SOCKET COMMUNICATIONS INC
Form S-3
September 26, 2003

As filed with the Securities and Exchange Commission on September 26, 2003
Registration No. 333-____________

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM S-3

REGISTRATION STATEMENT

Under
The Securities Act of 1933

SOCKET COMMUNICATIONS, INC.
(Exact name of Registrant as specified in charter)

Delaware	**94-3155066**
(State or other jurisdiction of incorporation or organization)	(IRS employer identification number)

37400 Central Court
Newark, CA 94560
(510) 744-2700
(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

David W. Dunlap
Chief Financial Officer
SOCKET COMMUNICATIONS, INC.
37400 Central Court
Newark, CA 94560
(510) 744-2700
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies to:
Herbert P. Fockler, Esq.
WILSON SONSINI GOODRICH & ROSATI
Professional Corporation
650 Page Mill Road
Palo Alto, CA 94304
(650) 493-9300

Approximate date of commencement of proposed sale to the public: From time to time after this Registration Statement becomes effective.
If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. [ ]

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. [X]

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. [ ]

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. [ ]

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered(1)	Proposed Maximum Offering Price Per Share(2)	Proposed Maximum Aggregate Offering Price(2)	Amount of Registration Fee
Common Stock, $0.001 par value per share	2,491,163 shares	$2.42	$6,028,615	$487.72

(1) Shares of Common Stock that may be offered pursuant to this Registration Statement include 707,958 shares that may be issued upon the exercise or conversion of warrants..

(2) Estimated solely for the purpose of calculation of the registration fee pursuant to Rule 457(c) under the Securities Act based on a per share price of $2.42, the average of the high and low reported sales prices of the Registrant's common stock on the Nasdaq National Market on September 23, 2003.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission acting pursuant to said Section 8(a) may determine.

SUBJECT TO COMPLETION, DATED SEPTEMBER 26, 2003

PROSPECTUS

2,491,163 Shares

Socket Communications, Inc.

Common Stock

This prospectus relates to 2,491,163 shares of our Common Stock which may be sold from time to time by certain stockholders set forth in "Selling Stockholders" section of this prospectus. Of the shares offered by this prospectus, such shares include 707,958 shares of Common Stock issuable upon exercise or conversion of warrants. The balance of the shares offered pursuant to this prospectus represent the number of shares of our Common Stock held by the selling stockholders or their transferees.

The prices at which the selling stockholders or their transferees may sell the shares will be determined by the prevailing market prices for the shares or in negotiated transactions. While we may receive proceeds upon the exercise of the warrants, we will not receive any proceeds from the sale of the shares offered by this prospectus.

Our Common Stock is quoted on the Nasdaq National Market under the symbol "SCKT" and is listed on the Pacific Exchange under the symbol "SOK." On September 23, 2003, the last reported sale price for our Common Stock on the Nasdaq National Market was $2.45 per share.

Investment in the securities involves a high degree of risk. See "Risk Factors" beginning on page 3.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ADEQUACY OR ACCURACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is September __, 2003.

The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

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THE COMPANY

We design, manufacture and sell products that connect handheld and notebook computers to the Internet, computer networks, and peripherals through both wireless and cable connections. Our products are designed for use with a broad range of handheld and notebook computers, and employ innovative designs that reduce battery power consumption and make them easy to install and use. Our products have been designed specifically for handheld computers and other battery-powered devices with standard expansion slots for plug-in cards. We believe that growth in the mobile workforce, combined with technical advances and cost reductions in handheld computers and networking technologies, is driving broader adoption of mobile data communications. Our products are designed to address the growing need for connectivity by enabling the use of handheld devices to extend data communications capabilities beyond location-dependent wired networks or telephone lines, thereby enabling mobile computer users to enhance their productivity, exploit time sensitive opportunities and improve customer satisfaction. Our products allow consumers to easily integrate hardware, software and services into complete mobile connectivity solutions.

Our products can be classified into four broad product families:

- Network connection products;
- Bar code scanning products;
- Serial products; and
- Embedded products and services.

Our *network connection products* are connection devices that can be plugged into standard expansion slots in handheld and notebook computers. These products allow users to connect their handheld and notebook computers to the Internet or to private networks via mobile phone services, or to communicate with other electronic devices such as desktop computers and printers. Our *bar code scanning products* plug into handheld or notebook computers and turn those devices into portable bar code scanners that can be used in various retail and industrial workplaces. Our *serial products* add connection ports to a notebook or handheld computer to enable users to connect these portable computers to standard peripherals designed for desktop PCs. Our *embedded products and services* allow manufacturers of mobile phones, handheld computers and other devices to build wireless connection functions into their products.

Handheld computers have evolved over the past several years from simple devices used mainly to hold personal information into small portable computers with functionality similar to desktop PCs. Advances in mobile network access and transfer speeds are enabling handheld computer users to access the Internet, send and receive email, access corporate data files, and exchange mobile instant messages anywhere and at any time. Growth in the mobile workforce and increasing reliance on the Internet and email are increasing the demand for mobile data communications. Advances in wireless connection technologies, particularly Bluetooth and Wireless LAN (WiFi), are being commercialized to allow handheld computers to interact wirelessly with nearby computers and with a wide array of electronic appliances, including mobile phones, printer, digital cameras, LAN access points, automobile communications systems, bar code scanners, home entertainment and security systems, public kiosks, public Internet access locations and vending machines. We believe we are well positioned to benefit from expected growth in mobile data communications by maintaining a leadership position in connection solutions for mobile devices. Our marketing and product development strategy is to capitalize on strategic partner relationships, offer a comprehensive range of products, build a strong brand name, diversify our distribution channels and support product developers.

We have an experienced management team and Board of Directors. Many of our senior officers joined us during the years 1992 through 1994, including Kevin Mills, President and CEO; co-founder Micheal Gifford, Business Unit Manager of our embedded and industrial business unit; David Dunlap, Chief Financial Officer; Len Ott, Chief Technical Officer; and Peter Phillips, Vice President of Marketing. Kevin Mills and Micheal Gifford serve on our Board of Directors. Our Board of Directors also includes co-founder Charlie Bass as Chairman, who has served in that capacity since 1992, along with four other independent directors. Two of our independent directors, Enzo Torresi and Gianluca Rattazzi, are former chief executive officers of high technology companies, and our two other independent directors, Leon Malmed and Peter Sealey, are former senior sales and marketing executives.

We were incorporated in California in March 1992, and reincorporated in Delaware at the time of our initial public offering in June 1995. We have approximately 60 full time employees, and our headquarters are located at 37400 Central Court, Newark, California 94560. Our telephone number is (510) 744-2700. We have established two marketing and support subsidiaries, Socket Communications, Europe, located in Grenoble, France, and Socket Communications K.K., located in Tokyo, Japan.

RISK FACTORS

An investment in the Common Stock offered by this prospectus involves a high degree of risk. You should carefully consider the risks described below, as well as the risks described in our annual and quarterly reports filed with the Securities and Exchange Commission, before deciding to purchase shares of our Common Stock. The risks described below are not the only ones that we face. Additional risks that generally apply to publicly traded companies, that are not yet identified or that we currently think are immaterial, may also adversely affect our company.

If any of the events, contingencies, circumstances or conditions described in the following risks actually occur, our business, financial condition or results of operations could be seriously harmed. The trading price of our Common Stock could, in turn, decline and you could lose all or part of your investment.

We have a history of operating losses, we cannot assure you that we will achieve ongoing profitability, and we have monthly payment obligations.

We have incurred significant operating losses since our inception. We may continue to incur operating losses through the third quarter of 2003 and possibly longer. For the fiscal year ended December 31, 2002 and the first six months of 2003, we incurred net losses of $2,971,830 and $995,172, respectively. To obtain profitability, we must accomplish numerous objectives, including the development of successful new products. We cannot foresee with any certainty whether we will be able to achieve these objectives in the future. Accordingly, we cannot assure you that we will generate sufficient net revenue to achieve ongoing profitability.

We also have debt payment obligations to Nokia Corporation under a Business Transfer Agreement that we entered into with Nokia in March 2002. These payments are in the amount of approximately $107,300, plus accrued interest, per month through November 2003, with a final payment of approximately $437,300 plus accrued interest, due in

December 2003. If we cannot achieve profitability, we will not be able to support our operations from positive cash flows, and we would use our existing cash to support operating losses and make debt payments to Nokia. We do not anticipate the need to raise additional capital through 2004 to fund our operations, but should the need arise we cannot assure you that additional capital will be available on acceptable terms, if at all, and any such terms may be dilutive to existing stockholders. If we are unable to secure the necessary capital, we may need to suspend some or all of our current operations.

We may require additional capital in the future, and we cannot assure you that capital will be available on reasonable terms, if at all, or on terms that would not cause substantial dilution to your stock holdings.

We have historically needed to raise capital to fund our operating losses. We may continue to incur operating losses through the third quarter of 2003 and possibly longer. Our forecasts are highly dependent on factors beyond our control, including market acceptance of our products and sales of handheld computers. If capital requirements vary materially from those currently planned, we may require additional capital sooner than expected. There can be no assurance that such capital will be available in sufficient amounts or on terms acceptable to us, if at all. Any sale of a substantial number of additional shares will cause dilution to our stockholders' investments and could also cause the market price of our Common Stock to fall.

A significant portion of our revenue currently comes from two distributors, and any decrease in revenue from these distributors could harm our business.

A significant portion of our revenue comes from two distributors, Ingram Micro and Tech Data, which together represented approximately 40 percent of our worldwide revenue in the first six months of 2003, and 30 percent of our worldwide revenue in fiscal 2002. We expect that a significant portion of our revenue will continue to depend on sales to Ingram Micro and Tech Data. We do not have long-term commitments from Ingram Micro or Tech Data to carry our products, and either could choose to stop selling some or all of our products at any time. If we lose our relationship with Ingram Micro or Tech Data, we could experience disruption and delays in marketing our products.

If the market for handheld computers fails to grow, we might not achieve our sales projections.

Substantially all of our products are designed for use with mobile personal computers, including handhelds, notebook computers and tablets. If the mobile personal computer industry does not grow or if its growth slows, we might not achieve our sales projections.

Our sales would be hurt if the new technologies used in our products do not become widely adopted.

Many of our products use new technologies, such as the Bluetooth wireless standard and 2D bar code scanning, which are not yet widely adopted in the market. If these technologies fail to become widespread, our sales will suffer.

If third parties do not produce and sell innovative products with which our products are compatible, we may not achieve our sales projections.

Our success is dependent upon the ability of third parties in the mobile personal computer industry to complete development of products that include or are compatible with our technology and to sell those products into the marketplace. Our ability to generate increased revenue depends significantly on the commercial success of Windows-powered handheld devices, particularly the Pocket PC, and other devices, such as the new line of handhelds with expansion options offered by Palm. If manufacturers are unable to ship new products such as Pocket PC and other Windows-powered devices or Palm devices on schedule, or if these products fail to achieve or maintain market acceptance, the number of our potential new customers would be reduced and we would not be able to meet our sales expectations.

We could face increased competition in the future, which would adversely affect our financial performance.

The market for handheld computers in which we operate is very competitive. Our future financial performance is contingent on a number of unpredictable factors, including that:

- consolidation among our competitors is resulting in companies with greater financial, marketing, and technical resources than ours;
- we periodically face intense price competition, particularly when our competitors have excess inventories and discount their prices to clear their inventories; and
- certain original equipment manufacturers of personal computers, mobile phones and handheld computers may make our products less significant by incorporating built-in functions, such as Bluetooth wireless technology and WiFi, into their products.

Increased competition could result in price reductions, fewer customer orders, reduced margins, and loss of market share. Our failure to compete successfully against current or future competitors could harm our business, operating results, or financial condition.

If we fail to develop and introduce new products rapidly and successfully, we will not be able to compete effectively, and our ability to generate sufficient revenues will be negatively affected.

The market for our products is prone to rapidly changing technology, evolving industry standards and short product life cycles. If we are unsuccessful at developing and introducing new products and services on a timely basis that include the latest technologies conforming with the newest standards and that are appealing to end users, we will not be able to compete effectively, and our ability to generate significant revenues will be seriously harmed.

The development of new products and services can be very difficult and requires high levels of innovation. The development process is also lengthy and costly. Short product life cycles expose our products to the risk of obsolescence and require frequent new product introductions. We will be unable to introduce new products and services into the market on a timely basis or compete successfully, if we fail to:

- identify emerging standards in the field of mobile computing products;
- enhance our products by adding additional features;
- invest significant resources in research and development, sales and marketing, and customer support;
- maintain superior or competitive performance in our products; and
- anticipate our end users' needs and technological trends accurately.

We cannot be sure that we will have sufficient resources to make adequate investments in research and development or that we will be able to make the technological advances necessary to be competitive.

If we do not correctly anticipate demand for our products, our operating results will suffer.

The demand for our products depends on many factors and will be difficult to forecast. We expect that it will become more difficult to forecast demand as we introduce and support more products and as competition in the market for our products intensifies. If demand increases beyond forecasted levels, we would have to rapidly increase production at our third-party manufacturers. We depend on suppliers to provide additional volumes of components, and those suppliers might not be able to increase production rapidly enough to meet unexpected demand. Even if we were able to procure enough components, our third-party manufacturers might not be able to produce enough of our devices to meet our customer demand. In addition, rapid increases in production levels to meet unanticipated demand could result in higher costs for manufacturing and supply of components and other expenses. These higher costs could lower our profit margins. Further, if production is increased rapidly, manufacturing yields could decline, which may also lower operating results.

If demand is lower than forecasted levels, we could have excess production resulting in higher inventories of finished products and components, which could lead to write-downs or write-offs of some or all of the excess inventories. Lower than forecasted demand could also result in excess manufacturing capacity at our third-party manufacturers and in our failure to meet some minimum purchase commitments, each of which may lower our operating results.

