Represents (i) 2,628,417 shares of common stock and 842,873 shares underlying warrants owned by the selling stockholder prior to the July 2006 private placement which are not being registered in this prospectus, (ii) 2,692,307 shares of common stock underlying a 6% senior secured convertible note and (iii) 1,884,615 shares of common stock issuable upon exercise of a common stock purchase warrant. In accordance with rule 13d-3 under the securities exchange act of 1934, Dr. Mortimer D. Sackler, the sole shareholder of the selling stockholder, may be deemed a control person, with voting and investment control, of the shares owned by the selling stockholder. Mortimer D.A. Sackler is the investment manager of Rainbow Gate and is the Sole Member, Manager and President of Stillwater LLC. Mortimer D.A. Sackler and Stillwater LLC disclaim beneficial ownership of the shares owned by Rainbow Gate. The selling stockholder has notified us that they are not broker-dealers and/or affiliates of broker-dealers.

(4) Represents (i) 3,141,088 shares of common stock and 463,942 shares underlying warrants owned by the selling stockholder prior to the July 2006 private placement which are not being registered in this prospectus, (ii) 3,076,923 shares of common stock underlying a 6% senior secured convertible note and (iii) 2,153,846 shares of common stock issuable upon exercise of a common stock purchase warrant. In accordance with rule 13d-3 under the securities exchange act of 1934, Jonathan G. White, Steven A. Meiklejohn and Joerg Fischer, each a Director of the selling stockholder, and Dr. Mortimer D. Sackler, the sole shareholder of the selling stockholder, may be deemed control persons, with voting and investment control, of the shares owned by such entity. The selling stockholder has notified us that they are not broker-dealers and/or affiliates of broker-dealers.

(5) Represents (i) 1,342,100 shares of common stock and 450,000 shares underlying warrants owned by the selling stockholder prior to the July 2006 private placement which are not being registered in this prospectus, (ii) 961,538 shares of common stock underlying a 6% senior secured convertible note and (iii) 673,076 shares of common stock issuable upon exercise of a common stock purchase warrant. The selling stockholder has notified us that he is not a broker-dealer and/or affiliated with broker-dealers.

(6) Represents (i) 769,230 shares of common stock underlying a 6% senior secured convertible note and (ii) 538,461 shares of common stock issuable upon exercise of a common stock purchase warrant. In accordance with rule 13d-3 under the securities exchange act of 1934, Joshua Silverman may be deemed a control person, with voting and investment control, of the shares owned by such entity. Mr. Silverman disclaims beneficial ownership over the shares owned by such entity. The selling stockholder has notified us that they are not broker-dealers and/or affiliates of broker-dealers.

(7) Represents (i) 272,727 shares underlying warrants owned by the selling stockholder prior to the July 2006 private placement which are not being registered in this prospectus, (ii) 769,230 shares of common stock underlying a 6%

senior secured convertible note and (iii) 538,461 shares of common stock issuable upon exercise of a common stock purchase warrant. In accordance with rule 13d-3 under the securities exchange act of 1934, Keith Goodman, the manager of the general partner of the selling stockholder, may be deemed a control person, with voting and investment control, of the shares owned by such entity. Keith Goodman disclaims beneficial ownership of the shares owned by the selling stockholder. The selling stockholder has notified us that they are not broker-dealers and/or affiliates of broker-dealers.

(8) Represents (i) 2,476,409 shares of common stock and 654,545 shares underlying warrants owned by the selling stockholder prior to the July 2006 private placement which are not being registered in this prospectus (ii) 769,230 shares of common stock underlying a 6% senior secured convertible note and (iii) 538,461 shares of common stock issuable upon exercise of a common stock purchase warrant. In accordance with rule 13d-3 under the securities exchange act of 1934, Hank Uberoi may be deemed a control person, with voting and investment control, of the shares owned by such entity. The selling stockholder has notified us that they are not broker-dealers and/or affiliates of broker-dealers.

(9) Represents (i) 507,657 shares of common stock underlying warrants owned by the managing member of the selling stockholder prior to the July 2006 private placement which are not being registered in this prospectus, (ii) 769,230 shares of common stock underlying a 6% senior secured convertible note and (iii) 538,461 shares of common stock issuable upon exercise of a common stock purchase warrant. In accordance with rule 13d-3 under the securities exchange act of 1934, Paul Cronson may be deemed a control person, with voting and investment control, of the shares owned by such entity. The selling stockholder has notified us that they are an affiliate of one or more broker-dealers. The broker-dealer that is an affiliate of Navacorp III, LLC was not involved in the purchase of the shares of the notes or warrants, and will not be involved in the sale of the shares being registered in this prospectus.

(10) Represents (i) 769,230 shares of common stock underlying a 6% senior secured convertible note and (ii) 538,461 shares of common stock issuable upon exercise of a common stock purchase warrant. In accordance with rule 13d-3 under the securities exchange act of 1934, Biron Roth and Gordon Roth may be deemed control persons, with voting and investment control, of the shares owned by such entity. The selling stockholder has notified us that they are not broker-dealers and/or affiliates of broker-dealers.

(11) Represents (i) 500,000 shares of common stock underlying warrants owned by the selling stockholder prior to the July 2006 private placement which are not being registered in this prospectus, (ii) 384,615 shares of common stock underlying a 6% senior secured convertible note and (iii) 269,230 shares of common stock issuable upon exercise of a common stock purchase warrant. The selling stockholder has notified us that he is not a broker-dealer and/or affiliated with broker-dealers.

(12) Represents (i) 618,000 shares of common stock and 340,000 shares underlying warrants owned by the selling stockholder prior to the July 2006 private placement which are not being registered in this prospectus, (ii) 192,307 shares of common stock underlying a 6% senior secured convertible note and (iii) 134,614 shares of common stock issuable upon exercise of a common stock purchase warrant. The selling stockholder has notified us that he is not a broker-dealer and/or affiliated with broker-dealers.

(13) Represents (i) 303,037 shares of common stock owned by the selling stockholder prior to the July 2006 private placement which are not being registered in this prospectus, (ii) 153,846 shares of common stock underlying a 6% senior secured convertible note and (iii) 107,692 shares of common stock issuable upon exercise of a common stock purchase warrant. The selling stockholder has notified us that he is not a broker-dealer and/or affiliated with broker-dealers.

(14) Represents (i) 1,000 shares of common stock and 237,315 shares underlying options owned by the selling stockholder prior to the July 2006 private placement which are not being registered in this prospectus, (ii) 115,384 shares of common stock underlying a 6% senior secured convertible note and (iii) 80,768 shares of common stock issuable upon exercise of a common stock purchase warrant. The selling stockholder has notified us that he is not a broker-dealer and/or affiliated with broker-dealers.

(15) Represents (i) 7,606,819 shares of common stock and 817,760 shares underlying warrants owned by the selling stockholder prior to the July 2006 private placement which are not being registered in this prospectus, and (ii) 1,923,077 shares of our common stock issuable upon exercise of a common stock purchase warrant at a price equal to $.26 per share. In accordance with rule 13d-3 under the securities exchange act of 1934, Mortimer D.A. Sackler, the Sole Member, Manager and President, may be deemed a control person, with voting and investment control, of the shares owned by such entity. The selling stockholder has notified us that they are not broker-dealers and/or affiliates of broker-dealers.

(16) Represents (i) 76,923 shares of common stock underlying a 6% senior secured convertible note and (ii) 53,846 shares of common stock issuable upon exercise of a common stock purchase warrant. In accordance with rule 13d-3 under the securities exchange act of 1934, Byron C. Roth, Chief Executive Officer and Gordon J. Roth, Chief Financial Officer, may be deemed control persons, with voting and investment control, of the shares owned by such entity. The selling stockholder has notified us that they are a broker-dealer and were involved in the sale of the shares being registered in this prospectus.

(17) This selling stockholder has contractually agreed not to convert notes or exercise warrants to the extent such conversion or exercise would cause this selling stockholder together with its affiliates, to have acquired a number of shares of common stock which would exceed 9.9% of the then-outstanding common stock, other than by virtue of the ownership of securities or rights to acquire securities that have limitations on the holders' right to convert, exercise or purchase similar to the limitation set forth in the notes and warrants.

PLAN OF DISTRIBUTION

Each selling stockholder of the common stock and any of their pledgees, assignees and successors-in-interest may, from time to time, sell any or all of their shares of common stock on the trading market or any other stock exchange, market or trading facility on which the shares are traded or in private transactions. These sales may be at fixed or negotiated prices. A selling stockholder may use any one or more of the following methods when selling shares:

- ordinary brokerage transactions and transactions in which the broker-dealer solicits purchasers;
- block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;
- purchases by a broker-dealer as principal and resale by the broker-dealer for its account;
- an exchange distribution in accordance with the rules of the applicable exchange;
- privately negotiated transactions;

- settlement of short sales entered into after the effective date of the registration statement of which this prospectus is a part;

- broker-dealers may agree with the selling stockholders to sell a specified number of such shares at a stipulated price per share;

- through the writing or settlement of options or other hedging transactions, whether through an options exchange or otherwise;

- any other method permitted pursuant to applicable law; or

- a combination of any such methods of sale.

The selling stockholders may also sell shares under Rule 144 under the Securities Act of 1933, as amended, if available, rather than under this prospectus.

Broker-dealers engaged by the selling stockholders may arrange for other brokers-dealers to participate in sales. Broker-dealers may receive commissions or discounts from the selling stockholders (or, if any broker-dealer acts as agent for the purchaser of shares, from the purchaser) in amounts to be negotiated, but, except as set forth in a supplement to this Prospectus, in the case of an agency transaction not in excess of a customary brokerage commission in compliance with NASDR Rule 2440; and in the case of a principal transaction a markup or markdown in compliance with NASDR IM-2440.

In connection with the sale of the common stock or interests therein, the selling stockholders may enter into hedging transactions with broker-dealers or other financial institutions, which may in turn engage in short sales of the common stock in the course of hedging the positions they assume. The selling stockholders may also sell shares of the common stock short and deliver these securities to close out their short positions, or loan or pledge the common stock to broker-dealers that in turn may sell these securities. The selling stockholders may also enter into option or other transactions with broker-dealers or other financial institutions or the creation of one or more derivative securities which require the delivery to such broker-dealer or other financial institution of shares offered by this prospectus, which shares such broker-dealer or other financial institution may resell pursuant to this prospectus (as supplemented or amended to reflect such transaction).

