

KOPIN CORP  
Form 10-K  
March 17, 2008  
Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
WASHINGTON, DC 20549

**FORM 10-K**

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

For the fiscal year ended December 30, 2006

OR

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

For the transition period to

Commission file number 0-19882

**KOPIN CORPORATION**

(Exact Name of Registrant as Specified in its Charter)

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**Delaware**  
(State or other jurisdiction of

incorporation or organization)

**200 John Hancock Rd., Taunton, MA**  
(Address of principal executive offices)

**04-2833935**  
(I.R.S. Employer

Identification No.)

**02780-1042**  
(Zip Code)

Registrant's telephone number, including area code: (508) 824-6696  
Securities registered pursuant to Section 12(b) of the Act: None  
Securities registered pursuant to Section 12(g) of the Act: Common Stock, par value \$.01 per share

Name of Each Exchange on Which Registered (Title of Class)  
NASDAQ National Market

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

(Do not check if a smaller reporting company)

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

As of June 30, 2007 (the last business day of the most recent second fiscal quarter) the aggregate market value of outstanding shares of voting stock held by non-affiliates of the registrant was \$310,387,176.

As of March 14, 2008, 71,043,391 shares of the registrant's Common Stock, par value \$.01 per share, were issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

None

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**Table of Contents**

**EXPLANATORY NOTE REGARDING RESTATEMENTS**

This Annual Report on Form 10-K for our fiscal year ended December 30, 2006 includes restatements of the following previously filed financial statements and data (and related disclosures): (1) our consolidated financial statements as of and for our fiscal years ended December 31, 2005 and December 25, 2004; (2) our selected consolidated financial data as of and for our fiscal years ended December 31, 2005, December 25, 2004, December 31, 2003 and December 31, 2002 contained in Item 6 Selected Consolidated Financial Data and (3) our unaudited quarterly financial data for the first two quarters in our fiscal year ended December 30, 2006 and for all quarters in our fiscal year ended December 31, 2005. These corrections are discussed in Legal Proceedings included in Item 3, Management's Discussion and Analysis of Financial Condition and Results of Operations included in Item 7 and Note 2, Restatement of Consolidated Financial Statements, to Consolidated Financial Statements and Exhibit 99.1.

The restatement of our consolidated financial statements reflects the correction of the following errors, in accordance with Financial Accounting Standards Board (FASB) No. 154 *Accounting Changes and Error Corrections* :

1. stock-based compensation expense not previously recorded for certain stock-based awards for which the original accounting was deemed incorrect;
2. tax-related adjustments resulting from the above errors in stock option accounting; and
3. the recording of previously unrecorded adjustments not related to accounting for stock options that were previously deemed to be immaterial to our consolidated financial statements.

On November 1, 2006, in response to a derivative lawsuit filed against the Company related to the Company's employee stock option granting practices and accounting (see Item 3 Legal Proceedings), our Board of Directors appointed a Special Investigation Committee of the Board of Directors, referred to as the Special Committee, composed solely of an independent director who was not on the Company's Board of Directors and who had no affiliation with the Company during the period between 1995 and 2005, to conduct a comprehensive investigation of our historical stock option practices.

Responding to the findings of the Special Committee, filed in a Form 8-K on May 9, 2007, we reviewed the measurement dates for stock option and nonvested restricted common share grants (collectively, stock-based awards ) used in our historical financial reporting. We reviewed the measurement dates for all 19.8 million of our historical stock-based award grants and reviewed all available evidence for each grant during the period from the January 1, 1995 through December 30, 2006, referred to as the Investigation Period.

Stock-based awards granted during the Investigation Period can be categorized as follows:

*New Hire Employee Stock-Based Awards.* Total awards made to new hire employees during the Investigation Period totaled 3.8 million.

*All Other Stock-Based Awards to Non-Officer Employees.* Total awards made to non-officers excluding new hires during the Investigation Period totaled 6.4 million.

*All Other Stock-Based Awards to Officers.* Total awards made to officers excluding new hires during the Investigation Period totaled 7.9 million.

*Director Stock-Based Awards.* Total awards made to members of the Board of Directors during the Investigation Period totaled 1.4 million.

*Consultant Awards.* Total awards made to consultants during the Investigation Period totaled 265,000.

Certain of the stock-based awards granted during the Investigation Period had exercise prices that tended to be at a price towards the lower end of range of common stock prices over a 90 day period from the original grant date.



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**Table of Contents***Impact of Restatement*

For stock-based awards granted during the period January 1, 1995 through December 31, 2005 of the Investigation Period, the accounting principle applied under United States Generally Accepted Accounting Principles (US GAAP) was Accounting Principles Board Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*. For stock-based awards granted during the period January 1, 2006 through December 30, 2006, of the Investigation Period we applied Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). APB 25 prescribed that there was a compensation element in a stock option award to an employee if the option exercise price was below the fair market value of the Company's stock on the measurement date. The measurement date is the date that the number of options the employee was to receive and the option exercise price were known. We typically accounted for all stock-based awards to new hires, employees, officers and directors, through December 31, 2005 under APB 25 using the stated grant date as the measurement date. We typically issued stock options with an exercise price equal to the fair market value of our common stock on the recorded grant date, and therefore recorded no stock-based compensation expense. We recorded compensation expense for awards of restricted common shares for the fair value of the common shares on the grant date over the vesting period. We refer to the measurement date used when the stock-based award was granted during the Investigation Period as the Original Measurement Date. If, as a result of our option review, we used a different measurement date than the Original Measurement Date to determine if there was an element of compensation expense in a stock-based award, we referred to the new measurement date as the Revised Measurement Date.

We reviewed 14.3 million stock-based awards granted to officers and non-officers (excluding new hire consultant and Board of Directors awards, which are addressed below) to verify that the terms of the awards were approved and known with finality on the Original Measurement Date. We determined that for 11.5 million stock-based awards the number of shares was not known with finality on the Original Measurement Date. In those situations where we had either not completed the process of determining the number of stock options a particular employee was to receive or the administrative process was not finished on the Original Measurement Date, a compensation charge is required to reflect the difference between the exercise price of the stock-based award and the stock price (when it exceeds the exercise price) on the date the determination or process was completed. We recorded compensation expense of \$33.6 million, excluding income tax effects, in connection with the restatement described above.

We reviewed 3.8 million stock-based awards granted to new hires to verify that the grant date was the same date as the date that the individual met the definition of an employee, generally the employee start date. We identified instances where employees did not start on their anticipated start date per their offer letter but commenced employment at a later date; however the option was granted based on the anticipated start date included in their offer letter. Compensation expense is required to reflect the difference between the exercise price of the stock option and the stock price on the employee start date. We identified 718,000 options following this pattern and recorded compensation expense of \$0.6 million, excluding income tax effects, in connection with the restatement described above. We identified one situation where an offer letter gave the employee an option to purchase 120,000 shares of our common stock with an exercise price equal to our common stock price on the date he commenced employment but we incorrectly granted the option with an exercise price equal to our common stock price on the date we made the offer of employment. We recorded compensation expense of \$1.0 million, excluding income tax effects, in connection with the restatement described above. We identified one situation where the employment offer letter gave the prospective employee an option to purchase 400,000 shares of our common stock at an exercise price equal to our common stock price on the date the employment offer letter was accepted. In this situation, compensation expense should have been recorded to reflect the difference between the exercise price and our common stock price on the date employment commenced. We recorded compensation expense of \$0.4 million, excluding income tax effects, in connection with the restatement described above.

We reviewed 265,000 stock option awards granted to consultants. We identified five grants to consultants totalling 205,000 options, which we accounted for incorrectly and we recorded compensation expense of \$1.8 million, excluding income tax effects, in connection with the restatement described above. Of the \$1.8 million of

**Table of Contents**

compensation expense, \$1.6 million related to two grants made in January of 1996. We originally accounted for these consultant awards under APB 25 and recorded no compensation expense for these awards.

We also reviewed 1.4 million stock-based awards to members of the Board of Directors. We identified two awards totaling 300,000 options for which we recorded compensation expense of approximately \$30,000, excluding income tax effects, as the result of an inconsistent pricing practice.

All financial information contained in this annual report gives effect to the restatements of our consolidated financial statements as described above. We have not amended, and we do not intend to amend, our previously filed annual reports or quarterly reports for each of the fiscal years and fiscal quarters of 1995 through 2005, and for the first two fiscal quarters of the fiscal year ended December 30, 2006. Financial information included in reports previously filed or furnished by us for the periods from fiscal 1995 through July 1, 2006 should not be relied upon and are superseded by the information in this annual report.

**Table of Contents****Part I****Forward Looking Statements**

*This Annual Report on Form 10-K contains forward-looking statements within the meaning of the United States Private Securities Litigation Reform Act of 1995, including without limitation statements made relating to our expectation that sales to Skyworks Solutions and the US Military will represent a significant portion of our revenues for 2008; our expectation that sales of our CyberDisplay products to customers who use them in camcorder applications will decline; our expectation that KoBrite will incur additional losses in the near term; our belief that in 2008 we will establish an 8-inch CyberDisplay manufacturing line; our belief that our material weakness in our internal controls will continue to exist in our fiscal year 2008; our expectation that a significant market for new wireless communications devices, including personal entertainment systems, will develop; our expectation that our CyberDisplay products will benefit from further general technological advances in the design and production of integrated circuits and active matrix LCDs, resulting in further improvements in resolution and miniaturization; our expectation that sales into the high speed fiber optic switching equipment market will not be significant in fiscal year 2008; our expectation not to pay cash dividends for the foreseeable future and to retain earnings for the development of our businesses; our expectation, based on current negotiations with our customers and certain contractual obligations, that the prices of certain products will decline in fiscal year 2008; our expectation that the sale prices of our commercial displays will decline, but our military product sales will increase, in fiscal year 2008; our expectation that we will expend between \$5.0 and \$9.0 million on capital expenditures over the next twelve months; our expectation that our third quarter would be our strongest sales quarter followed by our second quarter, fourth quarter and first quarter, in that order; our expectation that prices of our HBT transistors and display products sold for consumer electronic applications will decline by approximately 5 to 10 percent during fiscal year 2008, but may decline more depending on final negotiation with our customer; our expectation that competition will increase; our belief that our CyberDisplay products are well suited for new applications such as reading e-mail and browsing the Internet using digital wireless devices and other consumer electronics devices; our belief that small form factor displays will be a critical component in the development of advanced wireless communications systems; our belief that general technological advances in the design and fabrication of integrated circuits, LCD technology and LCD manufacturing processes will allow us to continue to enhance our CyberDisplay product manufacturing process; our belief that continued introduction of new products in our target markets is essential to our growth; our belief that GAIN HBT transistor wafers provide the performance characterization necessary for the next generation of wireless handsets and optoelectronic components; our belief that the costs of producing gallium arsenide integrated circuits by our customers will continue to exceed the costs associated with the production of competing silicon integrated circuits; our belief that our future success will depend primarily upon the technical expertise, creative skills and management abilities of our officers and key employees rather than on patent ownership; our belief that our available cash resources will support our operations and capital needs for at least the next twelve months; and our belief that the effect, if any, of reasonably possible near-term changes in interest rates on our financial position, results of operations, and cash flows should not be material. These forward-looking statements are based on current expectations, estimates, forecasts and projections about the industries in which we operate, management's beliefs, and assumptions made by management. In addition, other written or oral statements, which constitute forward-looking statements, may be made by or on behalf of us. Words such as expects, anticipates, intends, plans, believes, could, seeks, estimates, and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties and assumptions, which are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or forecasted in such forward-looking statements, whether as a result of new information, future events or otherwise. Factors that could cause or contribute to such differences in outcomes and results include, but are not limited to, those discussed below in Item 1A and those set forth in our other periodic filings filed with the Securities and Exchange Commission.*



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**Table of Contents****Item 1. Business**  
**Introduction**

We were incorporated in Delaware in 1984 and are a leading developer and manufacturer of III-V products and miniature flat panel displays. We use our proprietary semiconductor material technology to design, manufacture and market our III-V and display products. Our products enable our customers to develop and market an improved generation of products for applications in wireless and consumer electronic products. In December 2004, we adopted a fiscal year ending on the last Saturday in December by amending our bylaws to change our fiscal year end. The fiscal year ended December 31, 2005 includes 53 weeks and the fiscal years ended December 30, 2006 and December 25, 2004 each include 52 weeks. The fiscal years ended December 30, 2006, December 31, 2005 and December 25, 2004 are referred to as fiscal years 2006, 2005 and 2004, respectively, herein. Our principal executive offices are located at 200 John Hancock Road, Taunton, Massachusetts. Our telephone number is (508) 824-6696.

We commercially develop and manufacture gallium arsenide-based heterojunction bipolar transistor wafers (HBT transistor wafers) and other commercial semiconductor products that use gallium nitride and gallium arsenide-based substrates. From October 2000 until December 2004 we were developing light emitting diodes (LEDs) grown on sapphire substrates, which were called CyberLite LEDs. We stopped our internal CyberLite LED development activities in 2005 as discussed below. We collectively refer to our products based on compound semiconductor materials, including our HBT transistor wafers and CyberLite LEDs, as our III-V products because we use elements categorized on the III and V columns of the periodic table of elements to manufacture such products. Our primary III-V product is our HBT transistor wafer. Our HBT transistor wafers are customer-specific arrays of vertically oriented transistors that our customers use primarily to produce high performance integrated circuits for wireless communications products. Sales of our HBT transistor wafers to Skyworks Solutions, Inc. (Skyworks Solutions) accounted for approximately 36%, 32% and 31% of our total revenues for fiscal years 2006, 2005 and 2004, respectively. Skyworks Solutions also uses the foundry services of Advanced Wireless Semiconductor Company (AWSC) to process our HBT transistor wafers on their behalf. In 2005 we began selling HBT transistor wafers directly to AWSC for eventual resale by AWSC to Skyworks Solutions. Accordingly, an investor should view our sales to Skyworks Solutions and AWSC in the aggregate for evaluating the importance of Skyworks Solutions as a customer to Kopin. AWSC also purchases HBT transistor wafers from us for the processing and sale to other customers. Sales to AWSC in 2006 and 2005 were 13% and 7%, of our 2006 and 2005 revenues, respectively. In addition to Skyworks Solutions, original equipment manufacturers such as ANADIGICS and Triquint Semiconductor purchase our HBT transistor wafers.

In the fourth quarter of 2004, the Company entered into a joint venture, KoBrite Corp. (KoBrite), with a Taiwanese-based light emitting diode (LED) manufacturer, Kopin Taiwan Corporation (a Taiwanese-based III-V manufacturer), and financial investors, in which we agreed to transfer our CyberLite LED technology and production know-how and \$3.0 million of cash for a 23% interest in KoBrite. Subsequent to its formation, KoBrite entered into agreements with us to purchase certain equipment and to have the Company perform research and training activities with KoBrite employees until KoBrite's facilities were constructed and ready to receive the equipment. KoBrite agreed to pay us an estimated net \$5.8 million for the equipment and \$1.7 million for research and training activities and reimbursement of costs incurred in the transfer of the equipment. We discontinued manufacturing CyberLite LEDs as of March 31, 2005. As a result of such discontinued manufacturing operations, we recorded an impairment charge of \$5.3 million in 2004 and \$0.5 million in 2005. In addition, a charge of \$0.3 million was recorded in 2005 for equipment that we transferred to KoBrite but was damaged in-transit and we agreed to reimburse KoBrite for the value of the damaged equipment. We retain the right to market KoBrite's LEDs in the United States and to certain Japanese customers. For fiscal years 2005 and 2004, our CyberLite LED product sales were \$0.7 million and \$2.3 million, respectively. There were no CyberLite LED sales in 2006.