We depend on alliances and other business relationships with a small number of third parties, and a disruption in any one of these relationships would hinder our ability to develop and sell our products.

We depend on strategic alliances and business relationships with leading participants in various segments of the communications and mobile personal computer markets to help us develop and market our products. Our strategic partners may revoke their commitment to our products or services at any time in the future or may develop their own competitive products or services. Accordingly, our strategic relationships may not result in sustained business alliances, successful product or service offerings, or the generation of significant revenues. Failure of one or more of such alliances could result in delay or termination of product development projects, failure to win new customers, or loss of confidence by current or potential customers.

We have devoted significant research and development resources to design activities for Windows-powered mobile products and, more recently, to design activities for Palm devices. Such design activities have diverted financial and personnel resources from other development projects. These design activities are not undertaken pursuant to any agreement under which Microsoft or Palm is obligated to continue the collaboration or to support the products produced from the collaboration. Consequently, Microsoft or Palm may terminate their collaborations with us for a variety of reasons including our failure to meet agreed-upon standards or for reasons beyond our control, such as changing market conditions, increased competition, discontinued product lines, and product obsolescence.

We rely primarily on distributors, resellers, retailers and original equipment manufacturers to sell our products, and our sales would suffer if any of these third parties stops selling our products effectively.

Because we sell our products primarily through distributors, resellers, retailers and original equipment manufacturers, we are subject to risks associated with channel distribution, such as risks related to their inventory levels and support for our products. Our distribution channels may build up inventories in anticipation of growth in their sales. If such growth in their sales does not occur as anticipated, the inventory build up could contribute to higher levels of product returns. The lack of sales by any one significant participant in our distribution channels could result in excess inventories and adversely affect our operating results.

Our agreements with distributors, resellers, retailers and original equipment manufacturers are generally nonexclusive and may be terminated on short notice by them without cause. Our distributors, resellers, retailers and original equipment manufacturers are not within our control, are not obligated to purchase products from us, and may represent competitive lines of products. Our current sales growth expectations are contingent in part on our ability to enter into additional distribution relationships and expand our retail sales channels. We cannot predict whether we will be successful in establishing new distribution relationships, expanding our retail sales channels or maintaining our existing relationships. A failure to enter into new distribution relationships or to expand our retail sales channels could adversely impact our ability to grow our sales.

We allow our distribution channels to return a portion of their inventory to us for full credit against other purchases. We also supply some retailers on a consignment basis, which means we own the inventory until it is sold by the retailer and the inventory can be returned to us at any time. In addition, in the event we reduce our prices, we credit our distributors for the difference between the purchase price of products remaining in their inventory and our reduced price for such products. Actual returns and price protection may adversely affect future operating results, particularly since we seek to continually introduce new and enhanced products and are likely to face increasing price competition.

Our intellectual property and proprietary rights may be insufficient to protect our competitive position.

Our business depends on our ability to protect our intellectual property. We rely primarily on patent, copyright, trademark, trade secret laws, and other restrictions on disclosure to protect our proprietary technologies. We cannot be sure that these measures will provide meaningful protection for our proprietary technologies and processes. We cannot be sure that any patent issued to us will be sufficient to protect our technology. The failure of any patents to provide protection to our technology would make it easier for our competitors to offer similar products. In connection with our participation in the development of various industry standards, we may be required to license certain of our patents to other parties, including our competitors, that develop products based upon the adopted standards.

We also generally enter into confidentiality agreements with our employees, distributors, and strategic partners, and generally control access to our documentation and other proprietary information. Despite these precautions, it may be possible for a third party to copy or otherwise obtain and use our products, services, or technology without authorization, develop similar technology independently, or design around our patents.

Effective copyright, trademark, and trade secret protection may be unavailable or limited in certain foreign countries. Furthermore, certain of our customers have entered into agreements with us which provide that the customers have the right to use our proprietary technology in the event we default in our contractual obligations, including product supply obligations, and fail to cure the default within a specified period of time.

We may become subject to claims of intellectual property rights infringement, which could result in substantial liability.

In the course of our business, we may receive claims of infringement or otherwise become aware of potentially relevant patents or other intellectual property rights held by other parties. Many of our competitors have large intellectual property portfolios, including patents that may cover technologies that are relevant to our business. In addition, many smaller companies, universities, and individuals have obtained or applied for patents in areas of technology that may relate to our business. The industry is moving towards aggressive assertion, licensing, and litigation of patents and other intellectual property rights.

On June 30, 2003, Khyber Technologies Corporation filed a complaint against us in the United States District Court, Northern District of Ohio, alleging that we had infringed a patent held by Khyber in manufacturing, using and selling our portable bar code scanners. We are currently in the process of analyzing the merits of the complaint.

If we are unable to obtain and maintain licenses on favorable terms for intellectual property rights required for the manufacture, sale, and use of our products, particularly those products which must comply with industry standard protocols and specifications to be commercially viable, our results of operations or financial condition could be adversely impacted.

In addition to disputes relating to the validity or alleged infringement of other parties' rights, we may become involved in disputes relating to our assertion of our intellectual property rights. Whether we are defending the assertion of intellectual property rights against us or asserting our intellectual property rights against others, intellectual property litigation can be complex, costly, protracted, and highly disruptive to business operations by diverting the attention and energies of management and key technical personnel. Plaintiffs in intellectual property cases often seek injunctive relief, and the measures of damages in intellectual property litigation are complex and often subjective or uncertain. Thus, any adverse determinations in this type of litigation could subject us to significant liabilities and costs.

New industry standards may require us to redesign our products, which could substantially increase our operating expenses.

Standards for the form and functionality of our products are established by standards committees. Separate committees establish standards, which evolve and change over time, for different categories of our products. We must continue to identify and ensure compliance with evolving industry standards so that our products are interoperable and we remain competitive. Unanticipated changes in industry standards could render our products incompatible with products developed by major hardware manufacturers and software developers. Should any unanticipated changes occur, we would be required to invest significant time and resources to redesign our products to ensure compliance with relevant standards. If our products are not in compliance with prevailing industry standards for a significant period of time, we would miss opportunities to have our products specified as standards for new hardware components designed by mobile computer manufacturers and original equipment manufacturers.

Undetected flaws and defects in our products may disrupt product sales and result in expensive and time-consuming remedial action.

Our hardware and software products may contain undetected flaws, which may not be discovered until customers have used the products. From time to time, we may temporarily suspend or delay shipments or divert development resources from other projects to correct a particular product deficiency. Efforts to identify and correct errors and make design changes may be expensive and time consuming. Failure to discover product deficiencies in the future could delay product introductions or shipments, require us to recall previously shipped products to make design modifications, or cause unfavorable publicity, any of which could adversely affect our business and operating results.

Our quarterly operating results may fluctuate in future periods, which could cause our stock price to decline.

We expect to experience quarterly fluctuations in operating results in the future. We generally ship orders as received and as a result typically have little or no backlog. Quarterly revenue and operating results therefore depend on the volume and timing of orders received during the quarter, which are difficult to forecast. Historically, we have often recognized a substantial portion of our revenue in the last month of the quarter. This subjects us to the risk that even modest delays in orders may adversely affect our quarterly operating results. Our operating results may also fluctuate due to factors such as:

- the demand for our products;
- the size and timing of customer orders;

- unanticipated delays or problems in the introduction of our new products and product enhancements;
- the introduction of new products and product enhancements by our competitors;
- the timing of the introduction of new products that work with our connection products;
- changes in the proportion of revenues attributable to royalties and engineering development services;
- product mix;
- timing of software enhancements;
- changes in the level of operating expenses;
- competitive conditions in the industry including competitive pressures resulting in lower average selling prices; and
- timing of distributors' shipments to their customers.

Because we base our staffing and other operating expenses on anticipated revenue, delays in the receipt of orders can cause significant variations in operating results from quarter to quarter. As a result of any of the foregoing factors, our results of operations in any given quarter may be below the expectations of public market analysts or investors, in which case the market price of our Common Stock would be adversely affected.

The loss of one or more of our senior personnel could harm our existing business.

A number of our officers and senior managers have been employed for seven to ten years by us, including our President, Chief Financial Officer, Chief Technical Officer, Vice President of Marketing, and Senior Vice President for Business Development/General Manager Embedded and Industrial Systems Unit. Our future success will depend upon the continued service of key officers and senior managers. Competition for officers and senior managers is intense and there can be no assurance that we will be able to retain our existing senior personnel. The loss of key senior personnel could adversely affect our ability to compete.

If we are unable to attract and retain highly skilled sales and marketing and product development personnel, our ability to develop new products and product enhancements will be adversely affected.

We believe our ability to achieve increased revenues and to develop successful new products and product enhancements will depend in part upon our ability to attract and retain highly skilled sales and marketing and product development personnel. Our products involve a number of new and evolving technologies, and we frequently need to apply these technologies to the unique requirements of mobile connection products. Our personnel must be familiar with both the technologies we support and the unique requirements of the products to which our products connect. Competition for such personnel is intense, and we may not be able to attract and retain such key personnel. In addition, our ability to hire and retain such key personnel will depend upon our ability to raise capital or achieve increased revenue levels to fund the costs associated with such key personnel. Failure to attract and retain such key personnel will adversely affect our ability to develop new products and product enhancements.

We may not be able to collect revenues from customers who experience financial difficulties.

Our accounts receivable are derived primarily from distributors and original equipment manufacturers. We perform ongoing credit evaluations of our customers' financial conditions but generally require no collateral. Reserves are maintained for potential credit losses, and such losses have historically been within such reserves. However, many of our customers may be thinly capitalized and may be prone to failure in adverse market conditions. Although our collection history has been good, from time to time a customer may not pay us because of financial difficulty, bankruptcy or liquidation.

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We may be unable to manufacture our products because we are dependent on a limited number of qualified suppliers for our components.

Several of our component parts, including our serial interface chip, our Ethernet chip, and our bar code scanning modules, are produced by one or a limited number of suppliers. Shortages could occur in these essential materials due to an interruption of supply or increased demand in the industry. If we are unable to procure certain component parts, we could be required to reduce our operations while we seek alternative sources for these components, which could have a material adverse effect on our financial results. To the extent that we acquire extra inventory stocks to protect against possible shortages, we would be exposed to additional risks associated with holding inventory, such as obsolescence, excess quantities, or loss.

Our operating results could be harmed by economic, political, regulatory and other risks associated with export sales.

Export sales (sales to customers outside the United States) accounted for approximately 42 percent of our revenue in 2002 and approximately 40 percent of our revenue in the first six months of 2003. Accordingly, our operating results are subject to the risks inherent in export sales, including:

- longer payment cycles;
- unexpected changes in regulatory requirements, import and export restrictions and tariffs;
- difficulties in managing foreign operations;
- the burdens of complying with a variety of foreign laws;
- greater difficulty or delay in accounts receivable collection;
- potentially adverse tax consequences; and
- political and economic instability.

Our export sales are predominately denominated in United States dollars and in Euros for a portion of our sales to European distributors. Accordingly, an increase in the value of the United States dollar relative to foreign currencies could make our products more expensive and therefore potentially less competitive in foreign markets. Declines in the value of the Euro relative to the United States dollar may result in foreign currency losses relating to collection of Euro denominated receivables.

Our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure, and other events beyond our control.

Our corporate headquarters is located near an earthquake fault. The potential impact of a major earthquake on our facilities, infrastructure, and overall business is unknown. Additionally, we may experience electrical power blackouts or natural disasters that could interrupt our business. We do not have a detailed disaster recovery plan. We do not carry sufficient business interruption insurance to compensate us for losses that may occur. Any losses or damages incurred by us as a result of these events could have a material adverse effect on our business.

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The sale of a substantial number of shares of Common Stock could cause the market price of our Common

Stock to decline.

Sales of a substantial number of shares of our Common Stock in the public market could adversely affect the market price for our Common Stock. The market price of our Common Stock could also decline if one or more of our significant stockholders decided for any reason to sell substantial amounts of our Common Stock in the public market.

As of August 5, 2003, we had 27,812,211 shares of Common Stock outstanding. Substantially all of these shares are freely tradable in the public market, either without restriction or subject, in some cases, only to S-3 or S-8/S-3 prospectus delivery requirements and, in some cases, only to manner of sale, volume, and notice requirements of Rule 144 under the Securities Act.

As of August 5, 2003, we had 3,492 shares of Series E redeemable convertible preferred stock outstanding that are convertible into 40,140 shares of Common Stock at $0.87 per share. To the extent the market price of our Common Stock exceeds $0.87 per share, the holder of Series E may decide to convert some or all of the Series E into Common Stock, and such Common Stock would be freely tradable in the public market and subject only to S-3 prospectus delivery requirements.

As of August 5, 2003, we had 199,083 shares of Series F Preferred Stock outstanding that are convertible into 1,990,830 shares of Common Stock at $0.722 per share.

As of August 5, 2003, we had 6,071,674 shares subject to outstanding options under our stock option plans, and 670,088 shares were available for future issuance under the plans. We have registered the shares of Common Stock subject to outstanding options and reserved for issuance under our stock option plans. Accordingly, shares underlying vested options will be eligible for resale in the public market as soon as the options are exercised.

As of August 5, 2003, we had warrants outstanding to purchase a total of 2,591,268 shares of our Common Stock at exercise prices ranging from $0.722 to $2.73. All such warrants may be exercised at any time, and the shares issuable upon exercise may be resold, either without restrictions or subject, in some cases, only to S-3 prospectus delivery requirements, and, in some cases, only to manner of sale, volume, and notice requirements of Rule 144.