The selling stockholders and any broker-dealers or agents that are involved in selling the shares may be deemed to be "underwriters" within the meaning of the Securities Act in connection with such sales. In such event, any commissions received by such broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act. Each selling stockholder has informed us that it does not have any written or oral agreement or understanding, directly or indirectly, with any person to distribute the common stock. In no event shall any broker-dealer receive fees, commissions and markups which, in the aggregate, would exceed eight percent (8%).

We are required to pay certain fees and expenses incurred by us incident to the registration of the shares. We have agreed to indemnify the selling stockholders against certain losses, claims, damages and liabilities, including liabilities under the Securities Act.

Because selling stockholders may be deemed to be "underwriters" within the meaning of the Securities Act, they will be subject to the prospectus delivery requirements of the Securities Act. In addition, any securities covered by this prospectus which qualify for sale pursuant to Rule 144 under the Securities Act may be sold under Rule 144 rather than under this prospectus. Each selling stockholder has advised us that they have not entered into any written or oral agreements, understandings or arrangements with any underwriter or broker-dealer regarding the sale of the resale shares. There is no underwriter or coordinating broker acting in connection with the proposed sale of the resale shares

by the selling stockholders.

We agreed to keep this prospectus effective until the earlier of (i) the date on which the shares may be resold by the selling stockholders without registration and without regard to any volume limitations by reason of Rule 144(e) under the Securities Act or any other rule of similar effect or (ii) all of the shares have been sold pursuant to the prospectus or Rule 144 under the Securities Act or any other rule of similar effect. The resale shares will be sold only through registered or licensed brokers or dealers if required under applicable state securities laws. In addition, in certain states, the resale shares may not be sold unless they have been registered or qualified for sale in the applicable state or an exemption from the registration or qualification requirement is available and is complied with.

Under applicable rules and regulations under the Exchange Act, any person engaged in the distribution of the resale shares may not simultaneously engage in market making activities with respect to the common stock for the applicable restricted period, as defined in Regulation M, prior to the commencement of the distribution. In addition, the selling stockholders will be subject to applicable provisions of the Exchange Act and the rules and regulations there under, including Regulation M, which may limit the timing of purchases and sales of shares of the common stock by the selling stockholders or any other person. We will make copies of this prospectus available to the selling stockholders and have informed them of the need to deliver a copy of this prospectus to each purchaser at or prior to the time of the sale.

DESCRIPTION OF SECURITIES BEING REGISTERED

COMMON STOCK

We are authorized to issue up to 200,000,000 shares of common stock, par value $.001. As of August 1, 2006, there were 100,522,492 shares of common stock outstanding. Holders of the common stock are entitled to one vote per share on all matters to be voted upon by the stockholders. Holders of common stock are entitled to receive ratably such dividends, if any, as may be declared by the Board of Directors out of funds legally available therefore. Upon the liquidation, dissolution, or winding up of our company, the holders of common stock are entitled to share ratably in all of our assets which are legally available for distribution after payment of all debts and other liabilities and liquidation preferences of any outstanding preferred stock. Holders of common stock have no preemptive, subscription, redemption or conversion rights. The outstanding shares of common stock are validly issued, fully paid and nonassessable.

We have engaged Continental Stock Transfer & Trust Company of New York, as independent transfer agent and registrar.

PREFERRED STOCK

We are authorized to issued up to 10,000,000 shares of preferred stock. The shares of preferred stock may be issued in series, and shall have such voting powers, full or limited, or no voting powers, and such designations, preferences and relative participating, optional or other special rights, and qualifications, limitations or restrictions thereof, as shall be stated and expressed in the resolution or resolutions providing for the issuance of such stock adopted from time to time by the board of directors. The board of directors is expressly vested with the authority to determine and fix in the resolution or resolutions providing for the issuances of preferred stock the voting powers, designations, preferences and rights, and the qualifications, limitations or restrictions thereof, of each such series to the full extent now or hereafter permitted by the laws of the State of Delaware.

6% SENIOR SECURED CONVERTIBLE NOTES

On July 21, 2006, we entered into several Note Purchase Agreements to sell to certain qualified institutional buyers and accredited investors up to $5,970,000 in principal amount 6% Senior Secured Convertible Notes Due 2007-2008. 50% of the aggregate principle amount of each Note matures 1 year after the date of issuance and the remaining 50% matures 18 months after the date of issuance. The Notes pay 6% interest quarterly, commencing on September 1, 2006, and are convertible into shares of common stock at a conversion price equal to $0.26 per share. In addition, we have the right to redeem all of the outstanding principal and accrued and unpaid interest due under the Notes upon certain conditions, including, but not limited to, that no event of default has occurred or is continuing and that there is an effective registration statement registering the shares underlying the Notes. In addition, $20,000 of commissions payable in connection with the private placement were paid by us through the issuance of a $20,000 principal amount of 6% senior secured convertible note, together with warrants to purchase 53,846 shares of our common stock.

WARRANTS

On July 21, 2006, in connection with the Purchase Agreements, we sold and issued to the investors warrants to purchase 16,073,067 shares of our common stock. The Warrants are exercisable into shares of our common stock until July 21, 2011 at an exercise price of $0.36 per share. In addition, on July 21, 2006 we issued a warrant to purchase 1,923,077 shares of our common stock at a price equal to $.26 per share to Stillwater LLC as further described in this prospectus under the heading “July 2006 Note Purchase Agreements”. The investors may exercise the Warrants on a

cashless basis beginning one year after the date of issuance if the shares of common stock underlying the Warrants are not then registered pursuant to an effective registration statement or if an event of default, as defined in the Notes, has occurred and is continuing.

This prospectus covers the resale by the investors of the above-referenced common stock underlying the secured convertible notes and common stock underlying the warrants.

LEGAL MATTERS

Sichenzia Ross Friedman Ference LLP, New York, New York will issue an opinion with respect to the validity of the shares of common stock being offered hereby. In the past, a member of Sichenzia Ross Friedman Ference LLP, Richard Friedman, has received shares of common stock from us as consideration for legal services performed on our behalf. We are not registering any shares of common stock in this prospectus on behalf of Sichenzia Ross Friedman Ference LLP or Richard Friedman.

EXPERTS

Eisner LLP, Independent Registered Public Accountants, have audited, as set forth in their report thereon incorporated by reference herein, our financial statements as of December 31, 2005 and 2004 and for each of the three years in the period ended December 31, 2005, which included an explanatory paragraph expressing substantial doubt in our ability to continue as a going concern. The financial statements referred to above are incorporated by reference in this prospectus with reliance upon the auditors' opinion based on their expertise in accounting and auditing.

ctive September 2, 2011, our Board of Directors terminated cash compensation to all non-employee Board members as part of the Company’s cost reduction program. The non-employee directors who attended Board meetings and meetings as members of various committees of the Board were reimbursed for their out-of-pocket costs in attending the meetings of the Board of Directors.

In 2012, non-employee members of the Board have not received cash compensation for their services, but we have reimbursed them for their out-of-pocket costs in attending the meetings of the Board of Directors. Neither the chairmen of each committee of the Board nor any members of any committee have received any additional cash compensation for their service on such committees in 2012.

In May 2012, we issued Messrs. Kaplan and Hutchins 8,750 options to purchase common stock at an exercise price of $3.52 per share for their service on the Board through May 2013. We granted Messrs. Richie and Bianchino each 4,375 and Mr. Gans 7,500 shares of restricted stock valued at $3.52 per share in May 2012 for their service on the Board through May 2013.

Director compensation for the year ended December 31, 2012 was as follows:

Director Compensation

Name	Fees earned or paid in cash ($)	Stock awards ($) (3)	Option awards ($) (3)	Total ($)
Stanton E. Ross, Chairman of the Board (1)	$—	$—	$—	$—
Leroy C. Richie	$—	$15,400	$—	$15,400

Elliot M. Kaplan	$—	$—	$10,086	$10,086
Daniel F. Hutchins	$—	$—	$10,086	$10,086
Bernard A. Bianchino	$—	$15,400	$—	$15,400
Stephen Gans	$—	$26,400	$—	$26,400
Steven Phillips (2)	$—	$—	$27,226	$27,226

(1) Mr. Ross's compensation and option awards are provided in the Executive Compensation table because he did not receive compensation or stock options for his services as a director.

(2) Mr. Phillips resigned his position as Vice President – Engineering effective July 13, 2012. Mr. Phillips was elected as a Director concurrent with his resignation as an officer of the Company. For purposes of the above table, Mr. Phillips stock option and restricted stock grants during 2012 have been included as director compensation.

(3) Represents aggregate grant date fair value pursuant to ASC Topic 718 for the respective year for stock options and restricted stock granted. Please refer to Note 12 to the consolidated financial statements for further description of the awards and the underlying assumptions utilized to determine the amount of grant date fair value related to such grants.

Table Of Contents

Director Stock Option and Restricted Stock Grants

Name of Individual	Number of Restricted Shares of Common Stock Granted	Number of Options Granted	Average per Share Exercise Price
Stanton E. Ross (1)	—	—	$—
Leroy C. Richie (2)	4,375	—	$—
Elliot M. Kaplan	—	8,750	$3.52
Daniel F. Hutchins	—	8,750	$3.52
Bernard A. Bianchino (2)	4,375	—	$—
Stephen Gans (2) (3)	7,500	—	$—
Steven Phillips (4)	—	15,000	$4.80

_____

(1) Mr. Ross's compensation and option awards are noted in the Executive Compensation table because he did not receive compensation or stock options for his services as a director.

(2) The restricted stock grants were valued at an average price of $3.52 per share. Messrs. Richie, Bianchino and Gans were each granted a restricted stock award on May 25, 2012 for 4,375 shares with half vesting on November 1, 2012 and the remainder on May 1, 2013.

(3) Mr. Gans received a second restricted stock award on May 25, 2012 for 3,125 shares, which was also valued at $3.52 per share. This second restricted stock award to Mr. Gans vests over a graduated four-year period (312 shares on May 24, 2013, 625 shares on May 24, 2014, 938 shares on May 24, 2015 and 1,250 shares on May 24, 2016).

(4) Mr. Phillips resigned his position as Vice President – Engineering effective July 13, 2012. Mr. Phillips was elected as a Director concurrent with his resignation as an officer of the Company. For purposes of the above table, Mr. Phillips stock option and restricted stock grants during 2012 have been included as director compensation.