**Table of Contents**

Our CyberDisplay products are miniature, high performance, high resolution display products designed for consumer electronics, military and next generation mobile communications devices. To manufacture our CyberDisplays we purchase silicon-on-insulator wafers and perform several semi-conductor process steps at our Westborough, Massachusetts facility. After processing the wafers are cut into individual dies, the dies are then sent to our Korean subsidiary, Kowon, for back-end packaging and shipment to customers. Current applications of our CyberDisplay products include electronic view finders in camcorders and digital cameras, and we believe that our CyberDisplay products are well suited for new applications such as reading e-mail and browsing the Internet using digital wireless devices and viewing video from other consumer electronics devices such as MP3 or iPod storage devices. Our displays are also used by the United States Government in thermal weapon sights and we are working to incorporate them in night-vision goggle devices. We currently sell our CyberDisplay product to Samsung Electronics Co., Ltd. (Samsung) for use in digital camcorders and Eastman Kodak Company (Kodak), Olympus Corporation (Olympus) and Fuji Corporation (Fuji) for digital still cameras. For fiscal years 2006, 2005 and 2004, Samsung, the military customers, excluding research and development contracts, and JVC accounted for the following percentage of our total revenues ( \* denotes that the customer's revenues were less than 10% of our total company revenues):

Customer	Percent of Total Revenues		
	2006	2005	2004
Samsung Electronics	*	15%	28%
Military Customers	16%	11%	*
Victor Company of Japan (JVC)	*	13%	*

**Industry Overview***III-V Products*

Advanced semiconductor materials are used in the manufacture of integrated circuits for high frequency, low power applications. The rapid growth in the wireless communications industry, as well as the increasingly shorter product cycles of wireless products, has fueled demand for these integrated circuits, which are predominantly used in wireless handsets.

In first generation wireless handsets, integrated circuits used in high frequency, low power amplifiers were generally constructed with silicon-based semiconductors. These integrated circuits, while relatively inexpensive to manufacture, were unable to deliver the ever increasing performance demanded by wireless handset manufacturers and their customers. This inability led to the development of gallium arsenide products for use in wireless communications. Gallium arsenide is generally regarded as having better performance characteristics than silicon due, in part, to its inherent physical properties that permit gallium arsenide integrated circuits to operate at much higher frequencies than silicon integrated circuits, or operate at the same frequency with lower power consumption. The reduction in system power requirements is particularly important in portable applications, such as wireless handsets, because it extends battery life.

The high performance characteristics of gallium arsenide have led to an increased use of gallium arsenide based transistors to satisfy the industry's need for even greater performance. These gallium arsenide transistors include gallium arsenide field effect transistors and for second generation wireless handset products our HBT transistor wafer. Second generation wireless communications products use digital signal processing and generally operate at higher cellular frequencies. Air interface standards in these frequency bands have increased in recent years. These standards, which include Global System Mobile, or GSM, Time Division Multiple Access, or TDMA, and Code Division Multiple Access, or CDMA, provide improved capacity, sound quality and capabilities at cellular and wireless frequency bands, but are incompatible with each other and have fragmented the market for equipment. Suppliers of wireless handsets now offer multi-mode and multi-band wireless handsets which are capable of switching from one high frequency band to another to enable consumers to use wireless handsets across various territories and different interface standards. This new generation of products is significantly more complex than the prior generation and requires certain key features, including:

Simpler system design;

Support for higher frequencies;



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**Table of Contents**

Lower power consumption;

Improved signal quality; and

Wider range of operating temperatures.

*CyberDisplay Products*

Small form factor displays are used in the consumer electronics industry in products such as camcorders and digital cameras. We also expect that a significant market for new wireless communications devices, including personal entertainment systems, will develop. In order for this market to develop, advances in wireless communications systems such as greater bandwidth and increased functionality, including real-time wireless data, broadband Internet access and mobile television, will be necessary. In addition, economic models must be developed and implemented which compensate the owners of the media content. We believe small form factor displays will be a critical component in the development of advanced mobile wireless communications systems as these systems must provide high resolution images without compromising the portability of the product.

There are several display technologies currently available. The most commonly used technology in portable applications is based on the traditional liquid crystal display, or LCD, which is now in widespread use in products requiring a solid state monochrome or color display. These displays form an image by either transmitting or blocking light emitted from a source located behind the LCD. The principal LCD technologies are passive and active matrix.

*Passive Matrix LCD.* These displays are primarily used in calculators, watches, pagers and wireless handsets because of their relatively low cost and low power consumption. Their relatively low image quality, slow response time and limited viewing angle, however, make them inadequate for many demanding applications.

*Active Matrix LCD.* These displays are used primarily in laptop computers, instrumentation and projection systems. These displays are also being introduced on wireless handsets and storage devices such as Apple's iPods. In contrast to passive matrix LCDs, monochrome active matrix LCDs incorporate a transistor at every pixel location and color active matrix LCDs incorporate three transistors at every pixel location. This arrangement allows each pixel to be turned on and off independently which improves image quality and response time and also provides an improved side-to-side viewing angle of the display. The increased number of transistors required to produce those benefits, however, creates significant drawbacks, particularly in color applications. The high number of transistors used in conventional active matrix LCDs limits achievable pixel density and their relatively high power consumption makes them difficult to use in high information content ultra-portable electronics products.

We believe that the high growth potential for portable communications products can be realized effectively only if these products are available at a reasonable price and are able to clearly present to end users the information they wish to access without compromising the size of the product. These products, as well as future models of digital cameras and other consumer electronics, are well suited for the use of a miniature, low cost display with low power consumption and sharp monochrome or rich, full color high resolution images. To date, display technologies have not fully addressed these needs due to constraints with respect to size, power consumption, resolution, cost or full color capability.

**Our Solution**

*III-V Products*

We manufacture our HBT transistor wafers using our proprietary metal organic chemical vapor deposition (MOCVD) semiconductor growth techniques and our Wafer Engineering process. Our Wafer Engineering

## Table of Contents

process significantly reduces the number of defects which naturally occur when different semiconductor materials are combined. By depositing films of atomic-level thickness on gallium arsenide or indium phosphide wafers, we are able to create HBT transistor wafers that consist of a series of material layers which form a vertical transistor. This transistor structure enables the design of integrated circuits in which individual transistors are vertically arranged.

We believe that the vertical structure of an HBT transistor wafer, as opposed to the horizontal structure of a competing gallium arsenide field effect transistor, offers advantages to an integrated circuit manufacturer:

*Smaller Size.* We believe integrated circuits fabricated from our HBT transistor wafers can be made smaller than integrated circuits fabricated from gallium arsenide field effect transistors. Smaller size enables more die per wafer, which can increase manufacturing yields and lead to reduced costs.

*Faster Circuits.* We believe our HBT transistor wafers enable the design of faster integrated circuits than may be designed with gallium arsenide field effect transistors because the effective transistor gate length, or the distance an electron must travel within a transistor, is shorter. The transistor gate length of gallium arsenide field effect transistors is constrained by current optical lithography techniques to approximately 0.13 microns for commercial volumes. We currently manufacture our HBT transistor wafers in commercial volumes with an effective transistor gate length ranging from approximately 0.05 microns to 0.1 microns. We are able to achieve this result because the thickness of the vertical base layer of our HBT transistor wafers determines transistor gate length rather than the limitations of current optical lithography techniques.

We believe our HBT transistor wafers also offer the following additional advantages over gallium arsenide field effect transistors:

*Greater Power Efficiency.* Efficiency is a measure of power output as a percentage of battery power consumed by the device. We believe our HBT transistor wafers are more efficient and use less power to transmit the same output power than comparable gallium arsenide field effect transistors. Increased efficiency can translate into improved battery life and increased talk time.

*Improved Signal Quality.* Power amplifiers within wireless handsets are a key determinant of signal quality. We believe that power amplifiers based on our HBT transistor wafers can amplify signals with reduced distortion, providing increased signal quality. Improved signal quality is important for wireless networks that use digital air interface standards such as Time Division Multiple Access, or TDMA, and Code Division Multiple Access, or CDMA.

*Less Complexity.* Power amplifiers and other integrated circuits based on our HBT transistor wafers run on a single power supply voltage. In contrast, gallium arsenide field effect transistors generally require both a positive and negative power supply, which results in the need to include a negative voltage generator and other additional components or circuitry in the end product. As a result, we believe products using our HBT transistor wafers are easier to design, which can translate into reduced component costs and smaller equipment.

### *CyberDisplay Products*

Our principal CyberDisplay products are miniature high density color or monochrome active matrix LCDs with resolutions which range from approximately 320 x 240 resolution to 1280 x 1024 resolution. In contrast to current passive matrix and active matrix LCD approaches, our CyberDisplay products utilize high quality, single crystal silicon the same high quality silicon used in conventional integrated circuits. This single crystal silicon is not grown on glass; rather, it is first formed on a silicon wafer and then lifted off as a thin film using our proprietary Wafer Engineering technology. The thin film is patterned into an integrated circuit (including the active matrix, driver circuitry and other logic circuits) in an integrated circuit foundry and then transferred to glass using our proprietary Wafer Engineering technology, so that the transferred layer is a fully functional active matrix integrated circuit.

## **Table of Contents**

Our proprietary technology enables the production of transparent circuits on a transparent substrate, in contrast to conventional silicon circuits, which are on an opaque substrate. Our CyberDisplay products' imaging properties are a result of the formation of a liquid crystal layer between the active matrix integrated circuit glass and the transparent glass. We believe our manufacturing process offers several advantages over conventional active matrix LCD manufacturing approaches with regard to small form factor displays, including:

Greater miniaturization;

Reduced cost;

Higher pixel density;

Full color capability; and

Lower power consumption.

Our use of high quality single crystal silicon in the manufacture of our CyberDisplay products offers several performance advantages. High quality silicon enables high-speed displays, which operate up to 240 frames per second, compared to 60 frames per second for most active matrix LCDs. The color CyberDisplay products we sell generate colors by using color filters with a white backlight. Color filter technology is a process in which display pixels are patterned with materials, which selectively absorb or transmit the red, green or blue colors of light. We previously developed, but did not commercialize, color CyberDisplays products using color sequential technology whereby a backlight composed of three LEDs emit a sequence of red, green and blue light. In color sequential technology, each pixel either blocks or transmits the colored light 180 times per second, which allows the generation of color images without using three separate pixels.

Our CyberDisplay products have the additional advantage of being fabricated using conventional silicon integrated circuit lithography processes. These processes enable the manufacture of miniature active matrix circuits, resulting in comparable or higher resolution displays relative to passive and other active matrix displays that are fabricated on glass. Our production partners, United Microelectronics Corporation, or UMC, and MagnaChip, fabricate integrated circuits for our CyberDisplay products in their foundries in Taiwan and Korean, respectively. The fabricated wafers are then returned to our facilities, where we lift the integrated circuits off the silicon wafers and transfer them to glass using our proprietary technology. The transferred integrated circuits are then processed and packaged with liquid crystal at our Westborough, Massachusetts facility. The packaged units are then assembled into display panels at our Westborough, Massachusetts facility, our Korean subsidiary, Kowon Technology Co., Ltd. (Kowon), or an Asian packaging company and shipped to customers. This arrangement allows us to benefit from UMC's and MagnaChip's economies of scale and advanced fabrication processes. We expect our CyberDisplay products will benefit from further general technological advances in the design and production of integrated circuits and active matrix LCDs, resulting in further improvements in resolution and miniaturization.

## **Strategy**

Our objective is to be the leading supplier of advanced semiconductor materials and miniature displays that enable our customers to develop and manufacture differentiated communications, military and consumer electronic devices in high volumes. The critical elements of our strategy include:

*Increase the Number of Product Designs That Use Our Components.* Our goal is to grow sales of our components by increasing the number and type of products into which they are incorporated. Our product lines are subject to long design lead-times and we work closely with our customers to help them design and develop cost-effective products based on our III-V and CyberDisplay products. We use an aggressive pricing strategy as an inducement for manufacturers of consumer electronics and wireless communications products to integrate our products into their products.

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*Reduce Production Costs.* We intend to reduce our per unit production costs primarily through increasing manufacturing yield, lowering fixed costs per unit through increased sales volume, and

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## **Table of Contents**

increasing productivity and efficiency. We plan to increase productivity and efficiency by migrating from current CyberDisplay production line which uses 6 inch diameter wafers to a production line which uses 8 inch wafers and installing MOCVD reactors which can produce up to twelve 4 inch HBT transistor wafers as compared to our current reactors which can produce six 4 inch HBT transistor wafers at a time.

*Maintain Our Technological Leadership.* We believe our ability to develop innovative products based on our extensive materials science expertise enhances our opportunity to grow within our targeted markets. By continuing to invest in research and development, we are able to add to our expertise in the design of HBT transistor wafers, and innovative, high-resolution, miniature flat panel displays. We intend to continue to focus our development efforts on our proprietary HBT transistor wafers and miniature displays.

*Leverage Integrated Circuit and Display Technologies and Infrastructure.* We will continue to leverage our use of standard integrated circuit fabrication and LCD packaging technologies to achieve greater production capacity and to reduce capital investment and process development costs. Our use of these technologies allows us to engage third party manufacturers for certain portions of the fabrication of our CyberDisplay products and to take advantage of new technologies, cost-efficiencies and increased production capabilities of these third party manufacturers. We believe that general technological advances in the design and fabrication of integrated circuits, LCD technology and LCD manufacturing processes will allow us to continue to enhance our CyberDisplay product manufacturing process.

### **Markets and Customers**

#### *III-V Products*

We develop and manufacture customer and application specific HBT transistor wafers for advanced integrated circuit applications. We believe we are one of the world's leading suppliers of HBT transistor wafers and currently support volume production of four-inch and six-inch HBT transistor wafers. Our primary HBT transistor wafer product is based on an aluminum gallium arsenide vertical layer structure. We also offer customers HBT transistor wafers based on an indium gallium phosphide vertical layer structure. We vary our manufacturing process to create customized HBT transistor wafer products for customers. For fiscal years 2006, 2005 and 2004, sales of III-V products accounted for 62%, 47% and 44% of our revenues, respectively.

Using our HBT transistor wafers, our customers have developed gallium arsenide power amplifiers for wireless handsets. Our HBT transistor wafers are used in Code Division Multiple Access, Global System Mobile and Time Division Multiple Access power amplifiers, and third generation (3G) wireless handset standards. In those countries where one uniform standard has not yet been adopted, the diversity of standards requires equipment capable of operating in multiple modes and bands. This equipment is likely to require higher performance semiconductor technology such as our HBT transistor wafers.

In addition to wireless handset power amplifiers, our HBT transistor wafers are also being used in the fabrication of power amplifiers for devices which communicate using wireless fidelity or WiFi integrated circuits. Our HBT transistor wafers are also used in high-speed fiber optic switching equipment used in broadband Internet data transmission, wireless local area network chipsets (WLAN) and high speed instrumentation. Since 2001, there has been a significant decline in sales of our III-V products in the high speed fiber optic switching equipment market. Accordingly, we do not expect sales in this market will be significant in fiscal year 2007 or 2008.