Volatility in the trading price of our Common Stock could negatively impact the price of our Common Stock.

During the period from July 1, 2002 through August 5, 2003, our Common Stock price fluctuated between a high of $3.39 and a low of $0.51. The trading price of our Common Stock could be subject to wide fluctuations in response to many factors, some of which are beyond our control, including general economic conditions and the outlook of securities analysts and investors on our industry. In addition, the stock markets in general, and the markets for high technology stocks in particular, have experienced high volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our Common Stock.

USE OF PROCEEDS

We will not receive any of the proceeds from the sale of the shares sold under this prospectus, although we may receive up to approximately $1,932,725 upon full exercise of the warrants. All proceeds from the sale of the shares will be for the account of the selling stockholders. See "Selling Stockholders" and "Plan of Distribution."

INFORMATION CONTAINED IN THIS PROSPECTUS

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with information different from that contained in this prospectus. The selling stockholders listed in this prospectus are offering to sell, and seeking offers to buy, shares of our Common Stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date of this prospectus, regardless of the time of delivery of this prospectus or of any sale of our Common Stock.

FORWARD-LOOKING STATEMENTS

This prospectus contains forward looking statements within the meaning of the securities laws. These forward looking statements are subject to a number of risks and uncertainties, many of which are beyond our control. All statements other than statements of historical facts included in this prospectus, including the statements under "The Company" and elsewhere in this prospectus regarding our strategy, future operations, financial position, estimated revenues, projected costs, prospects, plans and objectives of management, are forward looking statements. When used in this prospectus, the words "will," "believe," "anticipate," "intend," "estimate," "expect," "project" and similar expressions are intended to identify forward looking statements, although not all forward looking statements contain such identifying words. All forward looking statements speak only as of the date of this prospectus. Neither we nor any of the selling stockholders undertake any obligation to update or revise publicly any forward looking statements, whether as a result of new information, future events or otherwise. Although we believe that our plans, intentions and expectations reflected in or suggested by the forward looking statements we make in this prospectus are reasonable, ultimately we may not achieve such plans, intentions or expectations.

We disclose important factors that could cause our actual results to differ materially from our expectations under "Risk Factors" and elsewhere in this prospectus. Such factors include, among others, the following: our ability to raise sufficient capital to fund our operations, our ability to achieve profitability, developments in the market for our products, including the market for mobile computers that use the Windows Pocket PC operating system, and developments in our relationships with our strategic partners. These cautionary statements qualify all forward looking statements attributable to us or persons acting on our behalf.

SELLING STOCKHOLDERS

On August 5, 2003 and September 12, 2003, we completed a private placement of shares of our Common Stock and warrants to purchase Common Stock pursuant to Securities Purchase Agreements. We issued 1,783,205 shares of Common Stock at $2.37 per share and five-year warrants to purchase up to an additional 534,962 shares of Common Stock at $2.73 per share. Net proceeds from the private placement after estimated costs and expenses were approximately $3.7 million. The first closing of the private placement was managed by Cardinal Securities, LLC. As partial consideration for its services, Cardinal Securities, LLC received five-year warrants to purchase up to 172,996 shares of Common Stock at $2.73 per share. Cardinal Securities, LLC assigned its warrants to H. Scott Coherd, Patrick E. Gaynes, Scott F. Koch, Robert L. Rosenstein, Spencer Trask & Co., Spencer Trask & Company f/b/o the participants under the Equity Participation Plan and Adam K. Stern.

The shares may be offered by the selling stockholders or by pledgees, donees, transferees or other successors in interest that receive such shares as a gift or through a private sale or other transfer. We may amend or supplement this prospectus from time to time to update the information provided in the table.

Certificate Name	Shares Beneficially Owned Prior to Offering	Number of Shares Being Offered	Shares Beneficially Owned After Offering Number	Percent(1)
August 5, 2003 Closing				
Capital Ventures International (2)	274,261	274,261	0	*
Cranshire Capital, L.P. (3)	274,261	274,261	0	*
Deephaven Small Cap Growth Fund, LLC (4)	274,261	274,261	0	*
Elliott Associates, L.P. (5)	249,268	219,409	29,859	*
Elliott International, L.P. (6)	349,115	329,115	20,000	*
Gryphon Master Fund, L.P. (7)	274,261	274,261	0	*
Portside Growth and Opportunity Fund (8)	274,261	274,261	0	*
RHP Master Fund, L.P. (9)	54,852	54,852	0	*
Vertical Ventures, LLC (10)	274,261	274,261	0	*
H. David Coherd (11)	27,391	27,391	0	*
Patrick E. Gaynes (12)	4,325	4,325	0	*
Scott F. Koch (13)	27,391	27,391	0	*
Robert L. Rosenstein (14)	27,391	27,391	0	*
Spencer Trask & Co. (15)	240,631	22,044	240,631	*
Spencer Trask & Co. f/b/o the participants under the Equity Participation Plan (16)	240,631	44,883	240,631	*
Adam K. Stern (17)	18,149	19,571	18,149	*
September 12, 2003 Closing				
Joe N. and Jamie W. Behrendt Revocable Trust 10/30/96 (18)	45,019	2,986	45,019	*
Lon Bell (19)	90,038	5,972	90,038	*
William J. Callahan & Joan M. Callahan JTWROS (20)	45,019	2,986	45,019	*
DCG&T FBO Elizabeth H. Bone SEP IRA (21)	16,023	1,528	16,023	*
DCG&T c/f Robert G. Heidenreich IRA (22)	24,028	2,291	24,028	*
Steven H. Deutsch & Wilma K. Deutsch (23)	36,023	2,389	36,023	*
Jacob M. Engel (24)	45,019	2,986	45,019	*
Jonathan Fleisig (25)	180,063	11,943	180,063	*
Maurice & Stacy Gozlan TIE (26)	90,038	5,972	90,038	*
Headwaters Holdings LLC (27)	180,063	11,943	180,063	*
Alec Jaret (28)	18,018	1,195	18,018	*
Thomas A. Masci, Jr. (29)	13,507	896	13,507	*
Kathleen S. McHugh (30)	9,009	549	9,009	*
O.T. Finance SA (31)	37,644	2,986	37,644	*
Elisha Rothman (32)	90,038	5,972	90,038	*
Mark C. Steadman (33)	41,957	957	41,957	*
Adam K. Stern (34)	18,149	1,195	18,149	*
Samuel V. Vail (35)	13,018	1,195	13,018	*
Paul J. Weir (36)	8,507	896	8,507	*
Ralph C Wintrode Trust DTD May 9, 2001 (37)	36,286	2,389	36,286	*

* Less than 1%.

(1) Based upon 28,373,643 shares of Common Stock outstanding as of the close of business on September 4, 2003 in accordance with Rule 13d-3 under the Securities Exchange Act of 1934.

(2) Includes 63,291 shares of Common Stock subject to a warrant. Heights Capital Management, Inc., as Capital Ventures International's authorized agent, has discretionary authority to vote and dispose of the shares held by Capital Ventures International and may be deemed to be the beneficial owner of those shares. Andrew Frost, in his capacity as President of Heights Capital Management, Inc., may also be deemed to have investment discretion and voting power over the shares held by Capital Ventures International. Mr. Frost disclaims any such beneficial ownership of the shares.

(3) Includes 63,291 shares of Common Stock subject to a warrant. Mitchell P. Kopin has voting control in respect of the securities held by Cranshire Capital, L.P. Mr. Kopin is the President of Downsview Capital, Inc., the general partner of Cranshire Capital, L.P.

(4) Includes 63,291 shares of Common Stock subject to a warrant. Deephaven Small Cap Growth Fund LLC is a

private investment fund that is owned by all of its investors and managed by Deephaven Capital Management LLC. Deephaven Capital Management LLC, of which Mr. Colin Smith is the Chief Executive Officer, has voting and investment control over the shares that are owned by Deephaven Small Cap Growth Fund, LLC.
(5) Includes 50,633 shares of Common Stock subject to a warrant. Paul Singer has voting control in respect of the securities held by Elliott Associates, L.P.
(6) Includes 75,950 shares of Common Stock subject to a warrant. Paul Singer has voting control in respect of the securities held by Elliott International, L.P. Mr. Singer is the general partner of Elliott International Capital Advisors Inc., the investment manager of Elliott International, L.P.
(7) Includes 63,291 shares of Common Stock subject to a warrant. E.B. Lyon, IV has voting control in respect of the securities held by Gryphon Master Fund, L.P. Mr. Lyon is the authorized agent of Gryphon Advisors, LLC, which is the general partner of Gryphon Management Partners, L.P., which is the general partner of Gryphon Partners, L.P., which is the general partner of Gryphon Master Fund, L.P.
(8) Includes 63,291 shares of Common Stock subject to a warrant. Peter Cohen, Thomas Strauss and Morgan Stark have voting control in respect of the securities held by Portside Growth and Opportunity Fund. Messrs. Cohen, Strauss and Stark are the managing members of C4S & Co., which is the managing member of Ramius Capital Group, LLC, which is the investment manager of Portside Growth and Opportunity Fund. Messrs. Cohen, Strauss and Stark disclaim beneficial ownership of the securities owned by Portside Growth and Opportunity Fund.
(9) Includes 12,658 shares of Common Stock subject to a warrant. RHP Master Fund, Ltd. is a party to an investment management agreement with Rock Hill Investment Management, L.P., a limited partnership of which the general partner is RHP General Partner, LLC. Pursuant to such agreement, Rock Hill Investment Management directs the voting and disposition of the shares owned by RHP Master Fund, L.P. Messrs. Wayne Bloch, Gary Kaminsky and Peter Lockhart own all the interests in RHP General Partner, LLC. The aforementioned entities and individuals disclaim beneficial ownership of the securities owned by RHP Master Fund, L.P.
(10) Includes 63,291 shares of Common Stock subject to a warrant. Joshua Silverman has voting control in respect of the securities held by Vertical Ventures, LLC.
(11) Includes 27,391 shares of Common Stock subject to a warrant.
(12) Includes 4,325 shares of Common Stock subject to a warrant.
(13) Includes 27,391 shares of Common Stock subject to a warrant
(14) Includes 27,391 shares of Common Stock subject to a warrant.
(15) Includes 22,044 shares of Common Stock subject to a warrant. Kevin Kimberlin and William Dioguardi have voting control in respect of these securities held by Spencer Trask & Co.
(16) Includes 44,883 shares of Common Stock subject to a warrant.Kevin Kimberlin and William Dioguardi have voting control in respect of these securities held by Spencer Trask & Co.
(17) Includes 19,571 shares of Common Stock subject to a warrant. Mr. Stern is also a selling stockholder with respect to his participation in the September 12, 2003 closing (see (34)).
(18) Includes 689 shares of Common Stock subject to a warrant. Joe N. Behrendt, as trustee of the Joe N. and Jamie W. Behrendt Revocable Trust 10/30/96, has voting control in respect of the securities held by Joe N. and Jamie W. Behrendt Revocable Trust 10/30/96.
(19) Includes 1,378 shares of Common Stock subject to a warrant.
(20) Includes 689 shares of Common Stock subject to a warrant. William J. Callahan and Joan M. Callahan have voting control in respect of the securities held by William J. Callahan & Joan M. Callahan JTWROS.
(21) Includes 353 shares of Common Stock subject to a warrant. Elizabeth H. Bone has voting control in respect of the securities held by DCG&T FBO Elizabeth H. Bone SEP IRA.
(22) Includes 529 shares of Common Stock subject to a warrant. Robert G. Heidenreich has voting control in respect of the securities held by DCG&T c/f Robert G. Heidenreich IRA.
(23) Includes 551 shares of Common Stock subject to a warrant. Steven H. Deutsch and Wilma K. Deutsch have voting control in respect of the securities held by Steven H. Deutsch and Wilma K. Deutsch.
(24) Includes 689 shares of Common Stock subject to a warrant
(25) Includes 2,756 shares of Common Stock subject to a warrant.
(26) Includes 1,378 shares of Common Stock subject to a warrant.
(27) Includes 2,756 shares of Common Stock subject to a warrant. Jeffrey D. Goshay, Jonathan D. Ungar and Sheldon Kahn have voting control in respect of the securities held by Headwaters Holdings LLC.
(28) Includes 276 shares of Common Stock subject to a warrant.
(29) Includes 207 shares of Common Stock subject to a warrant.
(30) Includes 127 shares of Common Stock subject to a warrant.
(31) Includes 689 shares of Common Stock subject to a warrant. Lucien I. Levy has voting control in respect of the securities held by O.T. Finance SA.
(32) Includes 1,378 shares of Common Stock subject to a warrant.
(33) Includes 221 shares of Common Stock subject to a warrant.
(34) Includes 276 shares of Common Stock subject to a warrant. Mr. Stern also is a selling stockholder with respect to Common Stock issuable upon exercise of warrants assigned to him by Cardinal Securities, LLC (see (17)).
(35) Includes 276 shares of Common Stock subject to a warrant.

(36) Includes 207 shares of Common Stock subject to a warrant.
(37) Includes 551 shares of Common Stock subject to a warrant. Ralph C. Wintrode has voting control in respect of the securities held by Ralph C. Wintrode Trust DTD May 9, 2001.

PLAN OF DISTRIBUTION

We are registering the shares of Common Stock and Common Stock issuable upon exercise or conversion of warrants on behalf of the selling stockholders. The Common Stock and Common Stock issuable upon exercise or conversion of warrants may be sold in one or more transactions at fixed prices, at prevailing market prices at the time of sale, at prices related to the prevailing market prices, at varying prices determined at the time of sale, or at negotiated prices. These sales may be effected at various times in one or more of the following transactions, or in other kinds of transactions:

- transactions on the NASDAQ Stock Market or on any national securities exchange or U.S. inter-dealer system of a registered national securities association on which the Common Stock may be listed or quoted at the time of sale;
- in the over-the-counter market;
- in private transactions and transactions otherwise than on these exchanges or systems or in the over-the-counter market;
- in connection with short sales of the shares;
- by pledge to secure or in payment of debt and other obligations;
- through the writing of options, whether the options are listed on an options exchange or otherwise;
- in connection with the writing of non-traded and exchange-traded call options, in hedge transactions and in settlement of other transactions in standardized or over-the-counter options; or
- through a combination of any of the above transactions.