Table Of Contents

Proposal Two

Approval of Amendment to our Articles of Incorporation to Increase the Number of Authorized Shares of our capital stock that we may issue from 9,375,000 to 85,000,000 shares, of which 75,000,000 shares shall be classified as common stock and 10,000,000 shares shall be classified as blank check preferred stock.

Proposal 2 seeks your approval of an amendment to our Articles of Incorporation, which we refer to as the "Articles Amendment," to increase the number of authorized shares of capital stock that we may issue from 9,375,000 to 85,000,000, of which 75,000,000 shares shall be classified as common stock and 10,000,000 shares shall be classified as blank check preferred stock. The Articles Amendment has the effect of creating a new class of stock: blank check preferred. The proposed Articles Amendment is set forth below:

"Article IX of the Articles of Incorporation of the Company is amended and restated in its entirety to read as follows:

(a) Authorized Shares. The aggregate number of shares of capital stock that the Corporation will have the authority to issue is eighty-five million (85,000,000) shares, of which seventy-five million (75,000,000) shares will be designated common stock, par value of $0.001 each share (the "Common Stock"), and ten million (10,000,000) shares will be blank check preferred stock, with a par value of $0.001 per share (the "Preferred Stock"). The holders of the Common Stock shall have one (1) vote per share on each matter submitted to a vote of stockholders. Each share of Common Stock shall be entitled to the same dividend and liquidation rights. The capital stock of this Corporation, after the amount of the subscription price has been paid in, shall never be assessable, or assessed to pay debts of this Corporation.

(b) Blank Check Preferred Stock. The Board of Directors is authorized, subject to the limitations prescribed in this Article IX, to provide for the issuance of the shares of blank check preferred stock in series, and by filing a certificate pursuant to the applicable law of the State of Nevada, to establish from time to time the number of shares to be included in each such series, and to fix the designation, powers, preferences and rights of the shares of each such series and the qualifications, limitations and restrictions thereof. The authority of the Board of Directors with respect to each series of Preferred Stock will include, but not be limited to, the rights to determine the following:

(i) The number of shares constituting that series of Preferred Stock and the distinctive designation of that series, which may be a distinguishing number, letter or title;

(ii) The dividend rate on the shares of that series of Preferred Stock, whether dividends will be cumulative, and if so, from which date(s), and the relative rights of priority, if any, of payment of dividends on shares of that series;

(iii) Whether that series of Preferred Stock will have voting rights, in addition to the voting rights provided by law, and, if so, the terms of such voting rights;

(iv) Whether that series of Preferred Stock will have conversion privileges and, if so, the terms and conditions of such conversion, including provision for adjustment of the conversion rate in such events as the Board of Directors determines;

Table Of Contents

(v) Whether or not the shares of that series of Preferred Stock will be redeemable and, if so, the terms and conditions of such redemption, including the date or date upon or after which they are redeemable, and the amount per share payable in case of redemption, which amount may vary under different conditions and at different redemption dates;

(vi) Whether that series of Preferred Stock will have a sinking fund for the redemption or purchase of shares of that series and, if so, the terms and amount of such sinking fund;

(vii) The rights of the shares of that series of Preferred Stock in the event of voluntary or involuntary liquidation, dissolution or winding up of the Corporation, and the relative rights of priority, if any, of payment of shares of that series; and

(viii) Any other relative rights, preferences and limitations of that series of Preferred Stock.

Each series of serial Preferred Stock, in preference to the Common Stock, will be entitled to dividends from funds or other assets legally available therefore, at such rates, payable at such times and cumulative to the extent as may be fixed by the Board of Directors of the Corporation pursuant to the authority herein conferred upon it. In the event of dissolution or liquidation of the Corporation, voluntary or involuntary, the holders of serial Preferred Stock, in preference to the Common Stock, will be entitled to receive such amount or amounts as may be fixed by the Board of Directors of the Corporation pursuant to the authority herein conferred upon it. Preferred Stock of any series redeemed, converted, exchanged, purchased or otherwise acquired by the Corporation shall be canceled by the Corporation and returned to the status of authorized but unissued Preferred Stock. All shares of any series of serial Preferred Stock, as between themselves, shall rank equally and be identical; and all series of serial Preferred Stock, as between themselves, shall rank equally and be identical, except as set forth in resolutions of the Board of Directors authorizing the issuance of the series."

Increase in Authorized Shares of Common Stock

We believe that an increase in the number of our authorized capital stock is prudent in order to assure that a sufficient number of shares of our capital stock is available for issuance in the future if our Board of Directors deems it to be in the best interests of our stockholders and us. Our Board of Directors has determined that a total of 75,000,000 shares of common stock to be a reasonable estimate of what might be required in this regard for the foreseeable future to (i) issue capital stock in acquisitions or strategic transactions and other proper corporate purpose that may be identified by our Board in the future; (ii) issue common stock to augment our capital and increase the ownership of our capital stock; and (iii) provide incentives through the grant of stock options and restricted stock to employees, directors, officers, independent contractors, and others important to our business under our stock option plans. Immediately following this increase, the Company will have approximately 72,924,436 shares of common stock authorized but unissued and available for issuance and 10,000,000 shares of preferred stock authorized but unissued and available for issuance. At present, we have 2,075,564 shares of common stock issued and outstanding and 11,107 shares issuable upon exercise of options granted under the Plans and no preferred stock authorized or issued.

The remaining authorized but unissued shares of capital stock will be available for issuance from time to time as may be deemed advisable or required for various purposes, including those noted above. Our Board will be able to authorize the issuance of shares for the foregoing purposes and other transactions without the necessity, and related costs and delays of either calling a special stockholders' meeting or waiting for the regularly scheduled Annual Meeting of Stockholders in order to increase the authorized capital. If in a particular transaction required stockholder approval by law or was otherwise deemed advisable by the Board, then the matter would be referred to the stockholders for their approval, even if we might have the requisite number of voting shares to consummate the transaction. The additional shares of common stock to be authorized by the Articles Amendment will have rights

identical to the currently outstanding common stock. Adoption of the Articles Amendment and issuance of the additional common stock authorized thereby will not affect the rights of the holders of our currently outstanding common stock, except for effects incidental to increasing the number of outstanding shares of our common stock, as discussed above.

Table Of Contents

Authorization of Blank Check Preferred Stock

In addition to the increase in our authorized common stock, the Articles Amendment also authorize the issuance of blank check preferred stock with such designations, rights and preferences as may be determined from time to time by our Board of Directors. Accordingly, upon effectiveness of the Articles Amendment, our Board of Directors will be authorized to issue the preferred stock without stockholder approval, except as may be required by applicable laws or rules. For example, under the rules of the NASDAQ Stock Market, shareholder approval is required for any potential issuance of 20% or more of our outstanding shares of common stock, including upon conversion of convertible preferred stock, in connection with acquisitions or discounted private placements. In connection with the issuance of the preferred stock, the Board would have the authority to designate and issue series of our preferred stock with dividend, liquidation, conversion, voting or other rights that could adversely affect the voting power or other rights of the holders of our common stock, substantially dilute the common stockholders' interests in the Company and depress the price of our common stock. In addition, although we do not presently intend to use the blank check preferred stock provision for such purpose, preferred stock authorized under such provision could be utilized, under certain circumstances, as a method of discouraging, delaying or preventing a change of control of the Company.

Our Board of Directors believes that authorization of blank check preferred stock is in the best interests of the Company and its stockholders because it is advisable to have the ability to authorize such shares of preferred stock and have them available for, among other things, possible issuances in connection with such activities as public or private offerings of shares for cash, acquisitions of other companies, pursuit of financing opportunities and other corporate purposes. However, we do not, at this time, have any plans, proposals or arrangements concerning the issuance of shares of our blank check preferred stock.

Effectiveness of the Articles Amendment

The amendment to our Articles of Incorporation described above will become effective upon the filing of the Articles Amendment with the Secretary of State of Nevada.

Potential Anti-Takeover effect of the Proposed Articles Amendment

The Articles Amendment relating to the increase in the number of authorized shares of our common stock and adoption of a blank check preferred stock is not intended to have any anti-takeover effect and is not part of any series of anti-takeover measures contained in our Articles of Incorporation or Bylaws in effect on the date of this proxy statement. However, our stockholders should note that the availability of additional authorized and unissued shares of common and preferred stock could make any attempt to gain control of the Company or the Board more difficult or time-consuming and that the availability of additional authorized and unissued shares might make it more difficult to remove management. Although the Board currently has no intention of doing so, shares of stock could be issued by the Board to dilute the percentage of stock owned by any stockholder and increase the cost of, or the number of, voting shares necessary to acquire control of the Board or to meet the voting requirements imposed by Nevada law with respect to a merger or other business combination involving us. The issuance of preferred stock with voting and conversion rights by our Board may adversely affect the voting power of the holders of common stock, including the loss of voting control to others.

Our Board of Directors did not propose this Articles Amendment for the purpose of discouraging mergers, tender offers, proxy contests, solicitation in opposition to management or other changes in control. We are not aware of any specific effort to accumulate our common stock or obtain control of us by means of a merger, tender offer, solicitation or otherwise. We have no present intention to use the increased number of authorized shares of stock or creation of the blank check preferred stock for anti-takeover purposes.

19

Table Of Contents

Effectiveness of Articles Amendment

The Articles Amendment will become effective once it is approved at the annual meeting and filed with the Secretary of State of Nevada. Upon filing the Articles Amendment with the Secretary of State of Nevada, our authorized shares of common stock will increase from 9,375,000 to 75,000,000 and our authorized preferred stock will increase from none to 10,000,000.

Vote Required and Recommendation

The affirmative vote of a majority of the issued and outstanding common stock will be required to approve the Articles Amendment.

Our Board of Directors Unanimously recommends that the stockholders vote

FOR the approval of the Amendment to our Articles of Incorporation to Increase the Number of Authorized Shares of our capital stock that we may issue from 9,375,000 to 85,000,000 shares, of which 75,000,000 shares shall be classified as common stock and 10,000,000 shares shall be classified as blank check preferred stock.

Proposal Three

Approval of the 2013 Stock Option and Restricted Stock Plan

The Company is seeking stockholder approval for the 2013 Stock Option and Restricted Stock Plan (the “2013 Plan”) including the reservation of 100,000 shares issuable under the 2013 Plan. The 2013 Plan was adopted by the Board of Directors on March 22, 2013, subject to stockholder approval at the annual meeting. Accordingly, no grants of options have been made under the 2013 Plan to date. If our stockholders approve the 2013 Plan, 100,000 shares will be available for future grants.