We design our HBT transistor wafers in collaboration with our customers' engineering teams in order to create customized products that meet their specific application needs. Once our HBT transistor wafers have been designed in a customer's product, we believe it would be costly for that customer to switch to an alternate



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## **Table of Contents**

supplier. Our largest customer for our HBT transistor wafers is Skyworks Solutions. Skyworks Solutions also uses the foundry services of Advanced Wireless Semiconductor Company (AWSC) to process our HBT transistor wafers on their behalf. In 2005, we began selling HBT transistor wafers directly to AWSC for eventual resale by AWSC to Skyworks Solutions. AWSC also purchases HBT transistor wafers from us for the processing and sale to other customers. Other customers of our gallium arsenide products include ANADIGICS and Triquint Semiconductor. For fiscal years 2006, 2005 and 2004, sales of gallium arsenide products to Skyworks Solutions accounted for approximately 36%, 32%, and 31% of our total revenues, respectively. Sales to AWSC in 2006 and 2005 were 13% and 7% of our 2006 and 2005 revenues, respectively. We believe an investor should view our sales to Skyworks Solutions and AWSC in the aggregate for evaluating the importance of Skyworks Solutions as a customer to Kopin. We have entered into a purchase and supply agreement with Skyworks Solutions, which has a scheduled termination date of July 2008, excluding the agreement's last buy option. Accordingly, we anticipate that sales of our HBT transistor wafers to Skyworks Solutions will continue to represent a significant portion of our revenues for the near future.

### *CyberDisplay Products*

We currently sell our CyberDisplay products to customers as a single component; a unit which includes a lens and backlight; or as a complete module, which includes the display, lens, backlight and electronics which are assembled in a plastic housing. We provide our CyberDisplay products to Samsung, Olympus, Fuji and Kodak for use in digital camcorders and cameras. We also sell CyberDisplay products to the U.S. Military and certain foreign countries. In addition, we are working with other customers to develop additional and new applications for our CyberDisplay products.

In order for our CyberDisplay products to function properly in their intended applications, integrated circuit chip sets generally are required. Several companies have designed integrated circuit chip sets to work with our CyberDisplay products.

For fiscal years 2006, 2005 and 2004, sales to Samsung, as a percentage of total revenue, were 8%, 15% and 28%, respectively. For fiscal years 2006, 2005 and 2004, sales to military customers, excluding research and development contracts, as a percentage of total revenue, were 16%, 11% and 7%, respectively. For fiscal year 2005, sales to JVC, as a percentage of total revenue, were 13%.

For fiscal years 2006, 2005 and 2004, research and development revenues, primarily from multiple contracts with various U.S. governmental agencies, accounted for approximately 7%, 6%, and 2%, respectively, of our total revenues.

### **Sales and Marketing**

We principally sell our HBT transistor wafer products directly to integrated circuit manufacturers in the United States and Asia. We sell our consumer electronic CyberDisplay products both directly and through distributors to original equipment manufacturers.

We believe that the technical nature of our products and markets demands a commitment to close relationships with our customers. Our sales and marketing staff, assisted by our technical staff and senior management, visit prospective and existing customers worldwide on a regular basis. We believe these contacts are vital to the development of a close, long-term working relationship with our customers, and in obtaining regular forecasts, market updates and information regarding technical and market trends. We also participate in industry specific trade shows and conferences.

Our design and engineering staff is actively involved with a customer during all phases of prototype design and production by providing engineering data, up-to-date product application notes, regular follow-up and technical assistance. In most cases, our technical staff works with each customer in the development stage to

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## **Table of Contents**

identify potential improvements to the design of the customer's product in parallel with the customer's effort. We have established a prototype product design group in Scotts Valley, California to assist our CyberDisplay customers with incorporating our products into their products and to reduce the time required to bring end products to the marketplace. This group is intended to assist customers in accelerating their design process, achieving cost-effective and manufacturable designs, and ensuring a smooth transition into high volume production. This group is also actively involved with research and development contracts for military applications.

### **Product Development**

We believe that continued introduction of new products in our target markets is essential to our growth. We have assembled a group of highly skilled engineers who work internally as well as with our customers to continue our product development efforts. For fiscal years 2006, 2005 and 2004 we incurred total research and development expenses of \$10.2 million, \$12.3 million, and \$15.0 million, respectively. Research and development expenses, which primarily related to our internal development programs for new HBT and CyberDisplay products and development of the processes to manufacture CyberDisplay products using 8 inch wafers, were \$5.3 million, \$5.8 million and \$12.7 million, respectively, for fiscal years 2006, 2005 and 2004.

#### *III-V Products*

We intend to continue developing HBT transistor wafers and other gallium arsenide products for advanced integrated circuit applications from other compound materials. We are working with current and potential customers in the development of the next generation of HBT transistor wafers, which will be based on Gallium Arsenide Indium Nitride (GAIN). We believe GAIN-HBT<sup>®</sup> transistor wafers will provide the performance necessary for the next generation of wireless handsets and optoelectronic components. We are also developing GaN (Gallium Nitride) high electron mobility transistor wafers.

In connection with the transfer of our CyberLite LED know-how into the KoBrite joint venture we have discontinued additional CyberLite LED development as of March 31, 2005.

#### *CyberDisplay Products*

Our product development efforts are focused towards continually enhancing the features, functions and manufacturability of our CyberDisplay products. A principal focus of this effort is the improvement of manufacturing processes for very small active matrix pixels, which we will use in succeeding generations of our CyberDisplay products. The pixel size of our current CyberDisplay products ranges from 12 to 15 microns and we believe that we will be able to achieve a pixel size of less than 10 microns in commercial production. This pixel size is in contrast to a pixel size of approximately 100 microns in a typical laptop computer display. The resolutions of our current commercially available CyberDisplay products are 521 x 218 (dot), 800 x 225 (dot), 200 x 225 (pixel), 320 x 240 (pixel), 640 x 480 (pixel), 854 x 480 (pixel), 800 x 600 (pixel) and 1,280 x 1,024 (pixel). In addition, we have demonstrated 2,560 x 2,048 resolution CyberDisplay products in a 1.5 inch diagonal display. We are also working on further decreasing the already low power consumption of our CyberDisplay products. Additional display development efforts include expanding the resolutions offered, transitioning from our six inch CyberDisplay production line to an eight inch line, increasing the quantity of CyberDisplay's active matrix pixel arrays processed on each wafer by further reducing the display size, increasing the light throughput of our pixels and increasing manufacturing yields.

### **Funded Research and Development**

We have entered into various development contracts with agencies of the U.S. government. These contracts help support the continued development of our core technologies. We intend to continue to pursue other U.S. government development contracts for applications that relate to our commercial product applications. Our

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## **Table of Contents**

contracts with U.S. government agencies contain certain milestones relating to technology development and may be terminated by the government agencies prior to completion of funding. Our policy is to retain our proprietary rights with respect to the principal commercial applications of our technology. To the extent technology development has been funded by a U.S. federal agency, under applicable U.S. federal laws the federal agency has the right to obtain a non-exclusive, non-transferable, irrevocable, fully paid license to practice or have practiced this technology for governmental use. Revenues attributable to research and development contracts for fiscal years 2006, 2005 and 2004 totaled \$5.2 million, \$5.0 million and \$2.1 million, respectively.

### **Competition**

#### *III-V Products*

With respect to our HBT transistor wafers, we presently compete with several companies, including IQE, V-PEC, and Hitachi Cable, as well as integrated circuit manufacturers with in-house transistor growth capabilities, such as RF Micro Devices and Fujitsu. In the gallium arsenide HBT transistor wafer market, pricing competition is intense as a result of significant manufacturing overcapacity. The production of gallium arsenide integrated circuits has been and continues to be more costly than the production of silicon integrated circuits. Although we have reduced production costs of our HBT transistor wafers by achieving higher volumes and reducing raw material costs, we cannot be certain we will be able to continue to decrease production costs. In addition, we believe the costs of producing gallium arsenide integrated circuits by our customers will continue to exceed the costs associated with the production of competing silicon integrated circuits. As a result, we must target markets where these higher costs are justified by their superior performance.

#### *CyberDisplay Products*

The display market is highly competitive and is currently dominated by large Asian-based electronics companies including Sharp, Hitachi, Seiko, Toshiba, Sony, NEC and Sanyo. The display market consists of multiple segments, each focusing on different end-user applications applying different technologies. Competition in the display field is based on price and performance characteristics, product quality and the ability to deliver products in a timely fashion. The success of our display product offerings will also depend upon the adoption of our CyberDisplay products by consumers as an alternative to traditional active matrix LCDs and upon our ability to compete against other types of well-established display products. Particularly significant is the consumer's willingness to use a near eye display device, a display viewed in a similar fashion as using a set of binoculars, as opposed to a direct view display which may be viewed from a distance of several inches to several feet. We cannot be certain that we will be able to compete against these companies and technologies or that the consumer will accept the use of such eyewear in general or our form factor specifically.

There are also a number of active matrix LCD and alternative display technologies in development and production. These technologies include reflective, field emission display, plasma, organic light emitting diode and virtual retinal displays, some of which target the high performance small form factor display markets in which our display products are sold. There are many large and small companies that manufacture or have in development products based on these technologies. Our CyberDisplay products will compete with other displays utilizing these and other competing display technologies.

### **Patents, Proprietary Rights and Licenses**

An important part of our product development strategy is to seek, when appropriate, protection for our products and proprietary technology through the use of various United States and foreign patents and contractual arrangements. We intend to prosecute and defend our proprietary technology aggressively. Many of our United States patents and applications have counterpart foreign patents, foreign applications or international applications through the Patent Cooperation Treaty. In addition, we have licensed United States patents and some foreign counterparts to these United States patents from MIT.

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## **Table of Contents**

The process of seeking patent protection can be time consuming and expensive and we cannot be certain that patents will be issued from currently pending or future applications or that our existing patents or any new patents that may be issued will be sufficient in scope or strength to provide meaningful protection or any commercial advantage to us. We may be subject to or may initiate interference proceedings in the United States Patent and Trademark Office, which can demand significant financial and management resources. Patent applications in the United States typically are maintained in secrecy until they are published eighteen months after their earliest claim to priority and since publication of discoveries in the scientific and patent literature lags behind actual discoveries, we cannot be certain that we were the first to conceive of inventions covered by pending patent applications or the first to file patent applications on such inventions. We cannot be certain that our pending patent applications or those of our licensors will result in issued patents or that any issued patents will afford protection against a competitor. In addition, we cannot be certain that others will not obtain patents that we would need to license, circumvent or cease manufacturing and sales of products covered by these patents, nor can we be sure that licenses, if needed, would be available to us on favorable terms, if at all.

We cannot be certain that foreign intellectual property laws will protect our intellectual property rights or that others will not independently develop similar products, duplicate our products or design around any patents issued to us. Our products might infringe the patent rights of others, whether existing now or in the future. For the same reasons, the products of others could infringe our patent rights. We may be notified, from time to time, that we could be or we are infringing certain patents and other intellectual property rights of others. Litigation, which could be very costly and lead to substantial diversion of our resources, even if the outcome is favorable, may be necessary to enforce our patents or other intellectual property rights or to defend us against claimed infringement of the rights of others. These problems can be particularly severe in foreign countries. In the event of an adverse ruling in litigation against us for patent infringement, we might be required to discontinue the use of certain processes, cease the manufacture, use and sale of infringing products, expend significant resources to develop non-infringing technology or obtain licenses to patents of third parties covering the infringing technology. We cannot be certain that licenses will be obtainable on acceptable terms, if at all, or that damages for infringement will not be assessed or that litigation will not occur. The failure to obtain necessary licenses or other rights or litigation arising out of any such claims could adversely affect our ability to conduct our business as we presently conduct it.

We also attempt to protect our proprietary information with contractual arrangements and under trade secret laws. We believe that our future success will depend primarily upon the technical expertise, creative skills and management abilities of our officers and key employees rather than on patent ownership. Our employees and consultants generally enter into agreements containing provisions with respect to confidentiality and employees generally assign rights to inventions made by them while in our employ. Agreements with consultants generally provide that rights to inventions made by them while consulting for us will be assigned to us unless the assignment of rights is prohibited by the terms of any agreements with their regular employers. Agreements with employees, consultants and collaborators contain provisions intended to further protect the confidentiality of our proprietary information. To date, we have had no experience in enforcing these agreements. We cannot be certain that these agreements will not be breached or that we would have adequate remedies for any breaches. Our trade secrets may not be secure from discovery or independent development by competitors.

## **Government Regulations**

We are subject to a variety of federal, state and local governmental regulations related to the use, storage, discharge and disposal of toxic, volatile or otherwise hazardous chemicals used in our manufacturing process. The failure to comply with present or future regulations could result in fines being imposed on us, suspension of production or cessation of operations. Any failure on our part to control the use of, or adequately restrict the discharge of, hazardous substances, or otherwise comply with environmental regulations, could subject us to significant future liabilities. In addition, we cannot be certain that we have not in the past violated applicable laws or regulations, which violations could result in required remediation or other liabilities. We also cannot be certain that past use or disposal of environmentally sensitive materials in conformity with then existing environmental laws and regulations will protect us from required remediation or other liabilities under current or future environmental laws or regulations.

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## **Table of Contents**

### **Investments in Related Businesses**

Since 1998, we have made investments totaling \$4.3 million in Kowon Technology Co. LTD (Kowon), a manufacturer of optoelectronic products located in South Korea, and have accumulated an ownership interest in Kowon of 73%. Kowon's revenues are principally denominated in U.S. dollars and its local expenses are principally denominated in South Korean won. In addition, Kowon holds U.S. dollars to pay certain expenses including purchases from Kopin. Accordingly, Kowon's operations are subject to exchange rate fluctuations. Kowon is an integral part of our CyberDisplay assembly process, performing most of the backend packaging processes to complete the display.

In 2001 and 2002, we acquired an aggregate of 1,101,502 shares of Micrel Incorporated (Micrel) as part of their acquisition of a company we previously invested in. As of December 30, 2006, we held approximately 200,000 shares of Micrel valued at \$2.2 million. Included in our net income were gains on the sale of Micrel stock of approximately \$1.2 million, in the fiscal year ended 2006.

In 2000, we made an investment of \$5.1 million and contributed certain technology for which we received a 40% interest in Kopin Taiwan Corporation (KTC), a Taiwan-based company. We account for our percent ownership interest in the operating results of this company using the equity method. We have manufactured products for KTC to sell to its customers and KTC manufactures product for us to sell to our customers. In addition, we provide technical services and sell raw substrates to KTC. For fiscal years 2006, 2005 and 2004 we had product sales of approximately \$0, \$0.3 million and \$2.1 million, respectively, to KTC. For fiscal years 2006, 2005 and 2004 we had purchases of approximately \$1.8 million, \$2.8 million and \$1.8 million, respectively, from KTC. For fiscal year 2004, we recorded losses of \$0.8 million, which represented our ownership percentage of KTC's operating results. As a result of our recording our proportional share of KTC's operating results, our investment was written-off and the carrying value of this investment since December 25, 2004 has been \$0. Dr. Hsieh, one of our Directors, is chairman of KTC. Dr. Hsieh owns approximately 1% of the outstanding common stock of KTC. KTC was also an investor in KoBrite and acquired an approximate 15% interest in KoBrite.

Since 2002, we have made investments in preferred stock totaling \$5.4 million in Kenet, Inc. (Kenet). Our equity ownership percentage of Kenet is approximately 18% and we account for this investment on the cost basis. In the fiscal year ended December 30, 2006, we invested an additional approximate \$2.5 million in Kenet to retain our approximate proportional interest in a Kenet equity offering. On January 30, 2008 Kopin and three other principle investors entered into a loan agreement with Kenet whereby each of the investors committed to loan Kenet up to \$1.0 million each through May 28, 2008. The loan agreement provides for interest at the rate of ten percent per annum and provides for the issuance of warrants to purchase Kenet's common stock. On January 30, 2008 Kenet borrowed \$1.2 million under the loan agreement of which \$0.3 million came from us. We have also been notified that Kenet anticipates drawing down an additional \$1.6 million under the loan agreement in March 2008 of which \$0.4 million would be from us. Our Chief Executive Officer is a founder and board member of Kenet and owns approximately 2% of Kenet. Certain of our directors and an officer have also invested in Kenet and their ownership ranges from 0.1% to 1.0%. We periodically review this investment for impairment. No impairment was deemed necessary on December 30, 2006 based on current projections.