The selling stockholders and their successors, including their transferees, pledgees or donees or their successors, may sell the Common Stock and Common Stock issuable upon exercise or conversion of warrants directly to purchasers or through underwriters, broker-dealers or agents, who may receive compensation in the form of discounts, concessions or commissions from the selling stockholders or the purchasers. These discounts, concessions or commissions as to any particular underwriter, broker-dealer or agent may be in excess of those customary in the types of transactions involved.

In addition, any securities covered by this prospectus which qualify for sale pursuant to Rule 144 of the Securities Act may be sold under Rule 144 rather than pursuant to this prospectus.

We entered into a registration rights agreement for the benefit of the selling stockholders to register the Common Stock and Common Stock issuable upon exercise or conversion of warrants under applicable federal and state securities laws. The registration rights agreement provides for cross-indemnification of the selling stockholders and us and our respective directors, officers and controlling persons against specific liabilities in connection with the offer and sale of the Common Stock and Common Stock issuable upon exercise or conversion of warrants, including liabilities under the Securities Act. We will pay substantially all of the expenses incurred by the selling stockholders incident to the offering and sale of the Common Stock and Common Stock issuable upon exercise or conversion of warrants.

LEGAL MATTERS

Wilson Sonsini Goodrich & Rosati, Professional Corporation, Palo Alto, California will pass upon certain legal matters relating to the validity of the securities offered for us hereby.

EXPERTS

Ernst & Young LLP, independent auditors, have audited our consolidated financial statements included in our Annual Report on Form 10 K for the year ended December 31, 2002, as set forth in their report, which is incorporated by reference in this prospectus and elsewhere in the registration statement. Our financial statements are incorporated by reference in reliance on Ernst & Young LLP's report, given on their authority as experts in accounting and auditing.

WHERE YOU CAN FIND MORE INFORMATION

We have filed with the Securities and Exchange Commission a registration statement on Form S-3, of which this prospectus is a part, under the Securities Act with respect to the shares of Common Stock offered hereby. This prospectus does not contain all of the information included in the registration statement. Statements in this prospectus concerning the provisions of any document are not necessarily complete. You should refer to the copies of these documents filed as exhibits to the registration statement or otherwise filed by us with the SEC for a more complete understanding of the matter involved. Each statement concerning these documents is qualified in its entirety by such reference.

We are subject to the informational requirements of the Securities and Exchange Act of 1934 and, accordingly, file reports, proxy statements and other information with the SEC. The SEC maintains a web site at http://www.sec.gov that contains reports, proxy and information statements and other information regarding registrants that file electronically with the Commission. Copies of our reports, proxy statements and other information also may be inspected and copied at the public reference facility maintained by the SEC at the Judiciary Plaza, 450 Fifth Street, N.W., Room 124, Washington, D.C. 20549. Copies of these materials can also be obtained by mail at prescribed rates from the Public Reference Section of the SEC, 450 Fifth Street, N.W., Washington, D.C. 20549 or by calling the SEC at 1 800 SEC 0330.

INFORMATION INCORPORATED BY REFERENCE

The SEC allows us to "incorporate by reference" the information we file with them, which means that we can disclose important information to you in this document by referring you to other filings we have made with the SEC. The information incorporated by reference is considered to be part of this prospectus, and later information filed with the SEC will update and supersede this information. We incorporate by reference the documents and information listed below and any future filings made with the SEC under Section 13(a), 13(c), 14 or 15(d) of the Securities and Exchange Act prior to the completion of the offering covered by this prospectus:

1. Our Annual Report on Form 10 K for the year ended December 31, 2002.
2. Our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2003 and June 30, 2003.
3. Our current reports on Form 8-K filed with the SEC on March 25, 2003, April 23, 2003, June 10, 2003, July 23, 2003, August 7, 2003 and September 16, 2003.
4. The description of our Common Stock contained in our Registration Statement on Form 8 A filed with the SEC on April 11, 1995 and our Registration Statement on Form 8 A/A filed with the SEC on June 15, 1995.

We will provide to any person, including any beneficial owner, to whom a prospectus is delivered, a copy of any of the information which has been incorporated by reference into this prospectus at no cost upon an oral or written request to:

Socket Communications, Inc.
37400 Central Court
Newark, CA 94560
Attention: David W. Dunlap
(510) 744 2700

You can also call David W. Dunlap, Chief Financial Officer of Socket Communications, at (510) 744 2700 with any questions about the shares offered under this prospectus.

2,491,163 Shares

SOCKET COMMUNICATIONS, INC.

COMMON STOCK

PROSPECTUS

No dealer, salesperson or other person is authorized to give any information or to represent anything not contained in this prospectus. You must not rely on any unauthorized information or representations. This prospectus is an offer to sell only the shares offered hereby, and only under circumstances and in jurisdictions where it is lawful to do so. The information contained in this prospectus is current only as of its date.

September ___, 2003

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

Item 14. Other Expenses of Issuance and Distribution

The Registrant will bear no expenses in connection with any sale or other distribution by the selling stockholders of the shares being registered other than the expenses of preparation and distribution of this Registration Statement and the Prospectus included in this Registration Statement. Such expenses are set forth in the following table. All of the amounts shown are estimates except the Securities and Exchange Commission registration fee.

	Amount To Be Paid
SEC registration fee	$ 487.72
Legal fees and expenses	25,000.00
Accounting fees and expenses	10,000.00
Miscellaneous	5,000.00
Total	$ 40,487.72

Item 15. Indemnification of Directors and Officers

Section 145 of the Delaware General Corporation Law (the "Delaware Law") authorizes a court to award, or a corporation's Board of Directors to grant, indemnity to directors and officers in terms sufficiently broad to permit such indemnification under certain circumstances for liabilities (including reimbursement for expenses incurred) arising under the Securities Act of 1933. Article VII of the Registrant's Certificate of Incorporation and Article VI of the Registrant's Bylaws provide for indemnification of the Registrant's directors and officers and authorize indemnification of employees and other agents to the maximum extent permitted by Delaware Law. In addition, the Registrant has entered into Indemnification Agreements with its officers and directors and certain stockholders.

Insofar as indemnification by us for liabilities arising under the Securities Act may be permitted to our directors, officers and controlling persons pursuant to the provisions referenced above or otherwise, the Registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by Registrant of expenses incurred or paid by one of Registrant's directors, officers, or controlling persons in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered hereunder, Registrant will, unless in the opinion of Registrant's counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

Item 16. Exhibits

Exhibits	
5.1	Opinion of Wilson Sonsini Goodrich & Rosati, P.C.
10.1(1)	Form of Securities Purchase Agreement entered into August 5, 2003 (first closing).
10.2(2)	Form of Securities Purchase Agreement entered into September 12, 2003 (second closing).
10.3(1)	Form of Registration Rights Agreement entered into as of August 5, 2003 (in respect of first and second closings).
10.4(1)	Form of Common Stock Warrant entered into August 5, 2003 (first closing).
10.5(2)	Form of Common Stock Warrant entered into September 12, 2003 (second closing).
23.1	Consent of Ernst & Young LLP, Independent Auditors.
23.2	Consent of Wilson Sonsini Goodrich & Rosati, P.C. (included in Exhibit 5.1).
24.1	Power of Attorney (see page II 4).

(1) Incorporated by reference to exhibits filed with Registrant's Current Report on Form 8 K that was filed with the Securities and Exchange Commission on August 7, 2003.
(2) Incorporated by reference to exhibits filed with the Registrant's Current Report on Form 8 K that was filed with the Securities and Exchange Commission on September 16, 2003.

Item 17. Undertakings

The undersigned Registrant hereby undertakes:

(1) To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement:

(i) To include any prospectus required by Section 10(a)(3) of the Securities Act;

(ii) Reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post effective amendment thereof) which, individually or in the aggregate, represent a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Securities and Exchange Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement;

(iii) To include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the effective registration statement;

provided, however, that subparagraphs (i) and (ii) shall not apply if the information required to be included in a post effective amendment by those subparagraphs is contained in periodic reports filed with or furnished to the Securities and Exchange Commission by the Registrant pursuant to Section 13 or Section 15(d) of the Securities Exchange Act that are incorporated by reference in the Registration Statement.

(2) For the purpose of determining any liability under the Securities Act treat each post effective amendment as a new registration of the securities offered therein, and the offering of such securities at that time to be the initial bona fide offering.

(3) Remove from registration by means of a post effective amendment any of the securities being registered which remain unsold at the termination of this offering.

(4) For the purpose of determining any liability under the Securities Act treat each filing of the Registrant's annual report pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 that is incorporated by reference in this Registration Statement as a new registration statement relating to the securities offered therein, and the offering of such securities at that time to be the initial bona fide offering.

(5) Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer of controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act will be governed by the final adjudication of such issue.

SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, the Registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-3 and has duly caused this Registration Statement to be signed on its behalf by the undersigned, thereunto duly authorized in the City of Newark, State of California, on the 26th day of September, 2003.

SOCKET COMMUNICATIONS, INC.

By: /s/ David W. Dunlap
David W. Dunlap
Chief Financial Officer and
Vice President of Finance and Administration

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below hereby constitutes and appoints, jointly and severally, Kevin J. Mills and David W. Dunlap, and each one of them, individually and without any other, his attorney in fact, each with full power of substitution, for him in any and all capacities, to sign any and all amendments (including post effective amendments) to this Registration Statement, and to sign any registration statement for the same offering covered by this Registration Statement that is to be effective upon filing pursuant to Rule 462(b) promulgated under the Securities Act of 1933, and all post effective amendments thereto, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys in fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Act of 1933, this Registration Statement has been signed on the 26th day of September, 2003 by the following persons in the capacities indicated.

Signature	**Title**
/s/ Kevin Mills Kevin Mills	President and Chief Executive Officer (Principal Executive), and Director
/s/ Charlie Bass Charlie Bass	Chairman of the Board
/s/ David W. Dunlap David W. Dunlap	Vice President of Finance and Administration and Chief Financial Officer (Principal Financial and Accounting Officer)
/s/ Micheal Gifford Micheal Gifford	Executive Vice President and Director
/s/ Enzo Torresi Enzo Torresi	Director
/s/ Gianluca Rattazzi Gianluca Rattazzi	Director
/s/ Peter Sealey Peter Sealey	Director
/s/ Leon Malmed Leon Malmed	Director

EXHIBIT INDEX

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(2) Incorporated by reference to exhibits filed with the Registrant's Current Report on Form 8 K that was filed with the Securities and Exchange Commission on September 16, 2003.

Exhibit 5.1

WILSON SONSINI GOODRICH & ROSATI
Professional Corporation
650 Page Mill Road
Palo Alto, CA 94304
(650) 565-3807

September 26, 2003

Socket Communications, Inc.
37400 Central Court
Newark, CA 94560

Re: Registration Statement on Form S-3

Ladies and Gentlemen:
At your request, we have examined the Registration Statement on Form S-3 to be filed by Socket Communications, Inc., a Delaware corporation (the "Company"), with the Securities and Exchange Commission on or about September 26, 2003 (the "Registration Statement") in connection with the registration under the Securities Act of 1933, as amended (the "Act"), of a total of 2,491,163 shares of the Company's common stock (the "Shares"), which may be offered for sale by the selling stockholders named therein to the public as described in the Registration Statement. As legal counsel for the Company, we have examined instruments, documents, certificates and records that we deem relevant and necessary for the basis of our opinion hereinafter expressed.

It is our opinion that, upon completion of the proceedings being taken or contemplated by us, as the Company's counsel, the Shares, when issued and sold in the manner described in the Registration Statement, in accordance with the resolutions adopted by the Board of Directors of the Company and in accordance with the applicable agreements and charter documents of the Company, will be legally and validly issued, fully paid and nonassessable.

We hereby consent to the filing of this opinion as an exhibit to the Registration Statement, including the prospectus constituting a part thereof, and further consent to the use of our name wherever it appears in the Registration Statement and any amendments thereto.

Very truly yours,

WILSON SONSINI GOODRICH & ROSATI Professional Corporation

/s/ Wilson Sonsini Goodrich & Rosati

Exhibit 23.1

CONSENT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

We consent to the reference to our firm under the caption "Experts" in this Registration Statement on Form S-3 and related Prospectus of Socket Communications, Inc. for the registration of 2,491,163 shares of its common stock and to the incorporation by reference therein of our report dated February 10, 2003 (except Note 14, as to which the date is March 28, 2003), with respect to the consolidated financial statements of Socket Communications, Inc. included in its Annual Report (Form 10 K) for the year ended December 31, 2002, filed with the Securities and Exchange Commission.