The Board of Directors believes that it is in the best interests of the Company and our stockholders for the Company to approve the 2013 Plan. There are relatively few shares available for grant under the existing stock option plans of the Company. The last stock option plan of the Company was approved in 2011. Due to the economic recession and dramatic stock market decline, including the price of the Company’s stock, the exercise prices of the vast majority of the options now outstanding are well above the current market price. The Board believes that equity awards assist in retaining, motivating and rewarding employees, executives and consultants by giving them an opportunity to obtain long-term equity participation in the Company. In addition, equity awards are an important contributor to aligning the incentives of the Company’s employees with the interests of our stockholders. The Board also believes equity awards are essential to attracting new employees and retaining current employees. Further, the granting of options to new and existing employees frequently permits the Company to pay lower salaries than otherwise might be the case. The Board of Directors believes that to remain competitive with other technology companies in our long-term incentive plans, the Company must continue to provide employees with the opportunity to obtain equity in the Company and that an inability to offer equity incentives to new and current employees would put the Company at a competitive disadvantage in attracting and retaining qualified personnel. Our named executive officers and directors have an interest in this proposal because they are expected to receive awards under the 2013 Plan if it is approved at the annual meeting.

Vote Required and Recommendation

The affirmative vote of a majority of the votes cast will be required to approve the 2013 Plan.

Our Board of Directors unanimously recommends that stockholders vote FOR the approval of the 2013 Stock Option and Restricted Stock Plan.

Table Of Contents

Summary of the 2013 Stock Option and Restricted Stock Plan

Our Board of Directors adopted the 2013 Plan on March 22, 2013. At the annual meeting, we are asking stockholders to approve the 2013 Plan and to approve the reservation of 100,000 shares issuable under the 2013 Plan. The 2013 Plan authorizes us to issue 100,000 shares of common stock upon exercise of options and grant of restricted stock awards. No options have been granted under the 2013 Plan to date. The 2013 Plan authorizes us to grant (i) to the key employees incentive stock options to purchase shares of common stock and non-qualified stock options to purchase shares of common stock and restricted stock awards and (ii) to non-employee directors and consultants' non-qualified stock options and restricted stock. As of March 22, 2013, approximately 91 employees, two executive officers, and six non-employee directors were eligible to participate in the 2013 Plan.

The following paragraphs provide a summary of the principal features of the 2013 Plan and its operation. The following summary is qualified in its entirety by reference to the 2013 Plan as set forth in Appendix A.

Objectives. The objective of the 2013 Plan is to provide incentives to our key employees, officers, directors and consultants to achieve financial results aimed at increasing stockholder value and attracting talented individuals to us. Persons eligible to be granted stock options or restricted stock under the 2013 Plan will be those persons whose performance, in the judgment of the Compensation Committee of our Board of Directors, can have significant impact on our success.

Oversight. Our Board will administer the 2013 Plan by making determinations regarding the persons to whom options or restricted stock should be granted and the amount, terms, conditions and restrictions of the awards. The Board also has the authority to interpret the provisions of the 2013 Plan and to establish and amend rules for its administration subject to the 2013 Plan's limitations. In addition, under the 2013 Plan, our Board is authorized to re-price any Option granted under the Plan by lowering its exercise price after it is granted, canceling an Option at a time when its exercise price exceeds the Fair Market Value of the stock underlying the Option, in exchange for another Option or Award, as well as any other action that is treated as a re-pricing under generally accepted accounting principles.

Number of Shares of Common Stock Available Under the 2013 Plan. If our stockholders approve the 2013 Plan, a total of 100,000 shares of our common stock will be reserved for issuance under the 2013 Plan.

The following table presents information concerning the outstanding equity awards for the Directors and Officers as of December 31, 2012:

Outstanding Equity Awards at Fiscal Year-End

Name	Number of securities underlying unexercised options (#) exercisable	Number of securities underlying unexercised options (#) unexercisable	Equity incentive plan awards: Number of securities underlying unexercised unearned options (#)	Option exercise price ($)	Option expiration date
Stanton E. Ross	—	15,000	—	$ 4.80	1/12/2022
Chairman, CEO and President	1,875	16,875	—	$ 13.20	1/10/2021
	2,250	1,500	—	$ 14.24	5/5/2019
	37,500	—	—	$ 54.40	1/2/2018

	21,875	—	—	$	32.40	10/15/2017
	25,000	—	—	$	12.80	3/3/2017
	24,228	—	—	$	8.00	8/31/2015
Leroy C. Richie	1,250	—	—	$	9.52	6/3/2021
Lead Outside Director	1,250	—	—	$	13.20	1/10/2021
	375	250	—	$	14.24	5/5/2019
	6,250	—	—	$	54.40	1/2/2018
	13,805	—	—	$	12.80	3/3/2017
	10,668	—	—	$	8.00	8/31/2015

Table Of Contents

Name	Number of securities underlying unexercised options (#) exercisable	Number of securities underlying unexercised options (#) unexercisable	Equity incentive plan awards: Number of securities underlying unexercised unearned options (#)	Option exercise price ($)	Option expiration date
Elliot M. Kaplan	4,375	4,375	—	$ 3.52	5/25/2022
Director	1,250	—	—	$ 9.52	6/3/2021
	1,250	—	—	$ 13.20	1/10/2021
	375	250	—	$ 14.24	5/5/2019
	6,250	—	—	$ 54.40	1/2/2018
	7,950	—	—	$ 12.80	3/3/2017
Daniel F. Hutchins	4,375	4,375	—	$ 3.52	5/25/2022
Director	1,250	—	—	$ 9.52	6/3/2021
	1,250	—	—	$ 13.20	1/10/2021
	375	250	—	$ 14.24	5/5/2019
	6,250	—	—	$ 54.40	1/2/2018
	1,250	—	—	$ 32.00	10/1/2017
Steven Phillips	—	15,000	—	$ 4.80	1/12/2022
Director, Former Vice President -Engineering	1,250	11,250	—	$ 13.20	1/10/2021
	1,125	750	—	$ 24.80	7/30/2019
	5,625	3,750	—	$ 14.28	5/4/2019
	5,625	3,750	—	$ 12.72	3/30/2019
Thomas J. Heckman	—	15,000	—	$ 4.80	1/12/2022
CFO, Treasurer and Secretary	1,250	11,250	—	$ 13.20	1/10/2021
	2,250	1,500	—	$ 24.80	7/30/2019
	2,250	1,500	—	$ 14.24	5/5/2019
	1,500	1,000	—	$ 12.72	3/30/2019
	12,500	—	—	$ 54.40	1/2/2018
	2,500	—	—	$ 32.40	10/15/2017
Kenneth L. McCoy	1,250	11,250	—	$ 13.20	1/1/2021
Former Director & Former Vice President — Marketing(1)	1,100	750	—	$ 24.80	5/5/2019
	1,100	750	—	$ 14.24	7/30/2019
	18,750	—	—	$ 54.40	1/2/2018
	12,500	—	—	$ 12.80	3/3/2017
	62,500	—	—	$ 8.00	8/31/2015

(1) Mr. McCoy resigned as an officer and as a director on January 11, 2012. He entered into a Consulting Agreement with the Company on January 13, 2012. Under such Agreement, which has two-year term, his outstanding stock options continue to be exercisable and unvested options continue to vest.

Types of Grants. The 2013 Plan allows for the grant of incentive stock options, non-qualified stock options and restricted stock awards. The 2013 Plan does not specify what portion of the awards may be in the form of incentive stock options, non-statutory options or restricted stock. Incentive stock options awarded to our employees are

qualified stock options under the Internal Revenue Code.

Statutory Conditions on Stock Option—Exercise Price. Incentive stock options granted under the 2013 Plan must have an exercise price at least equal to 100% of the fair market value of the common stock as of the date of grant. Incentive stock options granted to any person who owns, immediately after the grant, stock possessing more than 10% of the combined voting power of all classes of our stock, or of any parent or subsidiary corporation, must have an exercise price at least equal to 110% of the fair market value of the common stock on the date of grant. Non-statutory stock options may have an exercise price at least equal to 100% of the fair market value of the common stock as of the date of the grant.

Table Of Contents

- Dollar limit. The aggregate fair market value, determined as of the time an incentive stock option is granted, of the common stock with respect to which incentive stock options are exercisable by an employee for the first time during any calendar year cannot exceed $100,000. However, there is no aggregate dollar limitation on the amount of non-statutory stock options that may be exercisable for the first time during any calendar year.

- Expiration date. Any option granted under the 2013 Plan will expire at the time fixed by our Board of Directors, which cannot be more than ten years after the date it is granted or, in the case of any person who owns more than 10% of the combined voting power of all classes of our stock or of any subsidiary corporation, not more than five years after the date of grant.

- Exercisability. Our Board may also specify when all or part of an option becomes exercisable, but in the absence of such specification, the option will ordinarily be exercisable in whole or in part at any time during its term. However, the board of directors may accelerate the exercisability of any option at its discretion.

- Assignability. Options granted under the 2013 Plan are not assignable. Incentive stock options may be exercised only while the optionee is employed by us or within twelve months after termination by reason of death or disabilities or within three months after termination for any other reason.

Payment upon Exercise of Options. Payment of the exercise price for any option may be in cash, or with our consent, by withheld shares which, upon exercise, have a fair market value at the time the option is exercised equal to the option price (plus applicable withholding tax) or in the form of shares of common stock, subject to restrictions.

Restricted Stock. Our Board is authorized to grant restricted stock awards. A restricted stock grant is a grant of shares of our common stock, which is subject to restrictions on transferability, risk of forfeiture and other restrictions and which may be forfeited in the event of certain terminations of employment or service prior to the end of a restricted period specified by the Board of Directors. A participant granted restricted stock generally has all of the rights of a stockholder, unless otherwise determined by the Compensation Committee.

Merger or Sale of Assets. In the event of our merger with or into another corporation, or the sale of all or substantially all of our assets, any unvested Awards will vest immediately prior to closing of the event resulting in the change of control, and the Board shall have the power and discretion to provide for each award holder’s election alternatives regarding the terms and conditions for the exercise of such awards. The alternative may provide that each outstanding stock option and restricted stock award will be assumed or substituted for by the successor corporation (or a parent or subsidiary or such successor corporation). If there is no assumption or substitution of outstanding awards, the administrator will provide notice to the recipient of their alternatives regarding their right to exercise the stock option as to all of the shares subject to the stock option.