In 2005, we contributed our CyberLite LED technology and production know-how and \$3.0 million to a joint venture, KoBrite. For our contribution, we received a 23% interest in KoBrite. KoBrite was established under the laws of Mauritius and constructed manufacturing operations in China. Subsequent to its establishment, KoBrite entered into an agreement to pay us an estimated net \$5.8 million for certain equipment and \$1.7 million for the performance of research and training activities until such equipment was transferred to KoBrite. In the fourth quarter of 2005, certain equipment, which was to be transferred to KoBrite from Kopin, was damaged in transit and we recorded a charge of \$0.3 million to reimburse KoBrite for the damaged equipment. We are accounting for our ownership interest in KoBrite using the equity method. In the fiscal year 2006, we invested an

## **Table of Contents**

additional approximate \$2.0 million in KoBrite to retain our approximate proportional interest in a KoBrite equity offering.

We may from time to time make further equity investments in these and other companies engaged in certain aspects of the display and electronics industries as part of our business strategy. These investments may not provide us with any financial return or other benefit and any losses by these companies or associated losses in our investments may negatively impact our operating results. Certain of our officers and directors have invested in some of the companies we have invested in.

## **Employees**

As of December 30, 2006, our consolidated business employed 294 full-time and 5 part-time individuals. Of these, 14 hold Ph.D. degrees in Material Science, Electrical Engineering or Physics. Our management and professional employees have significant prior experience in semiconductor materials, device transistor and display processing, manufacturing and other related technologies. None of our employees are covered by a collective bargaining agreement. We consider relations with our employees to be good.

## **Web Availability**

We make available free of charge or through our website, [www.kopin.com](http://www.kopin.com), our annual reports on Form 10-K and other reports required under the Securities and Exchange Act of 1934, as amended, as well as certain of our corporate governance policies, including the charters for the Board of Directors' audit, compensation and nominating and corporate governance committees and its code of ethics, corporate governance guidelines and whistleblower policy. We will provide to any person without charge, upon request, a copy of any of the foregoing materials. Any such request must be made in writing to us, c/o Investor Relations, Kopin Corporation, 200 John Hancock Road, Taunton, MA 02780.

## **Item 1A. Risk Factors**

*The matters relating to the investigation by the Special Committee of the Board of Directors and the restatement of our consolidated financial statements may result in additional litigation and governmental enforcement action.* On November 1, 2006, in response to a derivative lawsuit filed against us, we commenced a voluntary review of our historical practices in granting stock options and our Board of Directors appointed a special committee of independent directors (the Special Committee) to conduct this review. On May 3, 2007, the Special Committee presented the findings of its stock option investigation to our Board of Directors and proposed various remedial measures. The Special Committee's review indicated that our financial statements for the period 1995 through July 1, 2006 should not be relied upon and the Company would need to restate its financial statements for fiscal 1995 through July 1, 2006 and the related interim periods. The Board of Directors accepted all of the findings of the Special Committee and has adopted, or is in the process of adopting, all of the remedial measures proposed. As a result of the Special Committee's investigation, as well as our internal review of our historical financial statements, we have recorded additional stock-based compensation expense for numerous stock-based awards made from 1995 through July 1, 2006. We have restated our consolidated financial statements for these periods to correctly account for stock-based awards for which the Special Committee or management determined that the measurement date for accounting purposes was different from the stated grant date. For more information on these matters, see Item 7,

Management's Discussion and Analysis of Financial Condition and Results of Operations Restatement, Note 2 of the Notes to Consolidated Financial Statements, and Item 9A, Controls and Procedures.

The internal review, the independent investigation, and related activities have required us to incur substantial expenses for legal, accounting, tax and other professional services, and have diverted management's attention from our business.

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**Table of Contents**

Our past stock option granting practices and the restatement of prior financial statements have exposed us to greater risks associated with litigation, regulatory proceedings and government enforcement actions. As described in Item 3, Legal Proceedings, two derivative lawsuits were filed in state courts against certain of our directors and certain of our current and former executive officers pertaining to allegations relating to stock-based awards. We may become the subject of, or otherwise be required to incur legal fees and costs in connection with, additional private litigation, regulatory proceedings, or government enforcement actions. No assurance can be given regarding the outcomes from such activities. The resolution of these matters will be time consuming, expensive, and will distract management from the conduct of our business. Our available directors and officers liability insurance may not be sufficient to cover our legal expenses or those of persons we are obligated to indemnify. Furthermore, if we are subject to adverse findings in litigation, regulatory proceedings or government enforcement actions, we could be required to pay damages or penalties or have other remedies imposed, which could harm our business, financial condition, results of operations and cash flows. Furthermore, the restatements of our financial results, the derivative litigation, and any negative outcome that may occur from the investigation, could impact our relationships with customers and our ability to generate revenue.

*Our common stock may be delisted from the NASDAQ Global Market and transferred to the National Quotation Service Bureau (the Pink Sheets), which may, among other things, reduce the price of our common stock and the levels of liquidity available to our stockholders.* As a result of our Special Committee Investigation commencing in November 2006, we failed to timely file our Form 10-Q for the three month period ended September 30, 2006, in March 2007 we failed to timely file our Form 10-K for the year ended December 30, 2006, and in May 2007, August 2007, and November 2007 we failed to timely file our Forms 10-Q for the three month periods ended March 31, 2007, June 30, 2007, and September 29, 2007, respectively. On November 15, 2006, NASDAQ notified us that the failure to file our Form 10-Q for the three month period ended September 30, 2006 caused us to violate the requirements for continued listing as set forth in Marketplace Rule 4310(c)(14) and that the Company's stock would be suspended from trading on November 27, 2006. On November 21, 2006 we requested a hearing before a NASDAQ Listing Qualifications Panel, or the Panel, to petition for continued listing on the NASDAQ Stock Market. The hearing was held on January 18, 2007. On February 22, 2007, the Panel informed us that we had been granted until May 14, 2007 to file our Form 10-K for the year ended December 30, 2006 and Form 10-Q for the interim period September 30, 2006 and any required restatements. On May 4, 2007, the Company made a request to the Panel for additional time beyond the May 14, 2007 deadline to file the delinquent Form 10-K and Forms 10-Q. On May 9, 2007, the Panel denied our request for additional time and notified the Company that it would suspend trading of the Company's stock on May 16, 2007. On May 14, 2007, NASDAQ Listing and Hearing Review Council, or the Council, notified us that it had called the Company's case for review and would delay its delisting pending a hearing before the Council. On May 16, 2007, NASDAQ informed us that the Company was not in compliance with NASDAQ Marketplace Rule 4310(c)(14) because it did not timely file its Quarterly Report on Form 10-Q for the quarter ended March 31, 2007. NASDAQ stayed any delisting as a result of our failure to file our Form 10-Q on a timely basis pending the hearing before the Council. On July 27, 2007, the Council notified us that we had until September 25, 2007 to file our Form 10-K for the year ended December 30, 2006, and Forms 10-Q for the interim periods September 30, 2006 and March 31, 2007 and any required restatements or the Company would be delisted on September 27, 2007. On September 7, 2007, we requested that the NASDAQ's Board of Directors exercise its discretionary authority under Rule 4809 to grant the Company continued listing beyond the Council's September 25, 2007 deadline to allow the Company time to complete its investigation into the Company's past stock option practices and related accounting and prepare and file its financial statements. On September 17, 2007, the NASDAQ's Board of Directors called for review the July 27, 2007 decision of the Council regarding Kopin's Common Stock and, pending further consideration, has stayed the Council's decision to suspend the Company's securities from trading. On October 17, 2007, the NASDAQ Board of Directors further stayed the suspension from trading until December 17, 2007. On December 12, 2007, the NASDAQ Board further stayed the suspension from trading until February 11, 2008. On February 7, 2008, the NASDAQ board further stayed the suspension from trading until March 17, 2008.

Although we have now filed our Form 10-K for the year ended December 30, 2006, our Forms 10-Q for the quarters ended September 30, 2006, March 31, 2007, June 30, 2007, and September 29, 2007, if the SEC

**Table of Contents**

disagrees with the manner in which we have accounted for and reported, or not reported, the financial impact of past stock-based awards, there could be further delays in filing subsequent SEC reports that might result in the delisting of our common stock from the NASDAQ Stock Market.

*Failure to achieve and maintain effective internal controls could adversely affect our ability to report our financial condition and results of operations accurately or on a timely basis. As a result, current and potential stockholders could lose confidence in our financial reporting, which could harm our business and the trading price of our stock.* As required by Section 404 of the Sarbanes-Oxley Act of 2002, our management is required to periodically evaluate the design and effectiveness of our disclosure controls and procedures. Our management identified material weaknesses in our application of generally accepted accounting standards and controls over the accounting for the issuance of stock options, which continued through December 30, 2006. In addition, we must document and test our internal control procedures in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, which requires our management to annually assess the effectiveness of our internal control over financial reporting. As a result of the material weaknesses described above, our disclosure controls and procedures were not effective as of December 30, 2006, which could result in a material misstatement in our annual and interim financial statements. Any failure to implement or difficulties experienced in implementing improved controls or any failure to maintain existing effective controls could have a material adverse effect on our business, operating results and stock price. For a more detailed discussion of our disclosure controls and procedures, see Item 9A, *Controls and Procedures* of this Annual Report on Form 10-K.

*We have experienced a history of losses and have a significant accumulated deficit.* Since inception, we have incurred significant net operating losses. As of December 30, 2006 we had an accumulated deficit of \$153.8 million. While we did generate income from operations in 2005, there can be no assurance that we will maintain profitability in the future.

*Our revenue and cash flow could be negatively affected by the loss of any of the few customers who account for a substantial portion of our revenues.* A few customers account for a substantial portion of our revenues. In addition sales of our CyberDisplay products for military applications is a significant factor in our future growth and profitability. The table below indicates what the percentages of our total revenues were from a particular customer and sales to military applications in a given year. The symbol \* indicates that sales to that particular customer for the given year were below 10 percent of our total revenues.

Customer	Sales as a Percent of Total Revenue		
	2006	2005	2004
Skyworks Solutions, Inc. (1)	36%	32%	31%
Advanced Wireless Semiconductor Company	13	*	*
Samsung Electronics	*	15	28
Victor Company of Japan (JVC)	*	13	*
Military Customers	16	11	*
United States Government Funded Research and Development Contracts	*	*	*

- (1) In addition to its internal capacity Skyworks Solution, Inc (Skyworks) also uses Advanced Wireless Semiconductor Company (AWSC) to perform processing. We sell our HBT wafers directly to AWSC for use in Skyworks products as well as other customers. If we assume all of the HBT products we sold to AWSC were for Skyworks use the combined sales to Skyworks and AWSC would be 49%, 39% and 32% or our revenues for the years ended 2006, 2005 and 2004, respectively.

We anticipate that sales to Skyworks Solutions and military customers will continue to represent a significant portion of our revenues for 2007 and 2008. We believe that historically we have provided Skyworks Solutions with the vast majority of its HBT transistor wafers. A significant reduction or delay in orders from any of our significant customers, particularly Skyworks Solutions or military customers in the aggregate, would



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**Table of Contents**

materially reduce our revenue and cash flow and adversely affect our ability to achieve or maintain profitability in the future. Our ability to generate cash flow and achieve profitability in 2008 will be dependent on developing new customers, increasing our market share of customers who use our CyberDisplay products for digital still camera applications and finding new applications for our CyberDisplay products, particularly eyewear devices. We have increased sales of CyberDisplay products for military applications in the year ended December 30, 2006 from historical levels. Such sales are to government contractors for the United States military. The amount and timing of such orders is dependent upon the United States military procurement processes, the government contractors' ability to successfully manage the program, and our ability to deliver more sophisticated CyberDisplay products.

*We may not be able to reduce the cost of raw materials from our vendors.* A critical part of our business strategy is to increase our sales and use the purchasing power obtained from these sales to obtain reduced raw material and component pricing from our vendors. In addition, part of our purchasing strategy is to find multiple vendors of our needed raw materials in order to create competition for lowering raw material and component prices. If we are unable to execute our sales growth strategy or find multiple vendors of the same raw materials and components we may be unable to execute our purchasing strategy and our products may not be cost competitive with our competitors' products. In addition, we may be able to execute our sales strategy but still be unable to reduce our raw material costs. If we are unable to reduce our raw material cost we may not be able to achieve profitability.

*We may be unable to increase revenues from CyberDisplay products if new products and applications are not developed.* CyberDisplay revenues for the fiscal years 2006, 2005 and 2004 were \$27.2 million, \$47.6 million and \$49.1 million, respectively. The decrease in 2006 CyberDisplay revenues since 2004 has resulted primarily from a significant decrease in sales of our CyberDisplay product to customers for use in camcorders, offset, in part by an increase in sales of our displays to the military and digital still camera markets. We had initial sales of display products into the military product and digital still camera markets in 2004 and since then we have been gaining experience in selling displays into these markets. We believe that our success in penetrating these and other markets, particularly military thermal weapon sights and night vision goggles, will significantly impact our ability to increase sales of CyberDisplays. In addition, our military products have a higher gross margin than our consumer display products and our success in increasing sales of military products are expected to significantly impact our ability to achieve or maintain profitability. Discussions with our commercial customers indicate that our competition continue to dramatically reduce their prices and some competitors are offering lower prices than us. We believe the average sales price of our displays to consumer product customers will have to decline in 2008 if we are to remain competitive in the market place. We believe the average sales price of our displays products sold for consumer electronic applications will decrease in the range of 5% to 10% during in 2007 and 2008. Accordingly, if we are unable to enter into new markets, particularly eyewear, or maintain or expand existing market share in the military and digital camera application segment revenues from CyberDisplay products will decline, which may impact our ability to achieve or maintain profitability in the future.

Accordingly, if we are unable to successfully sell our display products to digital still cameras, eyewear, and military product makers, we may be unable to grow CyberDisplay product revenues and our ability to achieve or maintain profitability will be adversely affected.

*The eyewear market segment may not develop or may take longer to develop than we anticipate.* Eyewear is the term used by the Company to describe a device which is worn in a similar fashion as eye glasses and contains one or two CyberDisplay displays for the viewing of video images. The source of these video images may be storage devices such as video iPods, DVD players or digital multimedia broadcasting (DMB) tuners. Currently, the consumer may view the image through a direct view LCD display which may range in size from one to four inches diagonal. We believe that the consumer will find this experience unsatisfactory and we believe eyewear will be a preferred solution. We sell, to commercial eyewear manufacturers, individual components such as the display, backlight and integrated circuits, or a binocular display module (BDM), which contains the various components combined into one unit or, we sell a complete eyewear solution which contains the BDM and audio

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**Table of Contents**

elements combined in a ready to use product. The eyewear manufacturing companies which are currently buying our displays for eyewear products tend to be small with limited financial resources and in-house engineering expertise. We believe that eyewear is a critical product for the long term revenue and cash flow growth of the CyberDisplay product line. If the eyewear market does not develop or we are unable to create and manufacture products which meet the needs of the eyewear market we may be unable to grow CyberDisplay product revenues and our ability to achieve or maintain profitability will be adversely affected.

*We may not be able to increase our military production capacity.* A critical part of our business strategy is to expand our military display production capacity and to implement a new manufacturing line which can utilize 8 inch wafers for our display production. The conversion of our existing 6 inch line to 8-inch will require the investment in new equipment and the redesign of our existing display products. It may also require the re-qualification of our existing display products with our customers. If we are unable to execute our military product display production facility plan, including the implementation of an 8 inch production line, or we can only manufacture and ship our CyberDisplay products in limited quantities, our revenues from CyberDisplay products may not grow, which may impact our ability to achieve or maintain profitability in the future.