/s/ Ernst & Young LLP

San Jose, California
September 24, 2003

S 6, 22 AND 25 OF Management For For THE BYLAWS OF THE COMPANY TO IMPLEMENT ANY

RESOLUTIONS TAKEN BY THE SHAREHOLDERS AFFECTING SUCH ARTICLES. 17 APPOINTMENT OF DELEGATES FOR THE EXECUTION AND Management For For FORMALIZATION OF THE MEETING'S RESOLUTION. 18 READING AND, IF APPLICABLE, APPROVAL OF THE Management For For MINUTES. 19 DECIDE WHETHER TO PERMIT SHARES TO CONTINUE TO Management For For BE BUNDLED IN UNITS BEYOND MAY 11, 2008, UNTIL THE SHAREHOLDERS APPROVE A RESOLUTION TO DISSOLVE SUCH UNIT STRUCTURE. 20 DECIDE WHETHER TO EXTEND, BEYOND MAY 11, 2008, THE Management Against Against CURRENT SHARE STRUCTURE OF THE COMPANY CONSISTING OF SERIES "B" ORDINARY SHARES THAT REPRESENT AT LEAST 51% OF OUR CAPITAL STOCK AND SERIES "D" SHARES WITH PREMIUM, NON-CUMULATIVE DIVIDEND RIGHTS AND LIMITED VOTING RIGHTS, WHICH REPRESENT UP TO 49% OF OUR CAPITAL STOCK, UNTIL THE SHAREHOLDERS APPROVE A RESOLUTION FOR THE CONVERSION OF THE SERIES "D" SHARES INTO SERIES "B" AND SERIES "L" SHARES. 21 DECIDE WHETHER TO AMEND ARTICLES 6, 22 AND 25 OF Management For For THE BYLAWS OF THE COMPANY TO IMPLEMENT ANY RESOLUTIONS TAKEN BY THE SHAREHOLDERS AFFECTING SUCH ARTICLES. 22 APPOINTMENT OF DELEGATES FOR THE EXECUTION AND Management For For FORMALIZATION OF THE MEETING'S RESOLUTION. 23 READING AND, IF APPLICABLE, APPROVAL OF THE Management For For MINUTES.
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-- GRUPO CONTL S A Security P3091R172 Meeting Type Ordinary General Meeting Ticker Symbol Meeting Date 24-Apr-2008 ISIN MXP3091R1239 Agenda 701541977 - Management Item Proposal Proponent Vote For/Against Management I. Appoint the Returning Officers, carrying out their duties and Management For For declare the instatement of the meeting II. Approve the annual report, message from the Chairman of the Management For For Board of Directors, report of the Director General that includes the individual and consolidated financial statements from Grupo Continental, S.A.B. and subsidiary Companies, to 31 DEC 2007, the report of the Board of Directors; and the opinion of the Board of Directors regarding the content of the report from the Director General III. Receive the report of the Audit and Corporate Practices Management For For Committee IV. Ratify the resolutions and acts of the Board of Directors during the Management For For 2007 FY V. Approve the allocation of results and to pay a cash dividend Management For For VI. Receive the report regarding the purchase of own shares Management For For VII. Approve to set the maximum amount allocated for the purchase of Management For For own shares VIII. Elect the Board of Directors Management For For IX. Elect the Chairman of the Audit and Corporate Practices Management For For Committee X. Approve to set the compensation for the Members of the Board of Management For For Directors XI. Approve the minutes of the meeting Management For For
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ULTRAPAR PARTICIPACOES SA Security P94396101 Meeting Type Annual General Meeting Ticker Symbol Meeting Date 28-Apr-2008 ISIN BRUGPAACNPR5 Agenda 701534340 - Management Item Proposal Proponent Vote For/Against Management 1. To take the accounts of the Board of Director's to examine, Non-Voting N/A N/A discuss and vote the financial statements, the External Auditors and Finance Committee opinion report, relating to FYE 31 DEC 2007 2. Ratification of the approval of the capital budget for the 2008 FY, Non-Voting N/A N/A in accordance with that decided by the Board of Directors on 20 FEB 2008 3. Allocation of the net profit from the FY that has ended, with the Non-Voting N/A N/A ratification of the dividend regarding the mentioned FY, already distributed and paid 4. Elect the Members of the Board of Directors and approve to set Management For For the remuneration 5. Elect the Members of the Finance Committee and approve to set Management For For the remuneration
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GEDEON RICHTER LTD Security 368467205 Meeting Type Annual General Meeting Ticker Symbol Meeting Date 28-Apr-2008 ISIN US3684672054 Agenda 701542070 - Management Item Proposal Proponent Vote For/Against Management 1. Receive the report of the Board of Directors on the 2007 business Management Abstain Against activities of the Company and the annual report prepared in accordance with the Accounting Act 2. Receive the report of the Auditor Management Abstain Against 3. Receive the report of the Supervisory Board including the report of

Management Abstain Against the Audit Committee 4. Approve the determination and allocation of the 2007 after-tax Management Abstain Against profit of the Company and the declaration of dividends for the 2007 business year on common shares 5. Approve the 2007 annual report of the company prepared in Management Abstain Against accordance with the accounting Act, including the 2007 balance sheet 6. Receive the report on the 2007 business activities of the Richter Management Abstain Against Group and the Consolidated Report prepared in accordance with the IFRS 7. Receive the report of the Auditor on the consolidated report Management Abstain Against 8. Receive the report of the Supervisory Board including the report of Management Abstain Against the Audit Committee on the consolidated report 9. Approve the 2007 consolidated report Management Abstain Against 10. Receive the Corporate Governance report Management Abstain Against 11. Authorize the Board of Directors for the purchase of own shares of Management Abs 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 initially expect to 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. 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 34 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. 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. This is especially an issue while the company staffing is small. We will also need to recruit additional management in order to expand according to our business plan. We are currently recruiting a chief financial officer. The failure to attract and retain additional management or personnel could have a material adverse effect on our operating results and financial performance. OUR BUSINESS DEPENDS ON NEW PRODUCTS AND TECHNOLOGIES. The market for our products is characterized by rapid changes in product, design and manufacturing process technologies. Our success depends to a large extent on our ability to develop and manufacture new products and technologies to match the varying requirements of different customers in order to establish a competitive position and become profitable. Furthermore, we must adopt our products and processes to technological changes and emerging industry standards and practices on a cost-effective and timely basis. Our failure to accomplish any of the above could harm our business and operating results. WE GENERALLY DO NOT HAVE LONG-TERM CONTRACTS WITH OUR CUSTOMERS. Our business is operated on the basis of short-term purchase orders and we cannot guarantee that we will be able to obtain long-term contracts for some time. Our current purchase agreements can be cancelled or revised without penalty, depending on the circumstances. In the absence of a backlog of orders that can only be canceled with penalty, we plan production on the basis of internally generated forecasts of demand, which makes it difficult to accurately forecast revenues. If we fail to accurately forecast operating results, our business may suffer and the value of your investment in the Company may decline. 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. 35 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 give expose us to various risks, including management of a multi-national organization, the complexities of complying with foreign laws and customs, political instability and the complexities of taxation in multiple jurisdictions. OUR BUSINESS MAY EXPOSE US TO PRODUCT LIABILITY CLAIMS. Our business may expose us to potential product liability claims. Although no such claims have been brought against us to date, and to our knowledge no such claim is threatened or likely, we may face liability to product users for damages resulting from the faulty design or manufacture of our products. While we plan to maintain product liability insurance coverage, there can be no assurance that product liability claims will not exceed coverage limits, fall outside the scope of such coverage, or that such insurance will continue to be available at commercially reasonable rates, if at all. OUR BUSINESS IS SUBJECT TO ENVIRONMENTAL REGULATIONS AND POSSIBLE LIABILITY ARISING FROM POTENTIAL EMPLOYEE CLAIMS OF EXPOSURE TO HARMFUL SUBSTANCES USED IN THE DEVELOPMENT AND MANUFACTURE OF OUR PRODUCTS. We are subject to various governmental regulations related to toxic, volatile, experimental and other hazardous chemicals used in our design and manufacturing process. Our failure to comply with these regulations could result in the imposition of fines or in the suspension or cessation of our operations. Compliance with these regulations could require us to acquire costly equipment or to incur other significant expenses. We develop, evaluate and utilize new chemical compounds in the manufacture of our products. While we attempt to ensure that our employees are protected from exposure to hazardous materials, we cannot assure you that potentially harmful exposure will not occur or that we will not be liable to employees as a result. RISKS RELATED TO OUR STOCK THE SUBSTANTIAL NUMBER OF SHARES THAT ARE OR WILL BE ELIGIBLE FOR SALE COULD CAUSE OUR COMMON STOCK PRICE TO DECLINE EVEN IF THE COMPANY IS SUCCESSFUL. Sales of significant amounts of common stock in the public market, or the perception that such sales may occur, could materially affect the market price of our common stock. These sales might also make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate. As of March 30, 2004, we have outstanding (i) options to purchase 7,242,824 shares; (ii) warrants to purchase 16,178,411 shares of common stock; and (iii) 0 shares of common stock underlying convertible securities. 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. 36 ITEM 7. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA FINANCIAL STATEMENT INDEX Page

 37 INDEPENDENT AUDITORS' REPORT Board of Directors and Stockholders eMagin Corporation Hopewell Junction, New York We have audited the accompanying consolidated balance sheet of eMagin Corporation and subsidiary (the "Company") as of December 31, 2003, and the related consolidated statements of operations, capital deficiency and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of eMagin Corporation and subsidiary as of December 31, 2003 and the consolidated results of their operations and their consolidated cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. /s/ Eisner LLP New York, New York February 13, 2004 With respect to Notes F(b) and O March 3, 2004 38 INDEPENDENT AUDITORS' REPORT REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS To the Shareholders of eMagin Corporation: We have audited the accompanying consolidated statements of operations, shareholders' equity (deficit) and cash flows of eMagin Corporation and subsidiaries for the year ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant statement presentation. We believe that our audit provides a reasonable basis for our opinion. In our opinion, the financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of eMagin Corporation and subsidiaries in conformity with accounting principles generally accepted in the United States of America. The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note 1 of the consolidated financial statements on Form 10-K for the year ended December 31, 2002, the Company's recurring losses from operations since inception and the working capital deficit raised substantial doubt about its ability to continue as a going concern. Management's plans concerning these matters were also described in Note 1 of the consolidated financial statements on Form 10-K for the year ended December 31, 2002. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. /s/ Grant Thornton LLP ---------------------- Grant Thornton LLP New York, New York April 11, 2003 39 eMagin Corporation Consolidated Balance Sheet December 31, 2003 ASSETS Current assets: Cash and cash equivalents $ 1,053,895 Trade and contract receivables 768,537 Unbilled costs and estimated profits on contracts in progress 75,359 Prepaid expenses and other current assets 287,957 Inventory 275,417 ---------------------- Total current assets 2,461,165 Equipment and leasehold improvements, net of accumulated depreciation of $2,149,991 1,200,939 Other long-term assets 86,907 ---------------------- Total assets $ 3,749,011 ====================== LIABILITIES Current liabilities: Accounts payable $ 234,869 Accrued payroll and benefits 952,850 Other accrued expenses, net dividends 988,569 Advanced payments 122,362 Current portion of long-term debt 38,184 Other current liabilities 18,008 ---------------------- Total current liabilities 2,354,842 Capitalized lease obligations 36,257 Notes payable and short-term debt subsequently converted to equity 6,124,451 ---------------------- Total liabilities 8,515,550 ---------------------- Commitments and contingencies CAPITAL DEFICIENCY Preferred Stock - authorized: 10,000,000 shares, none issued - Common Stock - $.001 par value, authorized 200,000,000 shares, Issued and outstanding 42,695,412 shares 42,694 Paid-in surplus 131,598,910 Deferred compensation (87,565) Accumulated deficit (136,320,578) ---------------------- Total capital deficiency (4,766,539) ---------------------- Total liabilities and capital deficiency $ 3,749,011 ====================== See notes to consolidated financial statements 40 eMagin Corporation Consolidated Statements of Operations Year Ended December 31, 2003 2002 -------------------