Amendment and Termination of the 2013 Plan. . The administrator has the authority to amend, alter, suspend, or terminate the 2013 Plan, except that stockholder approval will be required for any amendment to the 2013 Plan to the extent required by any applicable law, regulation, or Nasdaq or stock exchange rule. Any amendment, alteration, suspension, or termination will not, without the consent of the participant, materially adversely affect any rights or obligations under any stock option or restricted stock award previously granted. The 2013 Plan has a term of ten (10) years beginning March 22, 2013, unless terminated earlier by the administrator.

Table Of Contents

Recent Stock Option and Restricted Stock Award Grants to Employees, Consultants, and Directors

As of December 31, 2012, the Company had adopted five separate stock option and restricted stock plans: (i) the 2005 Stock Option and Restricted Stock Plan (the "2005 Plan"), (ii) the 2006 Stock Option and Restricted Stock Plan (the "2006 Plan"), (iii) the 2007 Stock Option and Restricted Stock Plan (the "2007 Plan"), (iv) the 2008 Stock Option and Restricted Stock Plan (the "2008 Plan") and (v) the 2011 Stock Option and Restricted Stock Plan (the "2011 Plan"). These Plans permit the grant of stock options or restricted stock to its employees, non-employee directors and others for up to a total of 875,000 shares of common stock. The Company believes that such awards better align the interests of its employees with those of its stockholders. Option awards have been granted with an exercise price equal to the market price of the Company's stock at the date of grant with such option awards generally vesting based on the completion of continuous service and having ten-year contractual terms. These option awards provide for accelerated vesting if there is a change in control (as defined in the Plans). The Company has registered all shares of common stock that are issuable under its Plans with the SEC. A total of 89,357 options remain available for grant under the various Plans as of December 31, 2012.

The 2005 Plan, 2006 Plan, 2007 Plan, 2008 and 2011 Plan are referred to as the "Plans."

The number of stock options and restricted stock awards that an employee, director, or consultant may receive under our Plans is in the discretion of the administrator and therefore cannot be determined in advance, although the Board of Directors' policy for 2012 was to grant directors and officers a combination of stock options and restricted shares.

The following table sets forth (a) the aggregate number of shares subject to options granted under the Plans during the year-ended December 31, 2012 and (b) the average per share exercise price of such options.

Stock Option and Restricted Stock Grants

Name of Individual or Group	Number of Restricted Shares of Common Stock Granted	Number of Options Granted	Average per Share Exercise Price
Stanton E. Ross, Chairman of the Board, CEO & President	—	15,000	$4.80
Leroy C. Richie, Director	4,375	—	$—
Elliot M. Kaplan, Director	—	8,750	$3.52
Daniel F. Hutchins, Director	—	8,750	$3.52
Bernard A. Bianchino, Director	4,375	—	$—
Stephen Gans, Director	7,500	—	$—
Kenneth L. McCoy, Former Director, Vice President – Marketing (1)	—	—	$—
Thomas J. Heckman, Vice President, CFO, Treasurer & Secretary	—	15,000	$4.80
Steven Phillips, Director, Former Vice President -- Engineering (2)	—	15,000	$4.80
All executive officers, as a group	—	30,000	$4.80
All directors who are not executive officers, as a group	16,250	32,500	$4.11
All employees who are not executive officers, as a group	—	78,875	$3.35

(1) Mr. McCoy resigned as an officer and as a director on January 11, 2012. He entered into a Consulting Agreement with the Company on January 13, 2012. Under such Agreement, which has two-year term, his outstanding stock

options continue to be exercisable and unvested options continue to vest.

(2) Mr. Phillips resigned his position as Vice President – Engineering effective July 13, 2012. Mr. Phillips was elected as a Director concurrent with his resignation as an officer of the Company. For purposes of the above table, Mr. Phillips stock option and restricted stock grants have been classified as a director who is not also an executive officer.

Table Of Contents

Federal Tax Aspects

The following summary is a brief discussion of certain federal income tax consequences to U.S. taxpayers and to the Company of stock option and restricted stock awards granted under the 2013 Plan. This summary is not intended to be a complete discussion of all of the federal income tax consequences of the 2013 Plan or of all of the requirements that must be met in order to qualify for the tax treatment described below. The following summary is based upon the provisions of U.S. federal tax law as in effect on the date hereof, which is subject to change (perhaps with retroactive effect), and does not constitute tax advice. In addition, because tax consequences may vary, and certain exceptions to the general rules discussed in this summary may be applicable, depending upon the personal circumstances of individual recipients and each recipient should consider his or her personal situation and consult with his or her own tax advisor with respect to the specific tax consequences applicable to him or her. The following assumes stock options have been granted at an exercise price per share at least equal to 100% of the fair market value of the Company’s common stock on the date of grant.

Tax consequences of nonqualified stock options. In general, an employee, director or consultant will not recognize income at the time of the grant of nonqualified options under the 2013 Plan. When an optionee exercises a nonqualified stock option, he or she generally will recognize ordinary income equal to the excess, if any, of the fair market value (determined on the day of exercise) of the shares of the common stock received over the option exercise price. The tax basis of such shares to the optionee will be equal to the exercise price paid plus the amount of ordinary income includible in his or her gross income at the time of the exercise. Upon a subsequent sale or exchange of shares acquired pursuant to the exercise of a nonqualified stock option, the optionee will have taxable capital gain or loss, measured by the difference between the amount realized on the sale or exchange and the tax basis of the shares. The capital gain or loss will be short-term or long-term depending on holding period of the shares sold.

Tax consequences of incentive stock options. In general, an employee will not recognize income on the grant of incentive stock options under the 2013 Plan. Except with respect to the alternative minimum tax, an optionee will not recognize income on the exercise of an incentive stock option unless the option exercise price is paid with stock acquired on the exercise of an incentive stock option and the following holding period for such stock has not been satisfied. For purposes of the alternative minimum tax, however, an optionee will be required to treat an amount equal to the difference between the fair market value (determined on the day of exercise) of our shares of the common stock received and the exercise price as an item of adjustment in computing the optionee's alternative minimum taxable income.

An optionee will recognize long-term capital gain or loss on a sale of the shares acquired on exercise, provided the shares acquired are not sold or otherwise disposed of before the earlier of: (i) two years from the date of grant of the option, or (ii) one year from the date of exercise of the option. In general, the amount of gain or loss will equal the difference, if any, between the sale price of such shares and the exercise price. If the stock is not held for the required period of time, the optionee will recognize ordinary income to the extent the fair market value (determined on the day of exercise) of the stock exceeds the option price, but limited to the gain recognized on sale. The balance of any such gain will be a short-term or long-term capital gain (depending on the applicable holding period).

For the exercise of a stock option to qualify for the foregoing incentive stock option tax treatment, an optionee generally must be an employee of the Company continuously from the date of the grant until any termination of employment, and in the event of a termination of employment, the stock option must be exercised within three months after the termination.

Table Of Contents

Tax consequences of restricted stock awards. In general, the recipient of a stock award that is not subject to restrictions will recognize ordinary income at the time the shares are received equal to the excess, if any, of the fair market value of the shares received over the amount, if any, the recipient paid in exchange for the shares. If, however, the shares are subject to vesting or other restrictions (that is, they are nontransferable and subject to a substantial risk of forfeiture) when the shares are granted (for example, if the employee is required to work for a period of time in order to have the right to sell the stock), the recipient generally will not recognize income until the shares becomes vested or the restrictions otherwise lapse, at which time the recipient will recognize ordinary income equal to the excess, if any, of the fair market value of the shares on the date of vesting (or the date of the lapse of a restriction) less the amount, if any, the recipient paid in exchange for the shares. If the shares are forfeited under the terms of the restricted stock award, the recipient will not recognize income and will not be allowed an income tax deduction with respect to the forfeiture.

A recipient may file an election under Section 83(b) of the Internal Revenue Code with the Internal Revenue Service within thirty (30) days of his or her receipt of a restricted stock award to recognize ordinary income, as of the award date, equal to the excess, if any, of the fair market value of the shares on the award date less the amount, if any, the recipient paid in exchange for the shares. If a recipient makes a Section 83(b) election, then the recipient will not otherwise be taxed in the year the vesting or restriction lapses, and, if the stock award is forfeited, he or she will not be allowed an income tax deduction. If the recipient does not make a Section 83(b) election, dividends paid to the recipient on the shares prior to the date the vesting or restrictions lapse will be treated as compensation income.

The recipient’s tax basis for the determination of gain or loss upon the subsequent disposition of shares acquired as stock awards will be the amount paid for such shares plus the amount includible in his or her gross income as compensation in respect of such shares.

Withholding and other consequences. Any compensation includible in the gross income of a recipient will be subject to appropriate federal and state income tax withholding.

Tax effect for the Company. The Company generally is entitled to an income tax deduction in connection with a stock option or restricted stock award granted under the 2013 Plan in an amount equal to the ordinary income realized by a recipient at the time the recipient recognizes such income (for example, the exercise of a nonqualified stock option). Special rules may limit the deductibility of compensation paid to the Company’s Chief Executive Officer and to each of its four most highly compensated executive officers under Section 162(m) of the Internal Revenue Code to the extent that annual compensation paid to any of the foregoing individuals exceeds $1,000,000.

The foregoing is only a brief summary of the effect of federal income taxation upon participants and the Company with respect to the grant and exercise of stock options, stock appreciation rights, and restricted stock awards under the 2013 Plan. It does not purport to be complete, and does not discuss the tax consequences of a recipient’s death or the provisions of the income tax laws of any municipality state or foreign country in which the recipient may reside. The foregoing Summary is not intended or written to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer.

Table Of Contents

Proposal Three

Advisory (non-binding) Vote on Executive Compensation

Digital's compensation policies and procedures are centered on a pay-for-performance philosophy, and we believe that they are strongly aligned with the long-term interests of our stockholders. Our compensation program is designed to attract, motivate, and retain the key executives who drive our success. Compensation that rewards excellence and reflects performance, and alignment of that compensation with the interests of long-term stockholders, are key principles of our compensation program design. Although we have made and will continue to make improvements to our compensation program from time to time, these key principles have been unchanged for many years.