*Our ability to offer and manufacture higher level CyberDisplay assemblies and modules will impact our ability to increase revenues and achieve or maintain profitability.* An important factor in our ability to expand into new military markets will be our ability to design and manufacture higher-level assemblies (HLAs). These HLAs typically consist of one or two CyberDisplay products, a backlight, lens and housing. Some HLAs also include a set of display driver electronics or a display driver chip. They are similar to our commercial BDM product but are designed to operate in the extreme conditions of combat. Our goal is to deliver an integrated HLA to our customer which eases integration into their products. These products require more complex integration of a greater variety of components than we currently use for our existing display products. They will require us to invest in additional engineering, manufacturing and test capability. Accordingly, if we are unable to develop and market these new display products or if we are unable to manufacture them in a cost-effective manner, our revenues may not grow and we may not be able to achieve or maintain profitability.

*Our competitors can provide integrated solutions.* Many portable consumer electronic devices, including camcorders and digital still cameras, have two displays for viewing images, an electronic viewfinder (EVF) and a flip-out or group view display. We only provide the display that is used as the electronic viewfinder. Our competitors may offer both EVF and flip-out displays and both displays may be run by the same interface electronics. A customer who buys our display is required to buy the flip-out display from another vendor who may compete with us. This may require our customer to purchase additional interface electronics to run our display. Our competitors may be able to offer a bundled solution of both displays and the interface electronics cheaper than the cost of buying our display and the other display and the interface electronics separately. If we are unable to offer displays with sufficient performance advantages over other displays to justify the additional cost of buying individual components versus a bundled solution or if our customers can not procure cost efficient interface electronics to run our display products, we may lose market share or be unable to grow our business which in turn would adversely affect our ability to achieve or maintain profitability.

*Our CyberDisplay products may not be widely accepted by the market.* Our success will in large part depend on the widespread adoption of the viewing format of our CyberDisplay products in multiple applications. Our success also depends upon the widespread consumer acceptance of our customers products. CyberDisplay products work best when used close to the eye, which may not be acceptable to consumers. Potential customers may be reluctant to adopt our CyberDisplay products because of concerns surrounding perceived risks relating to:

The introduction of our display technology generally;

Consumer acceptance of our CyberDisplay products; and

The relative complexity, reliability, usefulness and cost-effectiveness of our display products compared to other display products available in the market or that may be developed by our competitors.

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## Table of Contents

In addition, our customers may be reluctant to rely upon a relatively small company like us for a critical component. We cannot assure investors that prospective customers will adopt our CyberDisplay products or that consumers will accept our CyberDisplay products in future applications. If we fail to achieve market acceptance of our CyberDisplay products, our business may not be successful and we may not be able to achieve or maintain profitability.

*Our ability to manufacture and distribute our CyberDisplay products would be severely limited if the third parties that we rely on to manufacture integrated circuits for our CyberDisplay products fail to provide those services.* We depend on a Taiwanese company and a Korean company for the fabrication of integrated circuits for our CyberDisplay products. We have no long-term contracts with either of these two companies. These two companies use different methods to manufacture the integrated circuits and a shortage at one company cannot necessarily be supplied by the other company. If either company were to terminate its arrangement with us or become unable to provide the required capacity and quality on a timely basis, we would be able to manufacture and ship our CyberDisplay products only in limited quantities until replacement foundry services could be obtained. Furthermore, we cannot assure investors that we would be able to establish alternative manufacturing and packaging relationships on acceptable terms.

Our reliance on these foundries involves certain risks, including:

Lack of control over production capacity and delivery schedules;

Limited control over quality assurance, manufacturing yields and production costs;

The risks associated with international commerce, including unexpected changes in legal and regulatory requirements, changes in tariffs and trade policies and political and economic instability; and

Natural disasters such as earthquakes, tsunami, mudslides, drought, hurricanes and tornadoes.

One of the foundries and several other third parties with which we do business are located in Taiwan. Due to natural disasters such as earthquakes and typhoons that have occasionally occurred in Taiwan, many Taiwanese companies, including the Taiwanese foundry we use, have experienced related business interruptions. Our business could suffer significantly if either of the foundries we use had operations which were disrupted for an extended period of time, due to natural disaster, political unrest or otherwise. In addition, our CyberDisplays are manufactured on 6-inch silicon wafers. Although we are installing an 8-inch manufacturing line, we currently do not anticipate redesigning all of our displays made on 6-inch wafers so they can be manufactured on 8-inch wafers. We cannot be assured that if the 6-inch manufacturing facilities we use were damaged they would be restored. If the 6-inch production facilities were not restored we may be required to redesign our displays so that they can be manufactured on an 8-inch production line. If the displays had to be redesigned we may have to have the displays re-qualified by our customers, which would adversely affect our business until such qualification is complete.

In fiscal year 2003, there was an outbreak of Severe Acute Respiratory Syndrome (SARS). There were reports that consumer demand was negatively impacted by the outbreak of SARS. Our sales, manufacturing and distribution processes, and in turn our overall business operations, may be adversely affected if SARS, Avian Flu or similar situations occur.

*We depend on third parties to provide integrated circuit chip sets and other critical raw materials for use with our CyberDisplay products.* We do not manufacture the integrated circuit chip sets necessary for use with our CyberDisplay products. Instead, we rely on third party independent contractors for these integrated circuit chip sets and other critical raw materials such as special glasses and chemicals. We also use third parties to assemble our binocular display module (BDM). The critical raw materials, including the glasses and chemicals used in manufacturing the CyberDisplay products are used by other display manufacturers, many of which are

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**Table of Contents**

much larger than Kopin. In addition, our higher-level CyberDisplay assemblies, BDMs, HLAs and other modules include lenses, backlights, printed circuit boards and other components, which we purchase from third party suppliers. Some of these third party contractors and suppliers are small companies with limited financial resources. In addition, relative to the commercial market, the military buys a small number of units which prevents us from qualifying and buying components economically from multiple vendors. If any of these third party contractors or suppliers were unable or unwilling to supply these integrated circuit chip sets or other critical raw materials to us, we would be unable to manufacture and sell our CyberDisplay products until a replacement supplier could be found. We cannot assure investors that a replacement third party contractor or supplier could be found on reasonable terms or in a timely manner. As recently as the third quarter of 2006, we have experienced situations when our vendors could not supply the quantity or quality of critical raw materials we needed. As a result, we were unable to meet customer demand and our revenues, manufacturing yield and gross margins were adversely affected. Currently there is strong worldwide demand for display materials because of the significant growth of display sales over the last few years. In addition, there is strong demand for silicon wafers as a result of an increase in demand for solar cell. Any interruption in our ability to manufacture and distribute our CyberDisplay products could cause our display business to be unsuccessful and the value of investors' investment in us may decline.

*If we are unable to significantly increase our unit sales volume and reduce our production costs, our business will suffer.* Our III-V and CyberDisplay product lines currently have significant fixed costs and our ability to achieve or maintain profitability depends upon achieving significant sales volumes and higher gross profit margins. Our III-V product group is primarily comprised of heterojunction bipolar transistor (HBT) products. If we are unable to increase our III-V and CyberDisplay production levels and reduce manufacturing costs, we may lose customer orders and our business may be unprofitable.

*We may be unable to increase revenues from our HBT transistor wafers if the third party foundries we plan on using can not get qualified or are unable to produce the required product.* We have entered into an agreement with Kopin Taiwan Corporation (KTC) to provide foundry services to manufacture HBT transistor wafers for us. We entered into this agreement to provide us with additional capacity if needed. The ability to use KTC as a foundry is predicated on our ability to have our customers qualify our products, which utilize KTC's HBT transistor wafers. If we are unable to get the products which utilize KTC's wafers qualified by our customers and we are unable to meet customer demand utilizing only our internal resources we may lose customer orders and our profitability may be negatively affected.

*We may not be able to increase revenues and maintain profitability if we are unable to qualify our large capacity metal organic chemical vapor deposition (MOCVD) reactors.* During 2006, we acquired MOCVD reactors that can produce our HBTs products on either 4 or 6 inch gallium arsenide (GaAs) wafers. We acquired the reactors primarily for their ability to process 6 inch GaAs wafers. We currently have older reactors which also can manufacture HBTs using either 4 or 6 inch GaAs wafers and we sell HBT products on both 4 and 6 inch GaAs wafers. We believe the industry will migrate to 6 inch wafers over the next several years. Our largest customer, who accounted for approximately 49% of our fiscal year 2006 total revenues, purchases our HBT product on 4 inch GaAs wafers and we expect this customer will eventually migrate to 6 inch GaAs wafers in its manufacturing process. If we are unable to get our reactors qualified by this customer and other customers or if we are able to get the reactor qualified but can not manufacture the quantity our customers require or can not manufacture HBT products on 6 inch GaAs wafers in a cost effective manner our revenues and profitability will decline significantly.

*We may be unable to increase revenues from HBT transistor wafers if new product applications are not developed.* A critical market for our HBTs is wireless handsets. The growth rate of the wireless handset market has slowed over the last several years. We expect prices of our HBT transistor will decline by approximately 5 to 10 percent during 2007 and 2008. If the wireless handset unit volume grows in the range of 5 to 10 percent in 2007 and 2008 our HBT revenues may decrease unless we increase our market share or new markets are

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**Table of Contents**

developed. Revenues may also decline if we lose any of our customers or such customers reduce their orders from us. Accordingly, if we are unable to find additional applications for our HBT transistor wafers or increase our market share, our HBT transistor revenue may not grow and such absence of growth may impact our ability to achieve or maintain profitability.

*We generally do not have long-term contracts with our CyberDisplay customers, which makes forecasting our revenues and operating results difficult.* We generally do not enter into long-term agreements with our commercial CyberDisplay customers obligating them to purchase our products. Our business is characterized by short-term purchase orders and shipment schedules and we generally permit orders to be canceled or rescheduled before shipment without significant penalty. As a result, our customers may cease purchasing our products at any time, which makes forecasting our revenues difficult. In addition, due to the absence of substantial non-cancelable backlog, we typically plan our production and inventory levels based on internal forecasts of customer demand, which are highly unpredictable and can fluctuate substantially. Our operating results are difficult to forecast because we are continuing to invest in capital equipment and increasing our operating expenses for new product development. If we fail to accurately forecast our revenues and operating results, our business may not be successful and the value of investors' investment in us may decline.

*We may not be able to realize any profits under a multi-year supply agreement with a significant HBT customer.* We have a supply agreement with a significant HBT customer that expires in July 2008, excluding a last buy option contained in the agreement. Under the terms of this agreement we have agreed to maintain capacity levels for manufacturing HBT wafers and we committed to a declining pricing schedule. The agreement also requires us to give prior notice if we exit our HBT product line. In consideration for this agreement the customer agreed to source 100% of its HBT wafer needs from us subject to the customer's right to source HBT wafers from other sources if we are unable to meet its requirements under certain circumstances. We agreed that failure to meet our supply obligations under the agreement would allow our customer to obtain court ordered specific performance. If we do not perform, we could then be liable for monetary damages up to a maximum of \$45 million. The agreement obligates us to provide wafers at preset prices and as a result, our ability to make a profit under this agreement will be subject to fluctuations in the prices of raw materials, meeting customer wafer demand and to any increase in costs of goods or services required for us to perform under the agreement. If we are unable to manufacture the HBT wafers below these preset prices we may not be able to achieve or maintain profitability. There can be no assurance that this customer will agree to renew or extend our agreement when it is due to expire in which case we would potentially lose significant sales of our HBT products.

*We may have to record additional impairment losses.* In fiscal year 2004, we entered into an agreement to transfer our CyberLite LED operations into the KoBrite joint venture. Our CyberLite LED operations were performed in our facility located at 200 John Hancock Road, Taunton, MA. In addition, a portion of our III-V product line operations was performed in our 200 John Hancock Road facility. With the discontinuance of the CyberLite LED operations the recoverability of the 200 John Hancock Road leasehold improvement assets will be evaluated based on the cash flow from our III-V product line. In fiscal year 2004, based upon forecasted cash flow of our III-V product line, we recorded an impairment charge of \$3.2 million. We use our Korean operation for the back end packing steps required to manufacture some of our commercial CyberDisplay products. Our competition is moving more of its manufacturing operations to China which may make our Korean subsidiary unprofitable and require us to exit it. We recently installed new MOCVD reactors for our III-V product line and a new 8-inch manufacturing line for our display products. The forecasts used in our impairment analyses are based on certain estimates relating to III-V and CyberDisplay product line cash flows generated from these new equipments and previously owned equipment. If such estimates were too high, we may be required to record an additional impairment charge in the future.

*We may record additional losses from our investment in the KoBrite joint venture, which may impact our ability to achieve or maintain profitability.* We account for our investment in the KoBrite joint venture using the equity method, which requires us to record our proportional share of their operating results up to the amount we

## Table of Contents

have invested or committed to support, which is our current \$5.0 million investment. For the twelve months ended December 30, 2006 and December 31, 2005, we recorded \$0.6 million and \$0.2 million, respectively, of losses from the KoBrite joint venture. We anticipate that the joint venture will incur additional losses in the near term. If the joint venture generates operating losses in the future, we will record additional losses, which will impact our ability to achieve or maintain profitability.

*A disruption to our information technology systems could significantly impact our operations and impact our revenue and profitability. We maintain proprietary data processing systems and use customized software systems. We also use software packages which are no longer supported by their developer. An interruption to these systems for an extended period may impact our ability to operate the businesses and process transactions which could result in a decline in sales and affect our ability to achieve or maintain profitability.*

*Fluctuations in operating results make financial forecasting difficult and could adversely affect the price of our common stock. Our quarterly and annual revenues and operating results may fluctuate significantly for several reasons, including:*

The timing and successful introduction of additional manufacturing capacity;

The timing of the initial selection of our III-V and CyberDisplay products as a component in our customers' new products;

Availability of interface electronics for our CyberDisplay products supplied;

Competitive pressures on selling prices of our products;

The timing and cancellation of customer orders;

Our ability to introduce new products and technologies on a timely basis;

Our ability to successfully reduce costs;

The cancellation of U.S. government contracts; and

Our ability to secure agreements from our major customers for the purchase of our products.

We typically plan our production and inventory levels based on internal forecasts of customer demand, which are highly unpredictable and can fluctuate substantially. Our operating results are difficult to forecast because we are continuing to invest in capital equipment and increasing our operating expenses for new product development.

As a result of these and other factors, investors should not rely on our revenues and our operating results for any one quarter or year as an indication of our future revenues or operating results. If our quarterly revenues or results of operations fall below expectations of investors or public market analysts, the price of our common stock could fall substantially.

*We may be unable to modify our products to meet regulatory or customer requirements. From time to time our products are subject to new domestic and international requirements such as the European Union's Restriction on Hazardous Substances (RoHS) Directive. If we are unable to comply with these regulations we may not be permitted to ship our products, which would adversely affect our revenue and ability to achieve or maintain profitability.*

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*Increased competition may result in decreased demand or lower prices for our products.* Competition in the markets for our products is intense and we may not be able to compete successfully. We compete with several companies primarily engaged in the business of designing, manufacturing and selling integrated circuits or alternative display technologies, as well as the supply of other discrete products. Our competitors could develop

## Table of Contents

new process technologies that may be superior to ours, including technologies that target markets in which our products are sold. Many of our existing and potential competitors have strong market position, considerable internal manufacturing capacity, established intellectual property rights and substantial technological capabilities. Furthermore, they also have greater financial, technical, manufacturing, and marketing resources than we do, and we may not be able to compete successfully with them.