---------------- Revenue: Product revenue $ 2,213,290 $ 1,314,193 Contract revenue 364,809 840,658 Sales returns and allowances - (27,191) ------------------- ---------------- Total Revenue 2,578,099 2,127,660 Cost of goods sold: Costs of goods sold 5,141,448 - ------------------- ---------------- Gross (loss) profit (2,563,349) 2,127,660 ------------------- ---------------- Costs and expenses: Research and development, net of funding under cost sharing arrangements of $0 and $331,956, respectively 18,810 7,254,996 Amortization of purchased intangibles 331,442 1,325,796 Stock based compensation 2,183,418 1,646,917 Selling, general and administrative 3,197,605 4,506,321 ------------------- ---------------- Total costs and expenses, net 5,731,275 14,734,030 ------------------- ---------------- Other income (expense): Gain on on debt settlement 4,637,993 - Interest expense (1,283,254) (2,329,452) Other income (expense), net 216,570 23,111 ------------------- ---------------- Other income (expense) 3,571,309 (2,306,341) ------------------- ---------------- Net loss $ (4,723,315) $ (14,912,711) =================== ================ Basic and diluted loss per common share $ (0.13) $ (0.51) =================== ================ Weighted average outstanding common stock 35,998,435 29,416,838 =================== ================ See notes to consolidated financial statements 41 eMagin Corporation Consolidated Statements of Capital Deficiency --- Common Common Deferred Paid-in Accumulated Total Shares Stock Compensation Surplus Deficit --- Balance - December 31, 2001 25,171,183 $ 25,171 $(2,277,367) $ 114,058,560 $(116,684,552) $ (4,878,188) ------------- --------- ------------ ------------- -------------- ------------ Shares issued for financing round 4,899,179 4,899 3,475,619 3,480,518 Buyout of debt financing 500,000 500 89,632 90,132 Warrants issued 140,387 140,387 Stock issued for consideration 80,000 80 55,570 55,650 Stock options exercised 2,125 2 885 887 Stock options issued 35,329 35,329 Options forfeited 1,075,193 (1,075,193) - Finders fee on financing (35,000) (35,000) Beneficial conversion on financing 783,691 783,691 Original issue discount on financing 672,682 672,682 Issuance of common stock for services 202,493 202 146,716 146,918 Amortization of deferred compensation 739,191 739,191 Stock based compensation 872,399 872,399 Net loss for period (14,912,711) (14,912,711) ------------- --------- ------------ ------------- -------------- ------------ Balance - December 31, 2002 30,854,980 30,854 (462,983) 119,221,276 (131,597,263) (12,808,115) Conversion of debt to equity 6,101,972 6,102 - 4,447,996 - 4,454,098 Debt settlement 1,997,840 1,998 - 1,409,971 - 1,411,969 Exercise of warrants 1,479,900 1,480 - 1,136,595 - 1,138,075 Cashless exercise of warrants 270,910 271 - (271) - - Original issue discount on financing - - - 1,383,203 - 1,383,203 Beneficial conversion on financing - - - 616,797 - 616,797 Stock issued for services 656,435 656 - 561,302 - 561,958 Options exercised 846,793 847 - 279,199 - 280,046 Issuance of equity for interest and penalties 486,582 486 - 734,841 - 735,327 Amortization of deferred compensation - - 375,418 - - 375,418 Stock option compensation - - - 1,808,000 - 1,808,000 Net loss for period - - - - (4,723,315) (4,723,315) ------------- --------- ----------- ------------- -------------- ------------ Balance - December 31, 2003 42,695,412 $ 42,694 $ (87,565) $ 131,598,910 $ (136,320,578) $(4,766,539) ============== ========= =========== ============= ============== ============= See notes to consolidated financial statements 42 eMagin Corporation Consolidated Statements of Cash Flows Year Ended December 31, 2003 2002 -------------------- -------------------- Cash flows from operating activities: Net loss $ (4,723,315) $(14,912,711) Adjustments to reconcile net loss to net cash used in operating activities: Depreciation and amortization 552,849 1,842,480 Amortization of purchased intangibles 331,442 - Amortization of financing fees 37,244 - Debt discount amortization and charge for beneficial conversion feature 340,466 783,692 Stock based compensation 2,183,418 1,646,917 Interest related charges 915,325 1,446,654 Related to issuance of warrants - 140,387 Gain on debt settlement (4,637,993) - Stock issued for services 561,958 25,050 Changes in: - - Trade receivables (528,401) 593,300 Unbilled costs and estimated profits on contracts in progress 50,000 125,359 Costs and estimated profits in excess of billings on contracts - (326,291) Inventory (24,419) 341,718 Prepaid expenses and other current assets (276,109) 196,371 Other long-term assets 112,500 139,033 Advanced payments 122,362 (398,343) Deferred revenue (30,400) 30,400 Accounts payable, accrued expenses and accrued payroll (185,776) 2,738,847 Other current liabilities (5,497) - -------------------- -------------------- Net cash used in operating activities (5,204,346) (5,587,137) -------------------- -------------------- Cash flows from investing activities: Purchase of equipment (1,120,256) (84,745) Cash flows from financing activities: Proceeds from sales of common stock, net of issuance costs - 3,475,621 Proceeds from exercise of stock options and warrants 1,418,121 141,272 Proceeds from long- and short-term debt 6,000,000 1,443,478 Payments of long- and short-term debt (122,775) (43,880) -------------------- -------------------- Net cash provided by financing activities 7,295,346 5,016,491 -------------------- -------------------- Net increase (decrease) in cash and cash equivalents 970,944 (655,391) Cash and cash equivalents - beginning of year 82,951 738,342 -------------------- ------------------- Cash and cash equivalents - end of year $ 1,053,895 $ 82,951 ==================== =================== Cash paid for interest $ 15,649 Non-cash transactions: Conversion of debt to equity $ 4,454,098 Issuance of equity for penalties and interest $ 735,327 Issuance of equity for settlement of accounts payable $ 1,411,969 See notes to consolidated financial statements 43 eMAGIN CORPORATION Notes to Consolidated Financial Statements December 31, 2003 and 2002 Note A - NATURE OF BUSINESS Fashion Dynamics Corporation ("FDC") was organized on January 23, 1996, under the laws of the State of Nevada. FDC had no active business operations other than to acquire an interest in a business. On March 16, 2000, FDC acquired FED Corporation ("FED") (the "Merger"). The merged company changed its name to eMagin Corporation (the "Company" or "eMagin"). eMagin is a developer and manufacturer of optical systems and microdisplays for use in the electronics industry. eMagin's wholly-owned subsidiary, Virtual Vision Inc., develops and markets microdisplay systems and optics technology for commercial, industrial and military applications. Following the Merger, the business conducted by the Company is the business conducted by FED prior to the Merger. Through December 31, 2002, the Company was considered a development stage enterprise, in accordance with Statement of Financial Accounting Standards ("SFAS") No. 7, "Accounting and Reporting by Development Stage Enterprises". As of January 1, 2003, the Company has commenced planned principal operations and as such it is no longer considered to be a development stage enterprise in accordance with SFAS No 7. In accordance with SFAS No.7, the 2002 financial statements have been restated to give effect to the Company exiting the development stage. Note B - SIGNIFICANT ACCOUNTING POLICIES [1] Principles of consolidation: The accompanying consolidated financial statements of eMagin Corporation include the assets, liabilities, revenues and expenses of its wholly owned subsidiary. Inter-company transactions and balances are eliminated in consolidation. [2] Revenue and cost recognition: Revenue is recognized when products are shipped to customers, net of allowances for anticipated returns. The Company's revenue-earning activities generally involve delivering products and revenues are considered to be earned when the Company has completed the process by which it is entitled to such revenues. Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred, selling price is fixed or determinable and collection is reasonably assured. The Company also earns revenues from certain of eMagin's R&D activities under both firm fixed-price contracts and cost-type contracts, including some cost-plus-fee contracts. Revenues relating to firm fixed-price contracts are generally recognized on the percentage-of-completion method of accounting as costs are incurred (cost-to-cost basis). Revenues on cost-plus-fee contracts include costs incurred plus a portion of estimated fees or profits based on the relationship of costs incurred to total estimated costs. Contract costs include all direct material and labor costs and an allocation of allowable indirect costs as defined by each contract, as periodically adjusted to reflect revised agreed upon rates. These rates are subject to audit by the other party. Amounts can be billed on a bi-monthly basis. Billing is based on subjective cost investment factors. [3] Research and development costs: R&D costs are expensed as incurred. To date, activities of the Company have included the performance of R&D under cooperative agreements with United States Government agencies. Funding from such R&D contracts is 44 recognized as a reduction in operating expenses during the period in which the services are performed and related direct expenses are incurred. The Company has incurred research and development costs and earned funding under these agreements during the year ended December 31, 2003 as follows: Unfunded research and development $ 7,244,820 Research and development costs 331,956 Funding received (331,956) [4] Cash and cash equivalents: We consider all highly liquid instruments with an original maturity of three months or less at the date of purchase to be cash equivalents. [5] Accounts receivable: The majority our commercial accounts receivable are due from Original Equipment Manufacturers ("OEM"s). Credit is extended based on evaluation of a customers' financial condition and, generally, collateral is not required. Accounts receivable are payable in U.S. dollars, are due within 30-90 days and are stated at amounts due from customers net of an allowance for doubtful accounts. Any account outstanding longer than the contractual payment terms is considered past due. The Company determines the allowance by considering a number of factors, including the length of time trade accounts receivable are past due, eMagin's previous loss history, the customer's current ability to pay its obligation, and the condition of the general economy and the industry as a whole. The Company writes off accounts receivable when they become uncollectable, and payments subsequently received on such receivables are reported as income in the year the payment is received [6] Inventory: Inventory is stated at the lower of cost or market. Cost is determined using the first-in first-out method. The Company reviews the value of its inventory and reduces the inventory value to its net realized value based upon current market prices and contracts for future sales. [7] Equipment and leasehold improvements: Equipment and leasehold improvements are stated at cost. Depreciation on equipment is calculated using the straight-line method of depreciation over its estimated useful life. Amortization of leasehold improvements is calculated by using the straight-line method over the shorter of their estimated useful lives or lease terms. Expenditures for maintenance and repairs are charged to expense as incurred. In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," eMagin performs impairment tests on its long-lived assets, when circumstances indicate that their carrying amounts may not be recoverable. If required, recoverability is tested by comparing the estimated future undiscounted cash flows of the asset or asset group to its carrying value. Impairment losses, if any, are recognized based on the excess of the assets' carrying amounts over their fair values. [8] Income taxes: Deferred income taxes are recorded by applying enacted statutory tax rates to temporary differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. At December 31, 2003 and 2002, the Company has net deferred tax assets of approximately $56.7 million and $29.5 million, respectively, primarily resulting from the future tax benefit of net operating loss carryforwards discussed below and timing differences relating to amortization of goodwill and other intangible assets. Such net deferred tax assets are fully offset by valuation allowances due to the uncertainty as to their realizability. At December 31, 2003, the Company has net operating loss carryforwards totaling approximately $ 86.4 million, inclusive of the net operating losses acquired as part of the acquisition of FED, which expire through 2023, available to offset future federal taxable income. Pursuant to Section 382 of the Internal Revenue Code, the usage of a portion of these net operating loss carryforwards is limited due to changes in ownership that have occurred. [9] Loss per common share: In accordance with SFAS No. 128, "Earnings Per Share," net loss per common share amounts ("basic EPS") were computed by dividing net loss by the weighted average number of common shares outstanding and excluding any potential dilution. Net loss per common share amounts assuming dilution ("diluted EPS") were computed by 45 reflecting potential dilution from the exercise of stock options and warrants. Common equivalent shares have been excluded from the computation of diluted EPS for all periods presented as their effect is antidilutive. The Company's computation of dilutive loss per share for the year ended December 31, 2003 does not include options and warrants to purchase 21,725,607 common shares, as their effect would be antidilutive. [10] Comprehensive income (loss): The Company complies with the provisions of SFAS No. 130, "Reporting Comprehensive Income," which requires companies to report all changes in equity during a period, except those resulting from investment by owners and distributions to owners, for the period in which they are recognized. Comprehensive income (loss) is the total of net income (loss) and all other non-owner changes in equity (or other comprehensive income (loss) such as unrealized gains or losses on securities classified as available-for-sale, foreign currency translation adjustments and minimum pension liability adjustments. Comprehensive income (loss) must be reported on the face of the annual financial statements. The Company's operations did not give rise to any material items includable in comprehensive income (loss), which were not already in net income (loss) for the years ended December 31, 2003 and 2002. Accordingly, the Company's comprehensive income (loss) is the same as its net income (loss) for all periods presented. [11] Stock-based compensation: eMagin applies Accounting Principals Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations in accounting for its stock-based compensation plans. Accordingly, eMagin records expense for employee stock compensation plans equal to the excess of the market price of the underlying eMagin shares at the date of grant over the exercise price. As of December 31, 2003, the Company has outstanding options to purchase 12,148,570 shares. The Company has elected to follow APB No. 25, in accounting for its employee stock options. Under APB No. 25, when the exercise price of employee stock options equals the market price of the underlying stock on the date of grant no compensation expense is recorded. The Company discloses information relating to the fair value of stock-based compensation awards in accordance with Statement of Financial Accounting Standards No.123 ("SFAS No. 123"), "Accounting for Stock-Based Compensation." The following table illustrates the effect on net loss and loss per share as if the Company had applied the fair value recognition provision of SFAS No. 123. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions used for grants in 2003 and 2002, respectively: (1) average expected volatility of 100% and 150%, (2) average risk-free interest rates of 3.52% and 6.00%, and (3) expected lives of 7-10 years and 5-8 years and (4) dividends of 0% and 0%. The pro forma amounts that are disclosed in accordance with SFAS No. 123 reflect the portion of the estimated fair values of awards that were earned during the years ended December 31, 2003 and 2002. 