We support the principle that our corporate governance policies, including our executive compensation program, should be responsive to stockholder concerns. This principle is embodied in a non-binding, advisory vote that gives you as a stockholder the opportunity to approve the compensation of our named executive officers as disclosed in this proxy statement, including, among other things, our executive compensation objectives, policies and procedures. This vote is intended to provide an overall assessment of our executive compensation program rather than to focus on any specific item of compensation. The Compensation Committee, and the Board as a whole, value the opinions of our stockholders and intend to take the outcome of this vote into account when considering future executive compensation arrangements. However, because the vote is advisory, it will not directly affect any existing compensation awards of any of our executive officers, including our named executive officers.

As discussed above, our executive compensation program is designed:

- to demand and reward excellence from each of our executive officers and from the management team as a whole;
- to align Digital's interests with the interests of executives and other employees through compensation programs that recognize individual contributions toward the achievement of corporate goals and objectives without encouraging unnecessary or unreasonable risks;
- to further link executive and stockholder interests through equity-based compensation and long-term stock ownership arrangements;
- to recognize and reward excellence in an executive's performance in the furtherance of Digital's goals and objectives without undertaking unnecessary or excessive risk; and
- to attract and retain high caliber executive and employee talent.

The application of these principles and our executive compensation philosophy, policies and procedures have resulted in a corporate culture that demands excellence and recognizes individual and team performance without encouraging unnecessary or excessive risks. We align the interests of stockholders and executives by linking a substantial portion of compensation to the Company's performance. For example, approximately 32% of the total 2012 compensation disclosed in the Summary Compensation Table for our named executive officers (excluding the increase in the value of retirement benefits and earnings on deferred compensation) consisted of either incentives that were subject to pre-established performance criteria or equity awards whose ultimate value upon resale depends upon the value of our stock to stockholders. We have made and will continue to make improvements to our compensation program from time to time. In most cases, compensation decisions made during 2012 resulted in maintaining pay levels at the prior year's level with only a small, customary increase in base pay.

We encourage you to consider the detailed information provided in the Summary Compensation Table and the tables and other information that follow it. The Board and the Compensation Committee will review the advisory voting results and will take them into account in making future executive compensation decisions.

Table Of Contents

After reviewing the information provided above and in the other parts of this proxy statement, the Board of Directors asks you to approve the following advisory resolution:

Resolved, that Digital’s stockholders hereby approve, on an advisory, nonbinding basis, the compensation paid to Digital’s named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the compensation tables and narrative discussion in this proxy statement.

This advisory vote will be approved if it receives the affirmative vote of a plurality of the shares of common stock present in person or represented by proxy at the annual meeting and entitled to vote with respect to this proposal. Abstentions and broker non-votes will not affect the outcome of this proposal. If no voting specification is made on a properly returned and signed proxy card (excluding broker non-votes), the proxies named on the proxy card will vote “For” this resolution.

Our Board of Directors recommends that you vote FOR this proposal approving the compensation paid to Digital's named executive officers as disclosed herein.

Proposal Four

Advisory (Non-binding) Vote on the Frequency of Stockholder Votes

Regarding Executive Compensation

Our stockholders are entitled to cast an advisory vote at the annual meeting regarding how frequently stockholders should consider and cast an advisory vote to approve the compensation of our named executive officers. The choices are every three years, every two years or every year. While this is an advisory vote that is not binding on the Company or the Board of Directors, we will consider the outcome of this vote when making our determination regarding how frequently the advisory vote regarding executive compensation will be held.

We believe that a three-year frequency is preferable for such vote, because an annual or even biennial frequency creates the risk of relying upon hindsight to an unwarranted degree in evaluating the amount of executive compensation paid in one particular year. Our financial results in any particular year can be significantly impacted by factors beyond management's control and for which our executives deserve neither credit nor blame, (such as difficulties in forecasting in volatile economic conditions, or unexpected changes in the markets for our products and those of our customers. The determination of whether our executives' compensation is closely tied to performance and properly rewards excellence is best viewed over a multi-year period.

In addition, a three-year frequency would lead to more thoughtful change, if we received an advisory vote disapproving of our executive compensation program. We would use the time to fully understand the specific stockholder concerns that led to that vote, and to develop and consider alternatives. We would likely implement any resulting changes on a prospective basis beginning not earlier than the year following the stockholder vote in any case. This means that few if any of the changes would be reflected in the executive compensation reported in the proxy statement for the next stockholders' meeting. If the vote is held on a three-year frequency, the additional time will lead to more informed changes and the creation of sufficient compensation data to permit meaningful evaluation of any changes.

The Board of Directors values and encourages constructive dialogue with our stockholders on compensation and other important governance topics. The Board currently believes that providing stockholders with an advisory vote on our executive compensation philosophy, policies and procedures every three years will enhance the value of stockholder communication by encouraging a longer-term focus. We note that stockholders will also be asked to express their

views whenever we adopt or materially amend our executive equity compensation plans, and that stockholders can express their views to management or the Board at any time by contacting the Company Secretary.

Table Of Contents

After reviewing the information provided above and in the other parts of this proxy statement, the Board of Directors asks you to give your advisory vote regarding the frequency of stockholder advisory votes to approve the compensation of our named executive officers. You can give your advisory vote at the meeting or by indicating your preference on the enclosed proxy card, which asks for your vote pursuant to the following resolution:

RESOLVED, that Digital's stockholders recommend that the advisory, non-binding vote to approve the compensation of its named executive officers be held every (CHECK ONE):

_____ Three (3) years

_____ Two (2) years

_____ One (1) year

_____ Abstain

Note that the proxy card provides for the four choices identified above and that you are not voting to approve or disapprove the Board's recommendation. You should check only one alternative. The Board will consider the results of this advisory vote in determining the frequency of similar advisory votes in the future.

The outcome of this advisory vote will be determined by whichever of the choices (every three years, every two years or every year) receives the greatest number of votes cast. If at the most recent stockholder frequency vote a single frequency (i.e., three years, two years or one year) receives the support of a majority of the votes cast and we adopt a frequency that is consistent with that choice, we may exclude from future proxy statements any stockholder proposals that recommend a different frequency. Shares marked to indicate abstentions and broker non-votes will not affect the outcome of this proposal. If no voting specification is made on a properly returned and signed proxy card, the proxies named on the proxy card will vote for a frequency of every THREE YEARS for future advisory votes regarding executive compensation pursuant to this resolution.

Our Board of Directors recommends that you vote in favor of holding the advisory vote to approve the compensation of Digital's named executive officers every THREE YEARS.

Table Of Contents

Proposal 6

Ratification of Appointment of Independent Registered Public Accounting Firm

The Audit Committee of the Board of Directors has appointed Grant Thornton LLP as the independent registered public accounting firm to audit our financial statements for the year ending December 31, 2013 and recommends that our stockholders vote for ratification of such appointment. Although we are not required to seek stockholder approval of this appointment, the Board believes it to be sound corporate governance to do so. Notwithstanding the selection by the Audit Committee of Grant Thornton LLP, the Audit Committee may direct the appointment of a new independent registered public accounting firm at any time during the year if the Board of Directors determines that such a change would be in our best interest and in that of our stockholders. If the appointment is not ratified, the Audit Committee will investigate the reasons for stockholder rejection and will reconsider the appointment.

The Audit Committee believes that Grant Thornton LLP is well suited to provide the services that the Company requires in 2013 and beyond. Representatives of Grant Thornton LLP are expected to attend the annual meeting, where they will be available to respond to questions and, if they desire, to make a statement.

Audit and Related Fees

The following table is a summary of the fees billed to us by Grant Thornton LLP for the fiscal year ended December 31, 2012 and 2011:

Fee Category:	Fiscal 2012 Fees	Fiscal 2011 Fees
Audit Fees	$ 134,000	$ 126,700
Audit-Related Fees	—	—
Tax Fees	—	—
All Other Fees	—	—
Total Fees	$ 134,000	$ 126,700

Audit Fees. Such amount consists of fees billed for professional services rendered in connection with the audit of our annual financial statements and review of the interim financial statements included in our quarterly reports. It also includes services that are normally provided by our independent registered public accounting firms in connection with statutory and regulatory filings or engagements.

Audit-Related Fees. Consists of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements and are not reported under “Audit Fees.” These services include employee benefit plan audits, accounting consultations in connection with acquisitions, attest services that are not required by statute or regulation, and consultations concerning financial accounting and reporting standards.

Tax Fees. Tax fees consist of fees billed for professional services related to tax compliance, tax advice and tax planning. These services include assistance regarding federal, state and international tax compliance, tax audit defense, customs and duties, mergers and acquisitions, and international tax planning.

All Other Fees. Consists of fees for products and services other than the services reported above. In fiscal 2012 and 2011, there were no fees related to this category.

The Audit Committee's practice is to consider and approve in advance all proposed audit and non-audit services to be provided by our independent registered public accounting firm. All of the fees shown above were pre-approved by the Audit Committee.

The audit report of Grant Thornton LLP on the consolidated financial statements of the Company for the years ended December 31, 2012 and 2011 did not contain an adverse opinion or disclaimer of opinion, and was not qualified or modified as to uncertainty, audit scope or accounting principles.

Table Of Contents

During our fiscal year ended December 31, 2012, there were no disagreements with Grant Thornton LLP on any matter of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements if not resolved to Grant Thornton LLP's satisfaction would have caused it to make reference to the subject matter of such disagreements in connection with its reports on the financial statements for such periods.

During our fiscal years ended December 31, 2012 and 2011, there were no reportable events (as described in Item 304(a)(1)(v) of Regulation S-K).

Vote Required and Board Recommendation

If a quorum is present, the affirmative vote of a majority of the shares present and entitled to vote at the annual meeting will be required to ratify the appointment of Grant Thornton LLP as our independent registered public accounting firm. Abstentions will have the effect of a vote against this proposal, and broker non-votes will have no effect on the outcome of the vote with respect to this proposal.

Our Board of Directors unanimously recommends that stockholders vote
FOR the ratification of the appointment of Grant Thornton LLP
as the independent registered accounting firm of Digital Ally, Inc.
for the year ending December 31, 2013.

Table Of Contents

Notwithstanding anything to the contrary set forth in any of our previous filings under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended, that might incorporate future filings, including this proxy statement, in whole or in part, the Audit Committee Report shall not be incorporated by reference into any such filings.