In addition, many of our existing and potential customers manufacture or assemble displays and wireless communications devices and have substantial in-house technological capabilities and substantially greater resources than we do. We may not be able to sell our products to these customers and they may commercialize their internal capabilities to become our competitors. If one of our large customers establishes internal design and manufacturing capabilities, it could have an adverse effect on our operating results.

We expect competition to increase. This could mean lower prices or reduced demand for our products. Any of these developments would have an adverse effect on our operating results.

*Disruptions of our production of our III-V and CyberDisplay products would adversely affect our operating results.* If we were to experience any significant disruption in the operation of our facilities, we would be unable to supply III-V and CyberDisplay products to our customers. Our manufacturing processes are highly complex and customer specifications are extremely precise. We periodically modify our processes in an effort to improve yields and product performance and to meet particular customer requirements. In 2008, we anticipate establishing an 8-inch CyberDisplay manufacturing line. Converting to an 8-inch line will require changes to our manufacturing processes. Process changes or other problems that occur in the complex manufacturing process can result in interruptions in production or significantly reduced yields. Although we have two domestic manufacturing facilities for our HBT products, only one of the facilities contains our quality control testing and inspection systems. Loss of this facility could prevent us from shipping product made at our other facility. Additionally, as we introduce new equipment into our manufacturing processes, our III-V and CyberDisplay products could be subject to especially wide variations in manufacturing yields and efficiency. We may experience manufacturing problems that would result in delays in product introduction and delivery or yield fluctuations. We are also subject to the risks associated with the shortage of raw materials used in the manufacture of our products.

*If we fail to keep pace with changing technologies, we may lose customers.* Rapidly changing customer requirements, evolving technologies and industry standards characterize the wireless communications, semiconductor materials and display industries. To achieve our goals, we need to enhance our existing products and develop and market new products that keep pace with continuing changes in industry standards, requirements and customer preferences. If we cannot keep pace with these changes, our business could suffer.

*We may not be successful in protecting our intellectual property and proprietary rights.* Our success depends in part on our ability to protect our intellectual property and proprietary rights. We have obtained certain domestic and foreign patents and we intend to continue to seek patents on our inventions when appropriate. We also attempt to protect our proprietary information with contractual arrangements and under trade secret laws. Our employees and consultants generally enter into agreements containing provisions with respect to confidentiality and the assignment of rights to inventions made by them while in our employ. These measures may not adequately protect our intellectual and proprietary rights. Existing trade secret, trademark and copyright laws afford only limited protection and our patents could be invalidated or circumvented. Moreover, the laws of certain foreign countries in which our products are or may be manufactured or sold may not fully protect our intellectual property rights. Misappropriation of our technology and the costs of defending our intellectual property rights from misappropriation could substantially impair our business. If we are unable to protect our intellectual property and proprietary rights, our business may not be successful and the value of investors' investment in us may decline.



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**Table of Contents**

*Our products could infringe on the intellectual property rights of others.* Companies in the wireless communications, semiconductor and display industries steadfastly pursue and protect intellectual property rights. This has resulted in considerable and costly litigation to determine the validity of patents and claims by third parties of infringement of patents or other intellectual property. Our products, including former products such as our light emitting diodes (LEDs), could be found to infringe on the intellectual property rights of others. Other companies may hold or obtain patents or inventions or other proprietary rights in technology necessary for our business. Periodically companies inquire about our products and technology in their attempts to assess whether we violate their intellectual property rights. If we are forced to defend against infringement claims, we may face such costly litigation, diversion of technical and management personnel, and product shipment delays, even if the allegations of infringement are unwarranted. If there is a successful claim of infringement against us and we are unable to develop non-infringing technology or license the infringed or similar technology on a timely basis, or if we are required to cease using one or more of our business or product names due to a successful trademark infringement claim against us, it could adversely affect our business.

*Our business could suffer if we lose the services of, or fail to attract, key personnel.* In order to continue to provide quality products in our rapidly changing business, we believe it is important to retain personnel with experience and expertise relevant to our business. Our success depends in large part upon a number of key management and technical employees. The loss of the services of one or more key employees, including Dr. John C.C. Fan, our President and Chief Executive Officer, could seriously impede our success. We do not maintain any key-man insurance policies on Dr. Fan or any other employees. In addition, due to the level of technical and marketing expertise necessary to support our existing and new customers, our success will depend upon our ability to attract and retain highly skilled management, technical, and sales and marketing personnel. Competition for highly skilled personnel is intense and there may be only a limited number of persons with the requisite skills to serve in these positions. If the III-V or CyberDisplay markets experience an upturn, we may need to increase our workforce. Due to the competitive nature of the labor markets in which we operate, we may be unsuccessful in attracting and retaining these personnel. Our inability to attract and retain key personnel could adversely affect our ability to develop and manufacture our products.

*Recent rulemaking by the Financial Accounting Standards Board requires us to expense equity compensation given to our employees and may reduce our ability to effectively utilize equity compensation to attract and retain employees.* We historically have used stock options as a significant component of our employee compensation program in order to align employees' interests with the interests of our stockholders, encourage employee retention, and provide competitive compensation packages. The Financial Accounting Standards Board has adopted changes that require companies to record a charge to earnings based on the fair value of employee stock-based awards and other equity incentives effective January 1, 2006, which we have adopted. By causing us to incur significantly increased compensation costs, such accounting changes may cause us to reduce the availability and amount of equity incentives provided to employees, which may make it more difficult for us to attract, retain and motivate key personnel.

*We may pursue acquisitions and investments that could adversely affect our business.* In the past, we have made, and in the future we may make, acquisitions of, and investments in, businesses, products and technologies that could complement or expand our business. If we identify an acquisition candidate, we may not be able to successfully negotiate or finance the acquisition or integrate the acquired businesses, products or technologies into our existing business and products. Future acquisitions could result in potentially dilutive issuances of equity securities, the incurrence of debt and contingent liabilities, amortization expenses and write-downs of acquired assets.

*We may incur significant liabilities if we fail to comply with stringent environmental and the International Traffic in Arms Regulations or if we did not comply with these regulations in the past.* We are subject to a variety of federal, state and local governmental regulations related to the use, storage, discharge and disposal of toxic or otherwise hazardous chemicals used in our manufacturing process. We are also subject to federal International

## **Table of Contents**

Traffic in Arms Regulations (ITAR) laws which regulate the export of technical data and sale of products to other nations which may use these products for military purposes. The failure to comply with present or future regulations could result in fines being imposed on us, suspension of production, or a cessation of operations. Any failure on our part to control the use of, or adequately restrict the discharge of, hazardous substances, or otherwise comply with environmental regulations, could subject us to significant future liabilities. Any failure on our part to obtain any required licenses for the export of technical data and/or sales of our products or to otherwise comply with ITAR, could subject us to significant future liabilities. In addition, we cannot be certain that we have not in the past violated applicable laws or regulations, which violations could result in required remediation or other liabilities. We also cannot be certain that past use or disposal of environmentally sensitive materials in conformity with then existing environmental laws and regulations will protect us from required remediation or other liabilities under current or future environmental laws or regulations.

*Investors should not expect to receive dividends from us.* We have not paid cash dividends in the past, nor do we expect to pay cash dividends for the foreseeable future. We anticipate that earnings, if any, will be retained for the development of our businesses.

*Our stock price may be volatile in the future.* The trading price of our common stock has been subject to wide fluctuations in response to quarter-to-quarter variations in results of operations, announcements of technological innovations or new products by us or our competitors, general conditions in the wireless communications, semiconductor and display markets, changes in earnings estimates by analysts or other events or factors. In addition, the public stock markets recently have experienced extreme price and trading volatility. This volatility has significantly affected the market prices of securities of many technology companies for reasons frequently unrelated to the operating performance of the specific companies. These broad market fluctuations may adversely affect the market price of our common stock.

### **Item 1B. *Unresolved SEC Comments***

None.

### **Item 2. *Properties***

We lease our III-V and CyberDisplay product fabrication facilities. Our III-V product manufacturing facilities and corporate headquarters are located in Taunton, Massachusetts. The Taunton facilities occupy 25,100 and 60,000 square feet, including 6,000 and 4,900 square feet of contiguous environmentally controlled production clean rooms. The Taunton facilities are occupied under leases that expire in 2010 and 2012.

Our CyberDisplay production facility occupies 74,000 square feet in Westborough, Massachusetts, of which 10,000 square feet consist of contiguous environmentally controlled production clean rooms, of which 7,000 square feet are operated at a Class 10 level. We occupy our Westborough facility under a lease that expires in March 2012.

In addition to our Massachusetts facilities, we lease a 5,800 square foot design facility in Scotts Valley, California for developing prototypes of products incorporating our CyberDisplay product. This facility is occupied under a lease that expires in October 2012. Our subsidiary, Kowon Technology Co., LTD, owns two facilities in Kyungii-Do, South Korea, in which it manufactures its optoelectronic products and in which its corporate headquarters are located. These facilities occupy an aggregate of 28,000 square feet.

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**Table of Contents**

**Item 3. Legal Proceedings**

*Derivative Lawsuits* On August 15, 2006, two lawsuits were filed in Superior Court, Bristol County, Massachusetts against certain officers and directors of Kopin, purportedly derivatively on behalf of the Company (the Derivative Suits ). The complaints in the Derivative Suits assert that the named officers and directors breached their fiduciary duties and other obligations to the Company in connection with the Company's historical stock-based award granting process, the accounting for past stock-based awards, and historical sales of stock by certain individual defendants. Kopin is also named as a nominal defendant in the Derivative Suits, although the lawsuits are derivative in nature and purportedly asserted on behalf of Kopin. Kopin is in the process of evaluating these claims.

*Securities Law Action* On September 6, 2007, a complaint was filed against the Company and certain of its directors and officers in Superior Court, Bristol County, Massachusetts purportedly on behalf of a class of shareholders who held Kopin stock on September 6, 2007 (the Securities Law Action ). The plaintiffs in this action assert claims arising under Delaware General Corporations Law § 211(c), alleging that the Company failed to hold an annual shareholder meeting within the past thirteen months. The plaintiffs seek an order requiring the Company to schedule an annual shareholder meeting and to provide notice of the meeting in accordance with Kopin's by-laws. Due to the inherent uncertainties of litigation, we cannot predict the outcome of the Securities Law Action at this time, and we can give no assurance that the claim will not have a material adverse affect on our financial position or results of operations.

As a result of the Special Committee investigation, each of the Company's present senior officers has voluntarily agreed to eliminate any benefit received by such individuals from options having been granted to them at prices below the fair market value of the Company's common stock on the appropriate measurement date. For unexercised options this will be accomplished by either canceling them or increasing their exercise price to the appropriate fair market value and, for exercised options, by such individuals compensating the Company for the amount of such benefit, after reduction for any taxes paid, either through a cash payment or canceling vested options having a value equal to the amount of the payment.

*Late SEC Filings and NASDAQ Delisting Proceedings*

As a result of our Special Committee Investigation commencing in November 2006, we failed to timely file our Form 10-Q for the three month period ended September 30, 2006, in March 2007 we failed to timely file our Form 10-K for the year ended December 30, 2006, and in May 2007, August 2007, and November 2007 we failed to timely file our Forms 10-Q for the three month periods ended March 31, 2007, June 30, 2007, and September 29, 2007, respectively. On November 15, 2006 NASDAQ notified us that the failure to file our Form 10-Q for the three month period ended September 30, 2006 caused us to violate the requirements for continued listing as set forth in Marketplace Rule 4310(c)(14) and that the Company's stock would be suspended from trading on November 27, 2006. On November 21, 2006, we requested a hearing before a NASDAQ Listing Qualifications Panel, or the Panel, to petition for continued listing on the NASDAQ Stock Market. The hearing was held on January 18, 2007. On February 22, 2007, the Panel informed us that we had been granted until May 14, 2007 to file our Form 10-K for the year ended December 30, 2006 and Form 10-Q for the interim period September 30, 2006 and any required restatements. On May 4, 2007, the Company made a request to the Panel for additional time beyond the May 14, 2007 deadline to file the delinquent Form 10-K and Forms 10-Q. On May 9, 2007, the Panel denied our request for additional time and notified the Company that it would suspend trading of the Company's stock on May 16, 2007. On May 14, 2007, NASDAQ Listing and Hearing Review Council, or the Council, notified us that it had called the Company's case for review and would delay its delisting pending a hearing before the Council. On May 16, 2007, NASDAQ informed us that the Company was not in compliance with NASDAQ Marketplace Rule 4310(c)(14) because it did not timely file its Quarterly Report on Form 10-Q for the quarter ended March 31, 2007. NASDAQ stayed any delisting as a result of our failure to file our Form 10-Q on a timely basis pending the hearing before the Council. On July 27, 2007, the Council notified

## **Table of Contents**

us that we had until September 25, 2007 to file our Form 10-K for the year ended December 30, 2006, and Forms 10-Q for the interim periods September 30, 2006 and March 31, 2007 and any required restatements or the Company would be delisted on September 27, 2007. On September 7, 2007, we requested that the NASDAQ's Board of Directors exercise its discretionary authority under Rule 4809 to grant the Company continued listing beyond the Council's September 25, 2007 deadline to allow the Company time to complete its investigation into the Company's past stock option practices and related accounting and prepare and file its audited financial statements. On September 17, 2007 the NASDAQ's Board of Directors called for review the July 27, 2007 decision of the Council regarding Kopin's Common Stock and, pending further consideration, has stayed the Council's decision to suspend the Company's securities from trading. On October 17, 2007, the NASDAQ Board of Directors further stayed the suspension from trading until December 17, 2007. On December 12, 2007, the Board of Directors of the NASDAQ granted the Company additional time to regain compliance with NASDAQ rules regarding the timely filing of periodic reports with the U.S. Securities and Exchange Commission. The Board instructed the NASDAQ staff to give the Company until February 11, 2008 to file all delayed periodic reports necessary to regain compliance with the filing requirements. On February 7, 2008, the NASDAQ board further stayed the suspension from trading until March 17, 2008.

Although we have now filed our Form 10-K for the year ended December 30, 2006, our Forms 10-Q for the quarters ended September 30, 2006, March 31, 2007, June 30, 2007, and September 29, 2007, if the SEC disagrees with the manner in which we have accounted for and reported, or not reported, the financial impact of past stock-based awards, there could be further delays in filing subsequent SEC reports that might result in the delisting of our common stock from the NASDAQ Stock Market.

### *Indemnification Obligations*

Subject to certain limitations, we are obligated to indemnify our current and former directors, officers and employees in connection with the investigation of our historical stock option practices and related government inquiries and litigation. These obligations arise under the terms of our certificate of incorporation, our bylaws, applicable contracts, and Delaware law. The obligation to indemnify generally means that we are required to pay or reimburse the individuals' reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters. The litigation associated with our stock option investigation is in its early stages and we have not yet incurred any expenses specifically for the defense of a current or former officer or director.

### *Other Legal Matters*

We are named from time to time as a party to lawsuits in the normal course of our business. Litigation in general, and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of legal proceedings are difficult to predict.

### **Item 4. *Submission of Matter to a Vote of Security Holders***

Not applicable.

**Table of Contents****Part II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock is traded on the NASDAQ National Market under the symbol KOPN. The following table sets forth, for the quarters indicated, the range of high and low sale prices for the Company's common stock as reported on the NASDAQ National Market for the periods indicated.

	High	Low
Fiscal Year Ended December 31, 2005		
First Quarter	\$ 4.18	\$ 3.06
Second Quarter	4.50	2.67
Third Quarter	7.08	4.75
Fourth Quarter	7.23	5.32
Fiscal Year Ended December 30, 2006		
First Quarter	\$ 5.89	\$ 4.18
Second Quarter	5.68	3.56
Third Quarter	3.82	3.08
Fourth Quarter	3.70	3.21

As of December 2007, there were 523 stockholders of record of our common stock, which does not reflect those shares held beneficially or those shares held in street name.