2003 2002 ------------------ (in thousands) Net loss applicable to common stockholders, as reported $ (4,723) $ (14,913) Stock-based employee compensation expense included in reported net loss 2,183 - Stock-based employee compensation expense determined under fair value method (3,748) (1,226) ---------- ---------- Pro forma net loss $ (6,288) $ (16,139) ========== ========== Net loss per share: Basic and diluted, as reported $ (0.13) $ (0.51) Basic and diluted, pro forma $ (0.17) $ (0.55) Weighted average fair value per option $ 0.76 $ 0.74 46 [12] Fair value of financial instruments: The Company has various financial instruments, including cash, cash equivalents, accounts receivable, accounts payable and short and capitalized lease obligations. The Company believes the carrying values of its financial instruments approximate their fair values. The carrying amount of the short- and long-term debt approximates fair value at December 31, 2003 based on interest rates available to the Company and debt instruments with similar terms. [13] Use of estimates The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. These estimates and assumptions relate to recording net revenue, collectibility of accounts receivable, and the realizability of other intangible assets, accruals, income taxes, inventory realization and other factors. Management has exercised reasonable judgment in deriving these estimates; however, actual results could differ from these estimates. Consequently, change in conditions could affect eMagin's estimates. [14] Reclassifications: Certain amounts in the 2002 financial statements have been reclassified to conform to the 2003 presentation. Note C - RECEIVABLES Receivables at December 31, 2003 consist of the following: Trade receivables $ 899,174 Contract receivables 173,809 Unbilled receivables 75,359 ------------ Total 1,148,342 Less allowance for doubtful accounts (304,446) ------------ Net receivables $ 843,896 ============ Note D - Inventory The components of inventories as of December 31, 2003 are as follows: Raw materials $ 20,416 Work in process 43,750 Finished goods 211,251 ----------- Total Inventory $ 275,417 =========== Note E - EQUIPMENT AND LEASEHOLD IMPROVEMENTS Equipment and leasehold improvements and their estimated lives are as follows at December 31, 2003: Useful Lives Computer hardware and software 3 $ 328,758 Lab and factory equipment 3 2,547,165 Furniture, fixtures and office equipment 10 145,268 Leasehold improvements (a) 329,739 ------------ Total Fixed Assets 3,350,930 Less accumulated depreciation (2,149,991) ------------ Total Net Book Value $ 1,200,939 ============ (a) The shorter of either the life of the lease, or the useful life 47 Note F - DEBT The debt consisted of the following as of December 31, 2003: a Current portion of long term debt $ 38,184 b Restructuring Agreement 4,456,973 c Original Secured Notes 1,667,478 d Capitalized lease obligations 36,257 ------------------- e Total debt $ 6,198,892 =================== (a) This amount includes (i) $12,213 due to Citicorp Leasing over the next 12 months in lease payments for equipment; and (ii) $25,971 due to IBM over the next 12 months for leasehold improvements. The remaining balance under the Citicorp lease is due in 2005. (b) On April 25, 2003, eMagin entered into a Global Restructuring and Secured Note Purchase Agreement ("Restructuring Agreement") dated as of April 25, 2003 (the "Closing Date") with a group of several accredited institutional and individual investors whereby the investors agreed to lend the Company $6,000,000 in exchange for (i) the issuance of $6,000,000 principal amount of 9% secured convertible promissory notes due and payable on November 1, 2005 and (ii) warrants to purchase an aggregate of 7,749,921 shares of common stock of eMagin (subject to certain customary anti-dilution adjustments). Such warrants are exercisable for a period of three (3) years from the issue date. Interest is payable on the notes at a rate of 9% per annum and, at the Company's option, may be paid through the delivery of shares of the Company's common stock in lieu of cash interest payments on the maturity date of the loan, November 1, 2005. Subject to certain limitations, the notes may be converted, at the option of the holder, in whole or in part, into common shares with a conversion price of $0.7742, an amount equal to 105% of the volume weighted average of the closing price of eMagin's common shares as reported on The American Stock Exchange by the Wall Street Journal, New York City edition, for the five (5) trading days immediately preceding the closing date. The exercise price of the warrants on a per share basis is $.8110, an amount equal to 110% of the volume weighted average of eMagin's closing price of our common shares as reported on The American Stock Exchange by the Wall Street Journal, New York City edition, for the five (5) trading days immediately preceding the closing date. As of December 31, 2003 the Company had received the entire $6,000,000. The Company recorded $1,289,575 for the debt discount and $510,425 for the beneficial conversion as paid-in surplus, which is being amortized through November 1, 2005. For the year ended December 31, 2003, $256,973 was amortized to interest expense. The terms of the notes contain certain revisions, including financial and other covenants, which covenants relate to expenses, direct cost of goods sold, revenues and quarterly revenues. In the event that the Company is not in compliance with these covenants, 50% or more of the holders of the notes (in terms of the aggregate dollar value of the principal of the notes then issued and outstanding under the note purchase agreement) would be able to call an event of default. As of December 31, 2003, the Company was in violation of certain financial covenants. The notes have not been included in current liabilities because they were converted into shares of the Company's common stock on March 3, 2004 (see Note O). 48 (c)This amount includes secured convertible loans aggregating $1,625,000 issued under the secured note purchase agreements executed from November 27, 2001 through January 14, 2002 ("Original Secured Notes"). The Original Secured Notes accrue interest at a rate of 9.00% per annum and were due on June 30, 2003. Terms of the notes issued included a fixed conversion into the Company's shares of common stock at the rate of $0.5264 per share. The Company also granted warrants purchasing 921,161 shares of common stock with an exercise price of $0.5468 per share to the note holders. Such warrants are exercisable through January 2005. The total of the intrinsic value of the warrants issued to the note holders and the incremental intrinsic value of the repriced warrants of certain existing note holders of approximately $480,000 has been recorded as original issue discount, resulting in a reduction in the carrying value of this debt. The original issue discount was amortized into interest expense over the original period of the debt. In addition, based on the terms of the Original Secured Notes, the conversion terms of the debt provide for a beneficial conversion feature. The total value of the beneficial feature of the debt and the incremental value of the reset conversion feature of the existing debt of approximately $780,000 was recorded at January 14, 2002 as non-cash interest expense. In connection with the April 2003 financing described above, the note holders agreed to (a) amend the secured note issued to them, (b) terminate the security agreement dated November 27, 2001 that was entered into in connection with the purchase of the Original Secured Notes and allow the note holders to enter into a new security agreement with them on a pari passu basis in order for eMagin to continue its operations as a developer of virtual imaging technology, and (c) simultaneously participate in the new financing. The amendments to the notes included (i) extending the maturity dates of the note from June 30, 2003 to November 1, 2005, and (ii) revising and clarifying certain of the other terms and conditions of the note, including provisions relating to default and assignment of the note. On June 20, 2002, the Company entered into a $0.2 million Secured Note Purchase Agreement with an investor. The secured note accrues interest at 11% per annum and was due to mature on June 30, 2003 and was amended as a result of the financing the Company completed in April 2003. The Company also granted warrants, exercisable for a period of five years, to purchase 300,000 shares of common stock with an exercise price of $0.4257 per share to the investor, provided, however, that this warrant may not be exercised by the investor so long as the investor is the beneficial owner, directly or indirectly, of more than ten percent (10%) of the common stock of eMagin for purposes of Section 16 of the Securities Exchange Act 1934. The fair value of the warrants issued to this investor, which approximated $84,000, has been recorded as original issue discount, resulting in a reduction in the carrying value of this debt. The original issue discount was amortized into interest expense over the period of the debt. Pursuant to the April 2003 financing described above, the investor agreed to (a) amend the secured note issued to them, (b) terminate the security agreement dated June 20, 2002 that was entered into in connection with the purchase of the Original Secured Notes and allow the investors to enter into a new security agreement with them on a pari passu basis in order for eMagin to continue its operations as a developer of virtual imaging technology, and (c) simultaneously participate in the new financing. The amendments to the note included (i) amending the note issued on June 20, 2002 so as to provide that the note shall be convertible and will have the same conversion price as the notes issued pursuant to the April 2003 secured note purchase agreement, (ii) extending the maturity dates of the note from June 30, 2003 to November 1, 2005, and (iii) revising and clarifying certain of the other terms and conditions of the note, including provisions relating to interest payments, conversions, default and assignment of the note. Due to the amendment to a convertible note, the Company recorded a $106,372 beneficial conversion discount and a $93,628 original debt discount, to be amortized through November 2005. For the year ended December 31, 2003, the Company has amortized a total of $42,478 for original debt discount and for beneficial conversion discount. 49 (d) This amount is due to Citicorp Leasing as long-term debt for lease payments for equipment. In September 2003, in accordance with the agreement, the Company was required to convert two Series B Convertible Debentures in the amount of $121,739 each into 1,468,382 share of the Company's common stock at a conversion price from the original note purchase agreement of $0.18 per share Note G - DEBT SETTLEMENT In connection with the April 2003 Financing, the Company entered into settlement or restructuring agreements with certain of eMagin's other creditors, pursuant to which the creditors agreed to accept shares of eMagin's common stock in full or partial satisfaction of the amount owed to them, or which allow us to either make discounted payments to them or to make payments under more favorable payment terms than previously were in place. The Company converted the $1,000,000 loan plus interest to Travelers Insurance Company ("Travelers") into 2,137,757 shares of the Company's common shares at a conversion price from the original agreement of approximately $0.53 per share, based on the market value of eMagin's common stock on the date the Company entered into the agreement. The Company also converted the $3,000,000 loan plus interest to SK Corporation into 2,495,833 shares of the Company's common stock at a conversion price from the original agreement of approximately $1.28 per share, based on the market value of eMagin's common stock on the date the Company entered into the agreement. There was no gain recorded on these transactions. During 2003, the Company issued 1,997,840 shares of common stock with a market value of $1,411,969 in partial payment of accounts payable and debt which resulted in a $1,575,087 gain on debt settlement. In the third quarter of 2003, the Company exercised several lease buyout provisions. The Company purchased for cash, $950,000 of equipment, which resulted in a reduction of $598,493 in prepaid interest and a write-down of $3,062,906 in long- and short-term debt. As a result of the above transactions, the Company recorded $4,637,993 as a gain on settlement of debt for the year ended December 31, 2003. Note H - INCOME TAXES The difference between the statutory federal income tax rate on the Company's pre-tax income and the Company's effective income tax rate is summarized as follows: 2003 ----- U.S. Federal income tax provision (benefit) at federal statutory rate (35)% Change in valuation allowance 35 % ----- 0 % ===== Significant components of eMagin's deferred tax assets as of December 31, 2003 are as follows: Net operating losses $ 34,580,000 Goodwill and other intangibles 21,700,000 Allowance for doubtful accounts 121,778 Deferred payroll 195,010 Accrued vacation pay 70,401 ------------- Total 56,667,189 Less valuation allowance (56,667,189) ------------- Net Deferred Tax Asset $ 0 ============= As of December 31, 2003, eMagin has federal and state net operating loss carryforwards of approximately $86.4 million that will be available to offset future taxable income, if any, through December 2023. The utilization of net 50 operating losses is subject to a substantial limitation due to the change of ownership provisions under Section 382 of the Internal Revenue Code and similar state provisions. Such limitation may result in the expiration of the net operating losses before their utilization. A valuation allowance has been established to reserve for the deferred tax assets arising from the net operating losses and other temporary differences due to the uncertainty that their benefit will be realized in the future. In 2003, in connection with the restructuring of its indebtedness (see Note G), the Company realized income of $4,637,993. Under Section 108 of the Internal Revenue Code, this income is excludable for federal income tax purposes to the extent that the amount of the Company's liabilities immediately before the restructuring exceeds the fair market value of its assets as a going concern at such time. The Company estimates the entire $4,637,993 is excludable under this exception. Pursuant to Section 108 of the Internal Revenue Code, the excluded income reduces the Company's tax attributes as of January 1, 2004. Such reduction is first applied to reduce net operating loss carryforwards. Note I - STOCKHOLDERS' EQUITY As of December 31, 2002, the authorized number of shares of common stock of the Company consisted of 100,000,000 shares with a par value of $0.001 per share. On July 2, 2003 the shareholders approved an increase to 200,000,000 shares. In January 2002, the Company negotiated settlement of amounts due to a related party for services previously rendered via issuance of 192,493 shares of common stock. As such, the Company recorded the fair value of the shares of approximately $135,000 in selling, general and administrative expenses in the accompanying consolidated statements of operations. On February 27, 2002, the Company completed a private placement of securities with several institutional and individual investors of 3,617,128 shares of common stock at a price per share of $0.6913, generating gross proceeds of approximately $2,500,000, less issuance costs of approximately $35,000. In connection with the financing arrangement, the Company issued to the investors warrants to purchase 1,446,852 shares of common stock of the Company at an exercise price of $0.7542 per share. Also, the Company issued to an institution warrants to purchase 36,164 shares of common stock in connection with a finder's fee arrangement entered into between the two parties. Such warrants are exercisable through February 2005. The Company entered into a registration rights agreement providing for the registration of shares to be issued pursuant to a conversion of the Original Secured Notes and the shares to be issued pursuant to the exercise of the warrants issued thereunder. The Company was currently in default of this filing requirement. As a result of the default, the Company has accrued $87,362 in interest and penalties in 2002. On March 4, 2002, the Company entered into an equity line of credit agreement with a private equity fund (the "Fund") whereby the Company has the option, but not the obligation, to sell shares of common stock to the Fund for a three-year period at a price per share, as defined. The agreement provided for certain minimum and maximum monthly amounts up to a maximum of $15 million and, in certain circumstances, up to $20 million. On March 4, 2002 the Company and the Fund entered into an agreement whereby the Company issued 50,000 shares and the Fund agreed to extend the agreement. This agreement was terminated in December 2002 whereby the investor retained its warrants, the Company agreed to issue 500,000 shares of common stock and to pay the sum of $25,000 upon the completion of specific financing. In connection with the equity line of credit, the Company issued 30,000 shares of common stock to the Fund as compensation for certain services rendered in connection with the closing of the line of credit. As such, the Company recorded the fair value of the shares of approximately $31,000 in selling, general and administrative expenses for the year ended December 31, 2002. Also, the Company granted warrants purchasing up to 150,000 shares of common stock of the Company at an exercise price of $0.8731 per share. Such warrants are exercisable through September 2005. The intrinsic value of said warrants of approximately $140,000 is included in selling, general and administrative expenses in the year ended December 31, 2002. In April 2002, the Company announced a strategic investment from ROHM Company LTD ("Rohm"). ROHM purchased 1,282,051 shares of eMagin common stock at $0.78 per share as well as warrants to purchase an additional 512,820 shares of common stock at a conversion price of $0.85 per share for an investment of $1,000,000. The fair value of each warrant was estimated on the date of grant using the Black-Scholes option-pricing model. Such warrants are exercisable through April 2005. In 2002 the Company issued a third party 192,493 shares for consulting fees in lieu of cash. In April of 2003, the Company converted a $1,000,000 loan plus interest to Travelers in common shares totaling 2,137,757 at a conversion price from the original agreement of approximately $0.53 per share, based on the market value of our common stock on the date the agreement was entered into (see Note G). 