Report of the Audit Committee

Below is the report of the Audit Committee with respect to our audited consolidated financial statements for the fiscal year ended December 31, 2012, which includes our consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations, stockholders' equity and cash flows for each of the fiscal years ended December 31, 2012 and December 31, 2011 and the notes thereto.

In accordance with the written charter adopted by the Board of Directors, the Audit Committee of the Board of Directors has the primary responsibility for overseeing our financial reporting, accounting principles and system of internal accounting controls, and reporting its observations and activities to the Board of Directors. It also approves the appointment of our independent registered public accounting firm and approves in advance the services performed by such firm.

Review and Discussion with Management

The Audit Committee has reviewed and discussed with management our audited consolidated financial statements for the fiscal year ended December 31, 2012, the process designed to achieve compliance with Section 404 of the Sarbanes-Oxley Act of 2002, our assessment of internal control over financial reporting and the report by our independent registered public accounting firm thereon.

Review and Discussions with Independent Registered Public Accounting Firm

The Audit Committee has discussed with Grant Thornton LLP, our independent registered public accounting firm for fiscal year 2012, the matters the Audit Committee is required to discuss pursuant to Statement on Auditing Standards No. 61 (Communications with Audit Committees), which includes, among other items, matters related to the conduct of the audit of our consolidated financial statements.

The Audit Committee also has received the written disclosures and the letter from Grant Thornton LLP, required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees) and has discussed with Grant Thornton LLP, any relationships that may impact its independence, and satisfied itself as to the independent registered public accounting firm's independence.

Conclusion

Based on the review and discussions referred to above, the Audit Committee recommended to the Board of Directors that our audited consolidated financial statements for the fiscal year ended December 31, 2012 be included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 for filing with the Securities and Exchange Commission.

Respectfully submitted by:

THE AUDIT COMMITTEE OF THE BOARD OF DIRECTORS OF DIGITAL ALLY, INC.

Daniel F. Hutchins, Chairman
Leroy C. Richie
Stephen Gans
Bernard A. Bianchino

Table Of Contents

Executive Compensation

The following table presents information concerning the total compensation of the Company's Chief Executive Officer, Chief Financial Officer and the three other most highly compensated officers during the last fiscal year (the "Named Executive Officers") for services rendered to the Company in all capacities for the years ended December 31, 2012 and 2011:

Summary Compensation Table

Name and principal position	Year	Salary ($)	Bonus ($)	Stock awards ($) (1)	Option awards ($) (1)	All other compensation ($) (2)	Total ($)
Stanton E. Ross	2012	$ 175,000	$ —	$ —	$ 27,226	$ 13,551	$ 215,777
Chairman, CEO and President	2011	$ 259,998	$ —	$ —	$ 123,212	$ 15,033	$ 398,243
Kenneth L. McCoy	2012	$ 12,115	$ —	$ —	$ —	$ 2,739	$ 14,854
Former Director & Vice President – Marketing (3)	2011	$ 177,883	$ —	$ —	$ 82,141	$ 29,130	$ 289,154
Thomas J. Heckman	2012	$ 175,000	$ 50,000	$ —	$ 27,226	$ 17,786	$ 270,012
Vice President, Chief Financial Officer, Treasurer and Secretary	2011	$ 177,883	$ —	$ —	$ 82,141	$ 18,380	$ 278,404
Steven Phillips	2012	$ 109,038	$ —	$ —	$ 27,226	$ 9,751	$ 146,015
Director, Former Vice President - Engineering (4)	2011	$ 177,883	$ —	$ —	$ 82,141	$ 16,996	$ 277,020
Edward Smith	2012	$ —	$ —	$ —	$ —	$ 3,366	$ 3,366
Former Vice President – Operations (5)&(6)	2011	$ 13,461	$ —	$ —	$ —	$ 85,219	$ 98,680
Michael Caulfield	2012	$ 6,058	$ —	$ —	$ —	$ 1,232	$ 7,290
Former Vice President - Strategic Development (7)	2011	$ 93,749	$ —	$ —	$ 82,141	$ 14,316	$ 190,206

(1) Represents aggregate grant date fair value pursuant to ASC Topic 718 for the respective year for stock options granted. Please refer to Note 12 to the consolidated financial statements for further description of the awards and the underlying assumptions utilized to determine the amount of grant date fair value related to such grants.

(2) Amounts included in all other compensation include the following items: i) The employer contribution to the Company's 401(k) Retirement Savings Plan (the "401(k) Plan") on behalf of the named executive. The Company is required to provide a 100% matching contribution for all who elect to contribute up to 3% of their compensation to the plan and a 50% matching contribution for all employees' elective deferral between 4% and 5%. The employee is 100% vested at all times in the employee contributions and employer matching contributions; ii) Company paid healthcare insurance; iii) Company paid housing; and iv) Separation Agreement Payments. See "All Other Compensation Table" below.

(3) Mr. McCoy resigned as a director and officer on January 11, 2012.

(4) Mr. Phillips resigned his position as Vice President – Engineering effective July 13, 2012. Mr. Phillips was elected as a Director concurrent with his resignation as an officer of the Company. For purposes of the above table, Mr. Phillips compensation has been included in the above table for the period through his date of resignation.

(5) Other compensation amounts for Mr. Smith include payments due under Mr. Smith's separation agreement totaling $84,135 in 2011 and 3,366 in 2012. Mr. Smith resigned effective January 6, 2011. The Company entered into a separation agreement with Mr. Smith that required the Company to continue his compensation for twelve months. Mr. Smith was paid a total $13,461 through his resignation date in 2011 and the remaining $84,135 subsequent to his resignation for the year ended December 31, 2011.

(6) Mr. Smith separated from the Company on January 6, 2011.

(7) Mr. Caulfield resigned as an officer on January 11, 2012.

Table Of Contents

All Other Compensation Table

Name	Year	401(k) Plan contribution by Company	Company paid healthcare insurance	Flexible & health savings account contributions by Company	Housing allowance payments	Separation Agreement payments	Total
Stanton E. Ross Chairman, CEO and President	2012	$ —	$ 13,551	$ —	$ —	$ —	$ 13,551
	2011	$ 717	$ 13,816	$ 500	$ —	$ —	$ 15,033
Kenneth L. McCoy (1) Former Director & Vice President – Marketing	2012	$ 485	$ 770	$ —	$ 1,485	$ —	$ 2,739
	2011	$ 8,495	$ 8,635	$ —	$ 12,000	$ —	$ 29,130
Thomas J. Heckman Vice President, Chief Financial Officer, Treasurer and Secretary	2012	$ 7,000	$ 10,317	$ 469	$ —	$ —	$ 17,786
	2011	$ 8,495	$ 8,635	$ 1,250	$ —	$ —	$ 18,380
Steven Phillips (2) Director, Former Vice President -Engineering	2012	$ 4,362	$ 5,389	$ —	$ —	$ —	$ 9,751
	2011	$ 8,362	$ 8,635	$ —	$ —	$ —	$ 16,997
Edward Smith (3) Former Vice President – Operations	2012	$ —	$ —	$ —	$ —	$ 3,366	$ 3,366
	2011	$ 250	$ 820	$ 14	$ —	$ 84,135	$ 85,219
Michael Caulfield (1) Former Vice President - Strategic Development	2012	$ —	$ 1,232	$ —	$ —	$ —	$ 1,232
	2011	$ —	$ 13,816	$ 500	$ —	$ —	$ 14,316

(1) Messrs. McCoy and Caulfield resigned as officers and Mr. McCoy resigned as a director on January 11, 2012.
(2) Mr. Phillips resigned as an officer and concurrently was elected as a director on July 13, 2012.
(3) Mr. Smith separated from the Company on January 6, 2011.

Compensation Policy. The Company's executive compensation plan is based on attracting and retaining qualified professionals who possess the skills and leadership necessary to enable the Company to achieve earnings and profitability growth to satisfy its stockholders. The Company must, therefore, create incentives for these executives to achieve both Company and individual performance objectives through the use of performance-based compensation programs. No one component is considered by itself, but all forms of the compensation package are considered in total. Wherever possible, objective measurements will be utilized to quantify performance, but many subjective factors still come into play when determining performance.

Compensation Components. The main elements of its compensation package consist of base salary, stock options and bonus.

Base Salary. The base salary for each executive officer is reviewed and compared to the prior year, with considerations given for increase or decrease. The review is generally on an annual basis, but may take place more often in the discretion of the Compensation Committee.

For fiscal year 2012, the Compensation Committee extended the reduced executive officers' salaries that were implemented in 2011 in an effort to decrease overall compensation costs and to help the Company improve its operating results in 2012. As a result, the annual base salary of Stanton E. Ross, President and Chief Executive Officer, was set at $175,000 for 2013 which was the same as 2012. Mr. Ross' 2011 annual salary was reduced from $297,500 to $175,000 effective August 17, 2011. The Compensation Committee set the annual base salaries of Thomas J. Heckman, Chief Financial Officer at $175,000 for 2013, which is the same as his 2012 and 2011 levels.

Table Of Contents

The Committee plans to review the base salaries for possible adjustments on an annual basis. Base salary adjustments will be based on both individual and Company performance and will include both objective and subjective criteria specific to each executive's role and responsibility with the Company.

Stock Options and Restricted Stock Awards. The Compensation Committee determined stock option and restricted stock awards based on numerous factors, some of which include responsibilities incumbent with the role of each executive to the Company, tenure with the Company, as well as Company's performances. The vesting period of said options is also tied, in some instances, to Company performance directly related to certain executive's responsibilities with the Company.

Bonuses. The Compensation Committee has determined that each of the executive officers will be eligible for the following bonuses in 2013 based on their individual performance throughout the year: Stanton E. Ross and Thomas J. Heckman - $75,000 each. The Compensation Committee will review each executive officer's performance on a quarterly basis and determine what, if any, portion of the bonus he has earned and will be paid as of such point. it awarded Thomas J. Heckman a bonus of $50,000 for his performance in 2012.