In the past three years, we have not sold any securities which were not registered under the Securities Act.

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

**Equity Compensation Plan Information**

The following table sets forth information as of December 30, 2006 about shares of the Company's common stock outstanding and available for issuance under our existing equity compensation plans.

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders(1)	7,388,349	\$ 10.96	1,195,104(3)
Equity compensation plans not approved by security holders(2)	841,400	\$ 8.35	119,004
<b>Total</b>	<b>8,229,749</b>	<b>\$ 10.69</b>	<b>1,314,108</b>

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- (1) Consists of the 1992 Stock Option Plan and 2001 Equity Incentive Plan.
- (2) Consists solely of the 2001 Supplemental Equity Incentive Plan, which does not require the approval of, and has not been approved by, our stockholders. Non-qualified options were issued under such plan.
- (3) Options available under the 2001 Equity Incentive Plan.

**Table of Contents****Kopin Corporation****S&P 500 Information Technology Index****Nasdaq Stock Market U.S. Index**

On October 9, 2002, our Board of Directors authorized the repurchase of up to \$15.0 million of our common stock over a two year period. Through September 23, 2004, we repurchased a total of 103,200 shares for an aggregate \$378,319 under this program. Our Board of Directors subsequently authorized an extension of this program pursuant to which we were authorized to purchase up to \$14,621,681 of our common stock through October 2006. The specific timing and amount of repurchases varied based on market conditions, securities law limitations, and other factors. The repurchases were made using our cash resources. During the fourth quarter of fiscal 2006, we repurchased 160,000 shares for \$546,900 under this program. The transactions occurred in open market purchases.

<b>Period</b>	<b>Total number of Shares Purchased (a)</b>	<b>Average Price Paid per Share (b)</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (c)</b>	<b>Maximum Approximate Dollar of Shares that May Yet Be Purchased Under the Plans or Programs (d)</b>
October 1, 2006 through October 28, 2006	160,000	\$ 3.42	160,000	\$
October 29, 2006 through November 25, 2006		\$		\$
November 26, 2006 through December 30, 2006		\$		\$
Total	160,000	\$ 3.42	160,000	

**Table of Contents****Item 6. Selected Financial Data**

We have restated our consolidated financial statements as of and for each of the years ended December 31, 2002, December 31, 2003, December 25, 2004 and December 31, 2005, which is reflected in the following selected financial data. The restatement is more fully described in the Explanatory Note immediately preceding Part I, Item 1 and in Note 2, Restatement of Consolidated Financial Statements, which is included in Financial Statements and Supplementary Data in Item 8 of this Form 10-K. This information should be read in conjunction with our consolidated financial statements and notes thereto, and our Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 of this Form 10-K.

	2006	2005	Fiscal Year Ended		2002
		As	2004	2003	As
		Restated(1)	As	As	Restated(1)
			Restated(1)	Restated(1)	Restated(1)
			(in thousands, except per share data)		
<b>Statement of Operations Data:</b>					
Revenues:					
Net product revenues	\$ 65,902	\$ 85,247	\$ 85,213	\$ 74,883	\$ 74,808
Research and development revenues	5,189	5,049	2,068	1,669	1,993
<b>Total revenues</b>	<b>71,091</b>	<b>90,296</b>	<b>87,281</b>	<b>76,552</b>	<b>76,801</b>
Expenses:					
Cost of product revenues	49,293	54,970	73,182	61,419	59,481
Research and development funded programs	4,908	6,498	2,340	1,823	3,098
Research and development internal	5,341	5,766	12,693	13,014	14,700
Selling, general and administrative	19,317	14,114	10,141	10,228	12,300
Other			240	481	266
Impairment charges(2)		518	5,323		
	78,859	81,866	103,919	86,965	89,845
(Loss) income from operations	(7,768)	8,430	(16,638)	(10,413)	(13,044)
Other income and expense:					
Interest income	4,786	3,596	2,821	2,645	2,821
Other income	468	76	178	199	311
Other-than-temporary impairment of Micrel common stock					(10,211)
Gains (losses) on sales of Micrel common stock	1,208			312	(2,626)
Foreign currency transaction losses	(773)	(226)	(1,009)	(114)	(337)
Interest and other expenses	(56)	(122)	(70)	(30)	(134)
	5,633	3,324	1,920	3,012	(10,176)
(Loss) income before income taxes, minority interest in loss (income) of subsidiary, equity loss in unconsolidated affiliate and cumulative effect of accounting change	(2,135)	11,754	(14,718)	(7,401)	(23,222)
Tax benefit (provision)	273	(162)	330		
(Loss) income before minority interest in loss (income) of subsidiary, equity loss in unconsolidated affiliate and cumulative effect of accounting change	(1,862)	11,592	(14,388)	(7,401)	(23,222)
Minority interest in loss (income) of subsidiary	307	(435)	(106)	(873)	(1,038)
Equity loss in unconsolidated affiliate	(594)	(210)	(879)	(1,366)	(950)
(Loss) income before cumulative effect of accounting change	(2,149)	10,947	(15,373)	(9,640)	(25,210)
Cumulative effect of accounting change(3)		(443)			(12,582)
Net (loss) income	\$ (2,149)	\$ 10,504	\$ (15,373)	\$ (9,640)	\$ (37,792)
(Loss) income before cumulative effect of accounting change per share:					
Basic	\$ (0.03)	\$ 0.16	\$ (0.22)	\$ (0.14)	\$ (0.36)
Diluted	\$ (0.03)	\$ 0.16	\$ (0.22)	\$ (0.14)	\$ (0.36)



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Cumulative effect of accounting change per share:

Basic	\$	\$	(0.01)	\$	\$	(0.19)
Diluted	\$	\$	(0.01)	\$	\$	(0.19)

Net (loss) income per share:

Basic	\$	(0.03)	\$	0.15	\$	(0.22)	\$	(0.14)	\$	(0.55)
Diluted	\$	(0.03)	\$	0.15	\$	(0.22)	\$	(0.14)	\$	(0.55)

Weighted average number of common shares outstanding:

Basic	68,064	69,334	70,052	69,540	69,318
Diluted	68,064	69,879	70,052	69,540	69,318

**Table of Contents**

	2006	Fiscal Year Ended			
		2005 As Restated(1)	2004 As Restated(1)	2003 As Restated(1)	2002 As Restated(1)
<b>Balance Sheet Data:</b>					
Cash and cash equivalents and marketable debt securities	105,360	119,757	111,900	120,334	117,991
Working capital	116,118	128,950	123,509	115,822	112,661
Total assets	161,413	166,334	156,452	174,820	174,566
Long-term obligations	772	740			
Total stockholders' equity	140,965	146,275	139,419	153,053	153,732

- (1) See the Explanatory Note immediately preceding Part I, Item 1 and Note 2, Restatement of Consolidated Financial Statements, of the Notes to the Consolidated Financial Statements in this Form 10-K.
- (2) The Company recorded a \$0.5 million and \$5.3 million impairment charge in fiscal year 2005 and 2004, respectively, as a result of its discontinuance of CyberLite LED manufacturing and development activities.
- (3) The Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations an interpretation of FASB Statement No. 143, in 2005 and FASB Statement No. 142, Goodwill and Other Intangible Assets, in 2002.

**Table of Contents**

A summary of the adjustments to the Consolidated Statements of Operations for the years ended December 31, 2003 and 2002, and the Consolidated Balance Sheets as of December 25, 2004, and December 31, 2003 and 2002 is below (in thousands):

Fiscal Years Ended	2003 As previously Reported	Adjustment	2003 Restated	2002 As previously Reported	Adjustment	2002 Restated
<b>Statement of Operations Data</b>						
Revenues:						
Net product revenues	\$ 74,883	\$	\$ 74,883	\$ 74,808	\$	\$ 74,808
Research and development revenues	1,669		1,669	1,993		1,993
<b>Total revenues</b>	<b>76,552</b>		<b>76,552</b>	<b>76,801</b>		<b>76,801</b>
Expenses:						
Cost of product revenues	59,955	1,465	61,419	57,553	1,929	59,481
Research and development funded programs	1,823		1,823	3,098		3,098
Research and development internal	11,701	1,313	13,014	13,093	1,607	14,700
Selling, general and administrative	10,245	(17)	10,228	9,956	2,344	12,300
Other	481		481	266		266
	84,204	2,761	86,965	83,966	5,880	89,845
Loss from operations	(7,653)	(2,761)	(10,413)	(7,165)	(5,880)	(13,044)
Other income and expense:						
Interest income	2,645		2,645	2,820		2,811
Other income	199		199	310		311
Other-than-temporary impairment of Micrel common stock				(10,211)		(10,211)
Gains (losses) on sales of Micrel common stock	312		312	(2,626)		(2,626)
Foreign currency transaction losses	(114)		(114)	(337)		(337)
Interest and other expenses	(30)		(30)	(134)		(134)
	3,013		3,012	(10,178)		(10,176)
Loss before income taxes, minority interest in income of subsidiary, equity loss in unconsolidated affiliate and cumulative effect of accounting change	(4,639)	(2,761)	(7,401)	(17,341)	(5,880)	(23,222)
Tax benefit (provision)						
Loss before minority interest in income of subsidiary, equity loss in unconsolidated affiliate and cumulative effect of accounting change	(4,639)	(2,761)	(7,401)	(17,341)	(5,880)	(23,222)
Minority interest in income of subsidiary	(873)		(873)	(1,038)		(1,038)
Equity loss in unconsolidated affiliate	(1,366)		(1,366)	(949)		(950)
Loss before cumulative effect of accounting change	(6,878)	(2,761)	(9,640)	(19,330)	(5,880)	(25,210)
Cumulative effect of accounting change				(12,582)		(12,582)
Net loss	\$ (6,878)	\$ (2,761)	\$ (9,640)	\$ (31,912)	\$ (5,880)	\$ (37,792)
Loss before cumulative effect of accounting change per share:						
Basic	\$ (0.10)	\$ (0.04)	\$ (0.14)	\$ (0.28)	\$ (0.08)	\$ (0.36)
Diluted	\$ (0.10)	\$ (0.04)	\$ (0.14)	\$ (0.28)	\$ (0.08)	\$ (0.36)
Cumulative effect of accounting change per share:						
Basic	\$	\$	\$	\$ (0.18)	\$	\$ (0.19)
Diluted	\$	\$	\$	\$ (0.18)	\$	\$ (0.19)
Net loss per share:						
Basic	\$ (0.10)	\$ (0.04)	\$ (0.14)	\$ (0.46)	\$ (0.08)	\$ (0.55)
Diluted	\$ (0.10)	\$ (0.04)	\$ (0.14)	\$ (0.46)	\$ (0.08)	\$ (0.55)

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Weighted average number of common shares outstanding:				
Basic	69,540	69,540	69,318	69,318
Diluted	69,540	69,540	69,318	69,318

**Table of Contents**

<b>Balance Sheet Data</b>	<b>2004 As previously Reported</b>	<b>Adjustment</b>	<b>2004 Restated</b>
<b>ASSETS</b>			
Current assets:			
Cash and cash equivalents	\$ 17,816	\$	\$ 17,816
Marketable securities, at fair value	94,084		94,084
Accounts receivable, net of allowance of \$356,000	8,158	592	8,750
Accounts receivable from unconsolidated affiliates	931		931
Inventories	7,935	(112)	7,823
Prepaid expenses and other current assets	1,572	(108)	1,464
Optical equipment transferred to joint venture	5,786		5,785
Total current assets	136,282	372	136,653
Deferred tax asset		248	248
Property, plant & equipment	11,616		11,616
Other assets	7,935		7,935
Total assets	\$ 155,832	\$ 620	\$ 156,452
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>			
Current Liabilities:			
Accounts payable	\$ 4,715	\$ 592	\$ 5,307
Accounts payable from unconsolidated affiliates	1,194		1,194
Accrued payroll and expenses	2,549	(5)	2,544
Accrued warranty	1,030		1,030
Billings in excess of revenue earned	1,240		1,240
Accrued tax	700		700
Other accrued liabilities	1,437	(200)	1,237
Total current liabilities	12,865	\$ 387	13,252
Minority interest	3,781		3,781
Commitments and contingencies			
Stockholders equity:			
Preference stock, par value \$.01 per share: Authorized 3,000 shares; none issued and outstanding			
Common stock, par value \$.01 per share: Authorized 120,000,000 shares; issued 70,130,615 shares in 2004			
	701		701
Additional paid-in capital	263,461	37,528	300,989
Deferred compensation	(923)	(905)	(1,828)
Treasury stock (182,100 at cost)	(671)		(671)
Accumulated other comprehensive income	2,371		2,371
Accumulated deficit	(125,753)	(36,390)	(162,143)
Total stockholders equity	139,186	233	139,419
Total liabilities and stockholders equity	\$ 155,832	\$ 620	\$ 156,452

**Table of Contents**

Balance Sheet Data	2003		2003		2002		2002	
	As previously Reported	Adjustment	Restated	As previously Reported	Adjustment	Restated	As previously Reported	Adjustment
<b>ASSETS</b>								
Current assets:								
Cash and cash equivalents	\$ 29,145	\$	\$ 29,145	\$ 35,298	\$	\$ 35,298		
Marketable securities, at fair value	91,189		91,189	82,694		82,694		
Accounts receivable, net of allowance of \$1,200,000 in 2003 and 2002	6,771		6,771	6,680		6,680		
Inventories	5,920		5,920	4,773		4,773		
Prepaid expenses and other current assets	1,451		1,451	1,119		1,119		
Total current assets	134,476		134,476	130,564		130,564		
Property, plant & equipment	31,008		31,008	34,748		34,748		
Other assets	9,336		9,336	8,773		8,773		
Intangible assets, net				481		481		
Total assets	\$ 174,820	\$	\$ 174,820	\$ 174,566	\$	\$ 174,566		
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>								
Current Liabilities:								
Accounts payable	\$ 10,442	\$	\$ 10,442	\$ 7,415	\$	\$ 7,415		
Accrued payroll and expenses	2,225	684	2,909	2,105	3,186	5,291		
Accrued warranty	1,030		1,030	830		830		
Unearned revenue	1,379		1,379	1,108		1,108		
Other accrued liabilities	2,893		2,893	3,259		3,259		
Total current liabilities	17,969	684	18,653	14,717	3,186	17,903		
Minority interest	3,114		3,114	2,931		2,931		
Commitments and contingencies								
Stockholders' equity:								
Preference stock, par value \$.01 per share: Authorized 3,000 shares; none issued and outstanding								
Common stock, par value \$.01 per share: Authorized 120,000,000 shares; issued 70,044,960 shares in 2003 and 69,391,349 shares in 2002								
	700		700	694		694		
Additional paid-in capital	263,166	37,517	300,683	260,254	37,098	297,352		
Deferred compensation	(1,422)	(3,352)	(4,774)		(8,196)	(8,196)		
Accumulated other comprehensive income	3,214		3,214	1,013		1,013		
Accumulated deficit	(111,921)	(34,849)	(146,770)	(105,043)	(32,088)	(137,130)		
Total stockholders' equity	153,737	(684)	153,053	156,918	(3,186)	153,732		
Total liabilities and stockholders' equity	\$ 174,820	\$	\$ 174,820	\$ 174,566	\$	\$ 174,566		

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## **Table of Contents**

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion should be read in conjunction with our consolidated financial statements and notes to those statements and other financial information appearing elsewhere in this Form 10-K. The following discussion contains forward looking information that involves risks and uncertainties. Our actual results could differ materially from those anticipated in the forward looking statements as a result of a number of factors, including the risks discussed in Item 1A. Risk Factors and elsewhere in this Annual Report on Form 10-K.*

*The following discussion and analysis gives effect to the restatement described above in the Restatement of Consolidated Financial Statements explanatory note to this Annual Report on Form 10-K, and in Note 2 to our consolidated financial statements. For this reason, the data set forth in this section may not be comparable to discussions and data in our previously filed annual and quarterly reports.*

#### *Restatement*

#### *Background*

In November 2006, in response to a derivative lawsuit filed against the Company, the Company commenced an investigation relating to its stock-based awards granting practices and accounting. Mr. James Brewington, who joined the Company's Board of Directors in 2006 and was not affiliated with the Company during the period in question, was asked by the Board of Directors to serve on an Independent Special Committee to independently review the Company's stock-based award granting practices during the period between 1995 and 2005, referred to as the Complaint Period. The Special Committee then engaged an independent law firm and forensic accountants to review the stock-based awards granted during the Complaint Period. The Special Committee reviewed Compensation Committee minutes, Board of Director minutes, emails, other stock-based award granting documents and spreadsheets used in allocating stock-based awards and performed interviews with current and former members of the Board of Directors, Compensation Committee members, management and employees. The Special Committee's review included an evaluation of grant authorizations, an assessment of the appropriate measurement dates under generally accepted accounting principles and the appropriate equity pricing methodology.