51 The Company also converted a $3,000,000 loan plus interest to SK Corporation in common shares totaling 2,495,833 at a conversion price from the original agreement of approximately $1.28 per share, based on the market value of our common stock on the date the agreement was entered into (see Note G). New paragraph In September 2003, the Company converted two Series B Convertible Debentures in the amount of $121,739 each into 1,468,382 share of the Company's common stock at a conversion price from the original note purchase agreement of $0.18 per share. This transaction included a write-down of the unamortized beneficial conversion feature at the time of conversion. In 2003, the Company received approximately $1.1 million for the exercise of 1,479,900 warrants to purchase shares of common stock. The Company also issued 270,910 common shares in cashless exercises of warrants in exchange for 579,329 warrant shares. In 2003, the Company negotiated settlements of amounts due and amounts for future services, rendered via issuance of 656,435 shares of common stock. As such, the Company recorded the fair value of the services received and receivable in the future of $561,958 in selling, general and administrative expenses, prepaid expenses and reduction of accounts payable. During 2003, the Company received $280,046 for the exercise of options to purchase 846,793 shares of common stock. The Company's April 25, 2003 Registration Rights Agreement, which was entered into in connection with the Company's April 2003 financing, required the Company to file a registration statement with the Securities and Exchange Commission no later than 30 calendar days after the closing of the April 2003 financing. The Company was not able to file the registration statement within the required period and caused a default under the Registration Rights Agreement. As a result of this default, the Company was required to issue an additional 486,582 common shares for penalties and interest pursuant to the Registration Rights Agreement. For the year ended December 31, 2003, the Company recorded a charge to earnings of $735,324 for the penalties and interest. The Company filed its registration statement in July of 2003. In connection with the April 2003 financing, eMagin issued 387,496 warrants for expenses related to the offering. These warrants were issued to Larkspur Capital Corporation, a company in which one of the Company's directors is the managing director. Note J - STOCK COMPENSATION [1] Stock option plans: In 1994, the Company established the 1994 Stock Plan (the "1994 Plan"), which has been assumed by eMagin. The plan provided for the granting of options to purchase an aggregate of 1,286,000 shares of the common stock to employees and consultants of FED. In 2000, the Company established the 2000 Stock Option Plan (the "2000 Plan"), which has been assumed by eMagin. On July 16, 2001, the shareholders approved an increase in the aggregate number of shares of the Company's common stock reserved for issuance under the 2000 Plan from 3,900,000 to 5,900,000 shares. The Plan permits the granting of options and stock purchase rights to employees and consultants of the Company. The 2000 Plan allows for the grant of incentive stock options meeting the requirements of Section 422 of the Internal Revenue Code of 1986 (the "Code") or non-qualified stock options which are not intended to meet the requirements Section 422 of the Code. In 2003, eMagin established the 2003 Stock Option Plan (the "2003 Plan"). The 2003 Plan provided for the granting of options to purchase an aggregate of 9,200,000 shares of the common stock to employees and consultants. On July 2, 2003, the shareholders approved the plan and the 2003 Plan was subsequently amended by the Board of Directors on July 2, 2003 to reduce the number of additional shares that may be provided for issuance under the "evergreen" provisions of the 2003 Plan. The amended 2003 Plan provides for an increase of 2,000,000 shares in January 2004 and an annual increase on January 1 of each year for a period of nine (9) years commencing on January 1, 2005 of 3% of the diluted shares outstanding. Vesting terms of the options range from immediate vesting to a ratable vesting period of 10 years. Option activity for the years ended December 31, 2003 and 2002 are summarized as follows: 52 Weighted Average Shares Exercise Price ------------ ------------ Outstanding at December 31, 2001 3,544,721 $ 2.41 Options granted 4,788,722 0.40 Options canceled (2,440,358) 2.11 ------------ ------------ Outstanding at December 31, 2002 5,893,085 0.75 Options granted 7,528,676 0.42 Options exercised (859,993) 0.33 Options canceled (413,198) 2.14 ------------ ------------ Outstanding at December 31, 2003 12,148,570 $ 0.53 ============ ============ At December 31, 2003, there were 2,091,437 shares available for grant under the 2003 Plan, 2000 Plan and the 1994 Plan. In October 2002, the Company's Board of Directors approved the issuance of 5,185,000 options to employees, officers and directors. These options were not issued at the time of the Board of Directors' approval because there were not enough options available to be issued. Pursuant to the Company's Stock Option Plans, these options were issued concurrent with the approval of the 2003 Plan at the July 2003 shareholders' meeting. The Company recorded a charge of $1,808,000 in the year ended December 31, 2003 for the change in value of these options from the original Board approval date in October 2002 to the shareholder approval date in July 2003. The following table summarizes information about stock options outstanding at December 31, 2003: Options Outstanding Options Exercisable -- ---------------------------------- Weighted Average Weighted Weighted Remaining Average Average Number Contractual Exercise Number Exercisable Range of Exercise Prices Outstanding Life (In Years) Price Exercisable Price ----------------------- ---------------- --------------- ------------- --------------- ---------------- $ 0.18 - $1.02 10,616,901 4.23 $ 0.37 10,078,176 $ 0.35 $ 1.25 - $1.72 1,401,169 6.62 1.56 1,204,335 1.57 $ 2.25 - $6.30 130,500 4.67 2.47 119,750 2.40 ---------- ------ ---------- ------- 12,148,570 $ 0.53 11,402,261 $ 0.50 ========== ====== ========== ======= [2] Stock based compensation: Non-cash stock-based compensation expense represents expenses associated with stock option grants to the Company's officers and employees at below fair market value as additional compensation for their services and to induce them to lock-up their options for a longer time than would normally be specified under the Company's standard option grant. Deferred compensation is amortized over the remaining vesting period of the underlying options. [3] Warrants: At December 31, 2003, 12,336,289 warrants to purchase shares of common stock are issued, outstanding and exercisable at exercise prices ranging from $0.53 to $1.93. Note K - RECENTLY ISSUED ACCOUNTING STANDARDS In January 2003, the Financial Accounting Standards Board ("FASB") issued interpretation No. 46R ("FIN 46R"), "Consolidation of Variable Interest Entities." Until this interpretation, a company generally included another entity in its consolidated financial statements only if it controlled the entity through voting interests. FIN 46R requires a variable interest entity, as defined, to be consolidated by a company if that company is subject to a majority of the risk of loss from the variable interest entity's activities or is entitled to receive a majority of the entity's residual returns. Certain provisions of FIN 46R were deferred until the period ending after March 15, 2004. The adoption of FIN 46R for provisions effective during 2003 did not have a material impact on the Company's financial position, cash flows or results of operations. 53 In April 2003, the FASB issued Statement No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." (SFAS No. 149), which amends SFAS 133 for certain decisions made by the FASB Derivatives Implementation Group. In particular, SFAS 149: (1) clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative, (2) clarifies when a derivative contains a financing component, (3) amends the definition of an underlying financial component to conform it to language used in FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," and (4) amends certain other existing pronouncements.. This statement is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. In addition, most provisions of SFAS 149 are to be applied prospectively. The adoption of this standard did not have a material impact on the Company's financial position, cash flows or results of operations. In May 2003, the FASB issued SFAS No. 150 , "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity" ("SFAS 150"). FAS No. 150 changes the accounting for certain financial instruments that under previous guidance issuers could be accounted for as equity. It requires that those instruments be classified as liabilities in balance sheets. The guidance in SFAS No. 150 is generally effective for all financial instruments entered into or modified after May 31, 2003, and otherwise is effective on July 1, 2003. The adoption of SFAS No. 150 did not have a material impact on the Company's financial position, cash flows or results of operations. Note L - COMMITMENTS AND CONTINGENCIES [1] Royalty payments: The Company, in accordance with a royalty agreement, is obligated to make minimum annual royalty payments to a corporation commencing January 1, 2001. The minimum annual royalty of $31,500 per year due under this agreement commences in the first year of the agreement, and increases to minimum royalty payments of $125,000 in 2006. Under this agreement, the Company must pay to the corporation a certain percentage of net sales of certain products, which percentages are defined in the agreement. The percentages are on a sliding scale depending on the amount of sales generated. Any minimum royalties paid may be credited against the amounts due based on the percentage of sales. The royalty agreement terminates upon the expiration of the last-to-expire issued patent. For the years ended December 31, 2003 and 2002, royalty expense of approximately $115,000 and $61,000 respectively, is included in general and administrative expense. [2] Operating leases: The Company leases certain office facilities and office, lab and factory equipment under operating leases expiring through 2008. Certain leases provide for payments of monthly operating expenses. The approximate future minimum lease payments through 2008 are as follows: Year ending December 31, 2004 $ 257,999 2005 18,372 2006 18,372 2007 6,124 2008 - ------------ Total $ 300,867 ============ 54 Rent expense for the years ended December 31, 2003 and 2002 was approximately $839,738 and $1,107,000, respectively. eMagin's lease with IBM expires in March 2004. The Company is currently in the process of renewing the lease. eMagin's lease with Redson Building Partners has been paid in advance with common stock valued at $48,000 for the 2004 rent. [3] Employment benefit plans: eMagin has a defined contribution plan (the 401(k) Plan) under Section 401(k) of the Internal Revenue Code, which is available to all employees who meet established eligibility requirements. Employee contributions are generally limited to 15% of the employee's compensation. Under the provisions of the 401(k)Plan, eMagin may match a portion of the participating employees' contributions. There was no matching to the 401(k) Plan for the years ended December 31, 2003 and 2002. [4] Legal proceedings The Company is subject to various claims and proceedings in the ordinary course of business. The Company believes that none of these current claims or proceedings individually or in the aggregate, will have a material adverse impact on the Company; results of operations, cash flows or financial condition, although it can make no assurances in this regard. Note M - Related Party Transactions On February 27, 2002, eMagin Corporation and a group of several accredited institutional and individual investors entered into a Securities Purchase Agreement providing for the issuance and sale to the investors of (i) an aggregate of approximately 3.6 million shares of our common stock, and (ii) warrants exercisable for a period of three (3) years from the Closing Date for an aggregate of approximately 1.4 million shares of eMagin's common stock (subject to certain customary anti-dilution adjustments) (see Note I). Rainbow Gate Corporation, a corporation in which Mortimer D.A. Sackler is the investment manager, invested $500,000 in the Company under the agreement and received pursuant to such investment (i) 723,275 shares of eMagin's common stock, and (ii) warrants exercisable for 289,310 shares of eMagin's common stock. Mr. Sackler is currently a beneficial owner of more than five percent of the outstanding shares of eMagin's common stock. On June 20, 2002, the Company entered into a $0.2 million Secured Note Purchase Agreement with Mortimer D.A. Sackler (the "Bridge Note")(see Note F(c)). The secured note accrues interest at 11% per annum and was originally due to mature on June 30, 2003 and was amended as a result of a financing we completed in April 2003. The Company also granted warrants, exercisable for a period of five years, to purchase 300,000 shares of common stock with an exercise price of $0.4257 per share to the investor, provided, however, this warrant may not be exercised by the investor so long as the investor is the beneficial owner, directly or indirectly, of more than ten percent (10%) of the common stock of eMagin for purposes of Section 16 of the Securities Exchange Act 1934. The fair value of the warrants issued to this Investor, which approximated $84,000, has been recorded as original issue discount, resulting in a reduction in the carrying value of this debt. The original issue discount was amortized into interest expense over the period of the debt. Pursuant to the April 2003 financing described below, the investor agreed, to (a) amend the secured note issued to them, (b) terminate the security agreement dated June 20, 2002 that was entered into in connection with the purchase of the original secured notes and allow the investors to enter into a new security agreement with him on a pari passu basis in order for eMagin to continue its operations as a developer of virtual imaging technology, and (c) simultaneously participate in the new financing. The amendments to the note included (i) amending the note issued on June 20, 2002 so as to provide that the note shall be convertible and will have the same conversion price as the notes issued pursuant to the April 2003 secured note purchase agreement, (ii) extending the maturity dates of the note from June 30, 2003 to November 1, 2005, and (iii) revising and clarifying certain of the other terms and conditions of the note, including provisions relating to interest payments, conversions, default and assignment of the note. On April 25, 2003, eMagin Corporation and a group of several accredited institutional and individual investors (collectively, the "Investors") entered into a Restructuring Agreement whereby Investors agreed to lend eMagin $6,000,000 in exchange for (i) the issuance of $6,000,000 principal amount of 9.00% Secured Convertible Promissory Notes due on November 1, 2005 (the "Secured 55 Notes") and (ii) Warrants (the "Warrants") to purchase an aggregate of 7,749,921 shares of common stock of eMagin (subject to certain customary anti-dilution adjustments), which Warrants are exercisable for a period of three (3) years. Mr. Rivkin, who at the time of the transaction was a member of our Board of Directors, participated as an investor in the transaction and invested $125,000 in the Company. In return for such investment, Mr. Rivkin received (i) a Secured Convertible Promissory Note in an aggregate principal amount of $125,000, and (ii) warrants exercisable for 161,456 shares of eMagin's common shares. In addition, Stillwater LLC, an entity controlled by Mr. Mortimer D.A. Sackler, agreed to invest an aggregate of $2,600,000 under the transaction and will receive (i) Secured Convertible Promissory Notes in an aggregate principal amount of $2,600,000, and (ii) warrants exercisable for 3,358,300 of our common shares. As part of the transactions, Messrs. Sackler and Rivkin, who were the holders of an aggregate of $1,325,000 principal amount of secured notes that were purchased pursuant to a secured note purchase agreement entered into as of November 27, 2001 (collectively, the "Original Secured Notes"), and Mr. Sackler, who additionally was the holder of a $200,000 principal Bridge Note, agreed to (a) amend their respective Original Secured Notes and Bridge Note issued to them, (b) terminate the Security Agreement dated November 20, 2001 that was entered into in connection with the purchase of the Original Secured Notes and the Security Agreements dated June 20, 2002 that were entered into in connection with the purchase of the Bridge Note and allow the new investors to enter into a New Security Agreement (as defined below) with them on a pari passu basis in order for the Company to continue its operations as a developer of virtual imaging technology. The amendments to the Original Secured Notes and Bridge Note included (i) amending the Bridge Note so as to provide that the Bridge Note shall be convertible and