Other. In July 2008, the Company amended and restated its 401(k) retirement savings plan (the "401(k) Plan"). The amended plan requires the Company to provide a 100% matching contribution for employees who elect to contribute up to 3% of their compensation to the plan and a 50% matching contribution for employee's elective deferrals between 4% and 5%. The Company has made matching contributions for executives who elected to contribute to the 401(k) Plan during 2010. Each participant is 100% vested at all times in employee and employer matching contributions. As of December 31, 2012, 36,110 shares of Digital common stock were held in the 401(k) Plan. Mr. Heckman, as trustee of the 401(k) Plan, holds the voting power as to the shares of Digital common stock held in the 401(k) Plan. The Company has no profit sharing plan in place for employees. However, it may give consideration to adding such a plan to provide yet another level of compensation to its compensation plan.

The following table presents information concerning the grants of Plan-based awards to the Named Executive Officers during the year ended December 31, 2012:

Grants of Plan-Based Awards

Name	Grant date	Date approved by Compensation Committee	All other option awards: number of securities underlying options (#) (1)	Exercise or base price of option awards ($/Share)	Grant date fair value of stock awards ($) (2)
Stanton E. Ross Chairman, CEO and President	1/13/2012	1/13/2012	15,000	$ 4.80	$ 27,226
Thomas J. Heckman Vice President CFO, Treasurer and Secretary	1/13/2012	1/13/2012	15,000	$ 4.80	$ 27,226
Steven Phillips Former Vice President — Engineering	1/13/2012	1/13/2012	15,000	$ 4.80	$ 27,226

(1)

These stock option awards were made under the Digital Ally, Inc. Stock Option and Restricted Stock Plans and vest over a two-year period with 7,500 shares vesting on January 13, 2013 and the remainder on January 13, 2014 contingent upon whether the individual is still employed by the Company at that point.

(2) Stock awards noted represent the aggregate amount of grant date fair value as determined under ASC Topic 718. Please refer to 12 to the consolidated financial statements for further description of the awards and the underlying assumptions utilized to determine the amount of grant date fair value related to such grants.

(3) Mr. Phillips resigned as an officer effective July 13, 2012 and was concurrently appointed as a director. Mr. Phillips is included in the above table of Grants of Plan-Based Awards through his resignation date.

Table Of Contents

The following table presents information concerning the outstanding equity awards for the Named Executive Officers as of December 31, 2012:

Outstanding Equity Awards at Fiscal Year-End

Name	Number of securities underlying unexercised options (#) exercisable (1)	Number of securities underlying unexercised options (#) unexercisable (1)	Equity incentive plan awards: Number of securities underlying unexercised unearned options (#)	Option exercise price ($)	Option expiration date
Stanton E. Ross	—	15,000	—	$ 4.80	1/12/2022
Chairman, CEO	1,875	16,875	—	$ 13.20	1/10/2021
and President	2,250	1,500	—	$ 14.24	5/5/2019
	37,500	—	—	$ 54.40	1/2/2018
	21,875	—	—	$ 32.40	10/15/2017
	25,000	—	—	$ 12.80	3/3/2017
	24,228	—	—	$ 8.00	8/31/2015
Kenneth L. McCoy (2)	1,250	11,250	—	$ 13.20	1/1/2021
Former Director &	1,100	750	—	$ 24.80	5/5/2019
Vice President — Marketing	1,100	750	—	$ 14.24	7/30/2019
	18,750	—	—	$ 54.40	1/2/2018
	12,500	—	—	$ 12.80	3/3/2017
	62,500	—	—	$ 8.00	8/31/2015
Thomas J. Heckman	—	15,000	—	$ 4.80	1/12/2022
CFO, Treasurer and	1,250	11,250	—	$ 13.20	1/10/2021
Secretary	2,250	1,500	—	$ 24.80	7/30/2019
	2,250	1,500	—	$ 14.24	5/5/2019
	1,500	1,000	—	$ 12.72	3/30/2019
	12,500	—	—	$ 54.40	1/2/2018
	2,500	—	—	$ 32.40	10/15/2017
Steven Phillips (3)	—	15,000	—	$ 4.80	1/12/2022
Director, Former Vice President -	1,250	11,250	—	$ 13.20	1/10/2021
Engineering	1,125	750	—	$ 24.80	7/30/2019
	5,625	3,750	—	$ 14.28	5/4/2019
	5,625	3,750	—	$ 12.72	3/30/2019

(1) These stock option awards were made under the Digital Ally, Inc. Stock Option and Restricted Stock Plans and vest over a the prescribed period contingent upon whether the individual is still employed by the Company at that point.

(2) Mr. McCoy entered into a Consulting Agreement with the Company on January 13, 2012. Under such Agreement, which has two-year term, his outstanding stock options continue to be exercisable and unvested options continue to vest.

(3) Mr. Phillips resigned as an officer effective July 13, 2012 and was concurrently appointed as a director. Mr. Phillips' outstanding stock options continue to vest as long as he remains as a director and therefore are included in the above table of Outstanding Equity Awards at Fiscal Year End Grants of Plan-Based Awards.

Table Of Contents

The following table presents information concerning the stock options exercised and the vesting of stock awards during 2012 for the Named Executive Officers as of December 31, 2012:

Options Exercises and Stock Vested

	Option Awards		Stock Awards	
Name	Number of Shares acquired on exercise (#)	Value realized on exercise ($)	Number of Shares acquired on vesting (#)	Value realized on vesting ($)
Stanton E. Ross Chairman, CEO & President	—	$—	—	$—
Kenneth L. McCoy (1) Former Director & Vice President — Marketing	—	$—	—	$—
Thomas J. Heckman CFO, Treasurer and Secretary	—	$—	—	$—
Steven Phillips (2) Director, Former Vice President — Engineering	—	$—	—	$—

(1) Mr. McCoy resigned as an officer and as a director on January 11, 2012. He entered into a Consulting Agreement with the Company on January 13, 2012. Under such Agreement, which has a two-year term, his outstanding stock options continue to be exercisable and unvested options continue to vest.

(2) Mr. Phillips resigned as an officer effective July 13, 2012 and was concurrently appointed as a director. Mr. Phillips' outstanding stock options continue vest as long as he remains as a director and therefore are included in the above table.

Stock Option Plans

Securities Authorized for Issuance under Equity Compensation Plans

As of December 31, 2012, the Company had adopted five separate stock option and restricted stock plans: (i) the 2005 Stock Option and Restricted Stock Plan (the "2005 Plan"), (ii) the 2006 Stock Option and Restricted Stock Plan (the "2006 Plan"), (iii) the 2007 Stock Option and Restricted Stock Plan (the "2007 Plan"), (iv) the 2008 Stock Option and Restricted Stock Plan (the "2008 Plan") and (v) the 2011 Stock Option and Restricted Stock Plan (the "2011 Plan"). These Plans permit the grant of stock options or restricted stock to its employees, non-employee directors and others for up to a total of 875,000 shares of common stock. The Company believes that such awards better align the interests of its employees with those of its stockholders. Option awards have been granted with an exercise price equal to the market price of the Company's stock at the date of grant with such option awards generally vesting based on the completion of continuous service and having ten-year contractual terms. These option awards provide for accelerated vesting if there is a change in control (as defined in the Plans). The Company has registered all shares of common stock that are issuable under its Plans with the SEC. A total of 89,357 options remain available for grant under the various Plans as of December 31, 2012.

The Plans authorize us to grant (i) to the key employees incentive stock options (except for the 2007 Plan) to purchase shares of common stock and non-qualified stock options to purchase shares of common stock and restricted stock awards, and (ii) to non-employee directors and consultants non-qualified stock options and restricted stock. The

Compensation Committee of our Board of Directors administers the Plans by making recommendations to the Board of Directors or determinations regarding the persons to whom options or restricted stock should be granted and the amount, terms, conditions and restrictions of the awards.

The Plans allow for the grant of incentive stock options (except for the 2007 Plan), non-qualified stock options and restricted stock awards. Incentive stock options granted under the Plans must have an exercise price at least equal to 100% of the fair market value of the common stock as of the date of grant. Incentive stock options granted to any person who owns, immediately after the grant, stock possessing more than 10% of the combined voting power of all classes of our stock, or of any parent or subsidiary corporation, must have an exercise price at least equal to 110% of the fair market value of the common stock on the date of grant. Non-statutory stock options may have exercise prices as determined by our Compensation Committee.

Table Of Contents

The Compensation Committee is also authorized to grant restricted stock awards under the Plans. A restricted stock award is a grant of shares of the common stock that is subject to restrictions on transferability, risk of forfeiture and other restrictions and that may be forfeited in the event of certain terminations of employment or service prior to the end of a restricted period specified by the Compensation Committee. On July 31, 2008, we filed a registration statement on Form S-8 and an amendment to a previously filed Form S-8 with the SEC which registered 6,500,000 shares to be issued upon exercise of the stock options underlying the 2005 Plan, 2006 Plan, 2007 Plan and 2008 Plan. On March 28, 2012, we filed a registration statement on Form S-8 with the SEC which registered 500,000 shares to be issued upon exercise of the stock options or as restricted stock awards under the 2011 Plan.

Equity Compensation Plan Information as of December 31, 2012

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a) (c)
Equity compensation plans approved by stockholders	435,208	$ 17.87	81,828
Equity compensation plans not approved by stockholders	117,442	$ 17.87	7,529
Total all plans	552,650	$ 17.87	89,357

The number of stock options and restricted stock awards that an employee, director, or consultant may receive under our Plans is in the discretion of the administrator and therefore cannot be determined in advance, although the Board of Directors' policy in 2012 was to grant officers an award of 15,000 options and directors an award of either 4,375 restricted shares, or 8,750 options to purchase shares of common stock.

Table Of Contents

The following table sets forth (a) the aggregate number of shares subject to options granted under the Plans during the year-ended December 31, 2012 and (b) the average per share exercise price of such options.

Stock Option and Restricted Stock Grants

Name of Individual or Group	Number of Restricted Shares of Common Stock Granted	Number of Options Granted	Average per Share Exercise Price
Stanton E. Ross, Chairman of the Board, CEO & President	—	15,000	$4.80
Leroy C. Richie, Director	4,375	—	$—
Elliot M. Kaplan, Director	—	8,750	$3.52
Daniel F. Hutchins, Director	—	8,750	$3.52
Bernard A. Bianchino, Director	4,375	—	$—
Stephen Gans, Director	7,500	—	$—
Kenneth L. McCoy, Former Director, Vice President – Marketing (1)	—	—	$—
Thomas J. Heckman, Vice President, CFO, Treasurer & Secretary	—	15,000	$4.80
Steven Phillips, Director, Former Vice President -- Engineering (2)			