The Special Committee determined that for grants during the Complaint Period there were different amounts and types of information available to determine the appropriate measurement date for each grant. As such, validation of the appropriate measurement dates under Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees, or APB 25, was difficult to determine with precision. For such grants, the Special Committee evaluated all available evidence to establish reasonable dates upon which equity recipients and the stock-based awards were known, approved, fixed and ready to be communicated to employees.

For stock-based awards granted during the period January 1, 1995 through December 31, 2005 of the Investigation Period, the accounting principle applied under United States Generally Accepted Accounting Principles (US GAAP) was APB 25. For stock-based awards granted during the period January 1, 2006 through December 30, 2006, of the Investigation Period, we applied Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R). APB 25 prescribed that there was a compensation element in a stock option award to an employee if the option exercise price was below the fair market value of the company's stock on the measurement date. The measurement date is the date that the number of options the employee was to receive and the option exercise price were known. We typically accounted for all stock-based awards to new hires, employees, officers and directors, through December 31, 2005 under APB 25 using the stated grant date as the measurement date. We typically issued stock options with an exercise price equal to the fair market value of our common stock on the recorded grant date, and therefore recorded no stock-based compensation expense. We recorded compensation expense for awards of restricted common shares for the fair value of the common shares on the grant date over the vesting period. We refer to the measurement date used when the stock-based award was granted during the Investigation Period as the Original Measurement Date. If, as

## **Table of Contents**

a result of our option review, we used a different measurement date than the Original Measurement Date to determine if there was an element of compensation expense in a stock-based award, we referred to the new measurement date as the Revised Measurement Date.

### *Historical Stock-Based Award Granting Process*

Generally, stock-based awards were authorized by the Compensation Committee of the Board of Directors or the Board of Directors. The Compensation Committee implicitly delegated authority to the CEO and CFO to grant stock-based awards in the normal course of business to employees and new hires that were not officers. Our historical stock-based award granting processes for each category of awards is outlined below.

*New Hire Employee Stock-Based Awards.* Typically, the CEO would extend an offer to a potential new employee and the offer letter would contain a clause outlining the number of stock-based awards that the new hire was to receive on the date the individual began employment. Generally, the Original Measurement Date was the employment start date.

*All Other Stock-Based Awards to Non-Officers.* Typically, the CEO made recommendations to the Compensation Committee for the grant of stock-based awards to non-officers. The CEO would recommend a pool of stock-based awards that would be allocated to the individual employees. The Compensation Committee approved the terms of the pool, the result of which was generally documented in the minutes of the Compensation Committee meetings. The CFO would allocate the pool between our product line divisions. The product line general managers would then be responsible for determining the allocation of the awards to the employees in their product line division. The product line managers were required to complete the allocation in the same time frame. The allocation of the pool was typically documented in electronic spreadsheets. The results of the allocation were maintained in spreadsheets, which were the final accounting records. The Original Measurement Date was the date of approval by the Compensation Committee of the pool. Generally, we used the closing price of our common stock on the Original Measurement Date as the exercise price for stock options; therefore, typically no compensation expense was recorded in the consolidated financial statements for stock options grants to non-officers.

*All Other Stock-Based Awards to Officers.* Typically, the CEO made recommendations to the Compensation Committee for the grant of stock-based awards to officers. The Compensation Committee approved the terms of the awards. Evidence of the approval by the Compensation Committee was generally included in the minutes of the meetings for awards to certain executive officers, hereafter referred to as Group A. The evidence of the approval by the Compensation Committee generally did not describe the awards to certain other officers, hereafter referred to as Group B; although our practice was that all officer awards were discussed in the Compensation Committee meetings. Generally, the Original Measurement Date was the date of approval by the Compensation Committee. Generally, we used the closing price of our common stock on the Original Measurement Date as the exercise price for stock options; therefore, typically, no compensation expense was recorded in the consolidated financial statements for stock options granted to officers.

*Director Stock-Based Awards.* Typically, stock-based awards to members of the Board of Directors were made on the date an individual joined the Board of Directors and on an annual basis generally around the date of the annual shareholders' meeting as dictated by the terms of our equity plans under which these awards were granted. Generally, we used the closing price of our common stock on the Original Measurement Date as the exercise price for stock options; therefore, typically, no compensation expense was recorded in the consolidated financial statements for stock options granted to directors.

*Consultant Awards.* Typically, the CEO made recommendations to the Compensation Committee for the grant of stock-based awards to consultants. The Compensation Committee would typically approve the terms of the consultant awards which were typically documented in the agreement with the consultant.



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**Table of Contents**

*Revised Measurement Date*

As a result of the Special Committee's findings and our own further review of our stock-based award granting practices, we determined that the measurement dates for certain stock-based awards differed from the Original Measurement Date for such grants. In some instances, we were only able to locate sufficient evidence to identify the measurement date described in APB 25, the first date on which both the number of shares that an individual employee was entitled to receive and the exercise price were known, within a range of possible dates. As a result, a framework was developed to determine the Revised Measurement Date using the best available evidence of the date on which both the number of shares that an individual employee was entitled to receive and the exercise price were approved and known with finality. The information used to identify the Revised Measurement Dates for new hire stock based awards was available in the respective offer letters and personnel files. For all other awards, the minutes of the Board of Director meetings, minutes of the Compensation Committee meetings, written consents of the Board of Directors and Compensation Committee, emails, spreadsheets, Form 4 filings with the SEC, and other accounting records were used to identify the Revised Measurement Dates.

The methodology we used to determine the Revised Measurement Dates associated with prior stock-based awards was as follows:

*New Hire Employee Stock Based Awards.* The Original Measurement Date for stock-based awards granted to new employees was the anticipated employment commencement date documented in the employment offer letter. We determined that in certain instances the actual employment date was different from the anticipated employment date. We determined the Revised Measurement Date for each of these grants to be the date the employee actually commenced employment with the Company.

*All Other Stock-Based Awards to Non Officers.* We determined that the Original Measurement Date for 6.2 million of the 6.4 million stock-based awards granted to non-officer employees could not be relied on because the criteria for a measurement date had not been met under US GAAP then applicable at the Original Measurement Date. We determined the Revised Measurement Date for each stock-based award to non officers, other than grants of new hire employee stock-based awards, based upon the following decision matrix which factored in all available evidence. The decision matrix contemplates the strength of the available evidence in supporting the finality of the granting process. If the criteria described below in a particular bullet point was satisfied then the date derived from the information reviewed under that bullet point was the date chosen as the Revised Measurement Date; if not, we proceeded to the next bullet point criteria.

If the fully executed minutes of the Board of Director or Compensation Committee meetings documented the grantee, the number of stock-based awards they were to receive and the exercise price, the Revised Measurement Date was the date of the fully executed minutes, which was the same as the Original Measurement Date. 137,000 stock-based awards met this criteria and accordingly no compensation expense was recorded.

If a fully executed written consent of the Board of Directors or Compensation Committee documented the grantee, the number of stock-based awards they were to receive and the exercise price, the Revised Measurement Date was the date of the last signature from a Board member or Compensation Committee member on the fully executed consent. We used this criteria to determine the Revised Measurement Date for 420,000 stock-based awards and to record compensation expense of approximately \$413,000 as part of the restatement.

If documentation from the Company's third party stock option plan administrator documented the grantee, the number of stock-based awards they were to receive and the exercise price, the Revised Measurement Date was the date of such documentation. We used this criteria to determine the Revised Measurement Date for 207,000 stock-based awards and as the Company's common stock price on the Revised Measurement Date was lower than on the Original Measurement Date, no compensation expense was recorded.

**Table of Contents**

If documentation in the form of a final accounting spreadsheet contained the grantee, the number of stock option awards they were to receive and the exercise price for a significant percentage (defined as containing approximately 90% or more of the total award made to all employees and officers) of employees, the Revised Measurement Date was the date of such documentation. We used this criteria to determine the Revised Measurement Date for 1.0 million stock-based awards and to record compensation expense of approximately \$5.1 million. For these 1.0 million stock-based awards the number of days between the Original Measurement Date and the Revised Measurement Date was, on average, 99 days.

If documentation from one of the Company's product line general managers contained the grantee, the number of stock option awards they were to receive and the exercise price for a significant percentage of the pool for that product line division and the total pool was approved by the Board of Directors or the Compensation Committee, the Revised Measurement Date was the date of such documentation. We were unable to locate concurrent documentation of the allocation of the pool for both of our product line divisions. Therefore, we evaluated whether the evidence of the allocation of the pool for one of the product line divisions was substantially complete, as based on our process, both divisions would have been finalizing their allocation at the same time. We defined substantially complete as approximately 90% or more of the total awards for the product line division were finalized. If the evidence supporting the allocation of the pool for one of the product line divisions was substantially complete, we assumed the Revised Measurement Date was the same for both product line divisions. We used this criteria to determine the Revised Measurement Date for 2.6 million stock-based awards and to record compensation expense of approximately \$10.6 million as part of the restatement. For these 2.6 million stock-based awards, the number of days between the Original Measurement Date and the Revised Measurement Date was, on average, 69 days.

If documentation in the form of Company records used to support the annual Form 10-K filings documented the grantee, the number of stock-based awards they were to receive and the exercise price the Revised Measurement Date was the date of the filing of the Form 10-K. We used this criteria to determine the Revised Measurement Date for 1.9 million stock-based awards and to record compensation expense of approximately \$361,000 as part of the restatement. For these 1.9 million stock-based awards, the number of days between the Original Measurement Date and the Revised Measurement Date was, on average, 105 days.

*All Other Stock-Based Awards to Officers.* We determined that the Original Measurement Date for 5.3 million of the 7.9 million stock-based awards to officers could not be relied on because the criteria for a measurement date had not been met under US GAAP then applicable on that date. We determined the Revised Measurement Date for each stock-based award to officers, other than grants of new hire employee stock-based awards, based upon the following decision matrix which factored in available evidence. We assumed the Revised Measurement Date for stock-based awards to Group B officers was the same as for Group A officers unless the evidence indicated otherwise. The decision matrix contemplates the strength of the available evidence in supporting the finality of the granting process. If the criteria described below in a particular bullet point was satisfied then the date derived from the information reviewed under that bullet point was the date chosen as the Revised Measurement Date; if not, we proceeded to the next bullet point criteria.

If the fully executed minutes of the Board of Director or Compensation Committee meetings documented the grantee, the number of stock-based awards they were to receive and the exercise price, the Revised Measurement Date was the date of the fully executed minutes, which was the same as the Original Measurement Date. 2.6 million stock-based awards met this criteria and accordingly no compensation expense was recorded.

If a fully executed consent of the Board of Directors or Compensation Committee documented the grantee, the number of stock-based awards they were to receive and the exercise price, the Revised Measurement Date was the date of the last signature from a Board member or Compensation Committee member on the fully executed consent. We used this criteria to determine the Revised Measurement Date for 460,000 stock-based awards and to record compensation expense of approximately \$445,000 as part of the restatement.

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## Table of Contents

If the fully executed minutes of the Board of Director or Compensation Committee meetings subsequently documented or clarified the grantee and the number of stock-based awards they were to receive and the exercise price which were discussed in Compensation Committee minutes of a prior date, the Revised Measurement Date was the date of the clarifying Board of Director's meeting. We used this criteria to determine the Revised Measurement Date for 2.8 million stock-based awards and to recorded compensation expense of approximately \$10.5 million as part of the restatement.

If documentation in the form of a final accounting spreadsheet contained the grantee, the number of stock option awards they were to receive and the exercise price for a significant percentage (defined as containing approximately 90% or more of the total awards to employees and officers) of employees, the Revised Measurement Date was the date of such documentation. We used this criteria to determine the Revised Measurement Date for 500,000 stock-based awards and to record compensation expense of approximately \$3.4 million.

If a Form 4 filed with the Securities and Exchange Commission documented the grantee and the number of stock-based awards they were to receive and the exercise price, the Revised Measurement Date was generally the filing date of the Form 4. We used this criteria to determine the Revised Measurement Date for 1.5 million stock-based awards and to record compensation expense of approximately \$2.8 million as part of the restatement. For these 1.5 million stock-based awards, the number of days between the Original Measurement Date and the Revised Measurement Date was, on average, 66 days.

*Director Stock-Based Awards.* The 1997 Directors Stock Option Plan (the Directors Plan), which terminated in 2002, provided for the automatic grant of stock options to our outside directors, such that the grants require no independent action of the Board of Directors or any committee of the Board of Directors. The Directors Plan permits the issuance of stock options with an exercise price of either the closing price of the Company's stock on the day before the grant or the closing price of the Company's stock on the day of grant. We identified two awards where the exercise price of the award was the previous day's closing price. We recorded compensation expense of \$30,000 for the difference between the previous day's closing price and the closing price on the date of grant.

The Compensation Committee also made one award to a Director as an incentive to assist management in increasing the value of the Company. We could not locate documents which described the specific services the Director was to perform and accordingly this grant was treated as a non employee grant. The additional compensation expense for this award was \$27,000.

### *Restatement Adjustments*

Applying the methodology described above, we calculated stock-based compensation expense for periods prior to fiscal 2006 under APB 25 based upon the intrinsic value on the Revised Measurement Dates of stock-based awards to new hires, officers, non-officers and directors and the vesting provisions of the underlying stock-based award. We calculated the intrinsic value on the Revised Measurement Date as the closing price of our common stock on such date as reported on the Nasdaq National Market, now the Nasdaq Global Market (NASDAQ), less the exercise price per share of common stock, multiplied by the number of shares subject to such award. We recognize these amounts as compensation expense over the vesting period of the underlying stock-based award (generally four years). We also determined that Emerging Issues Task Force (EITF) Issue 96-18: Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services should have been applied for certain stock-based awards to consultants in 1996. Under EITF 96-18, we remeasure, and report in our consolidated statement of operations, the intrinsic value of the options at the end of each reporting period until the measurement date, which is the date the option vests.

In applying the methodologies above, if the Company's stock price on the Revised Measurement Date was lower than the original grant price, no compensation expense adjustment was recorded. The equity award plans

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## Table of Contents

under which the stock based awards discussed above were granted allow for the Board of Directors or its designee to issue stock options of the Company with an exercise price they choose; however, for a stock option to qualify as an incentive stock option, the plan contains certain rules which are believed to be consistent with the requirements of the Internal Revenue Service. These rules essentially require that the equity awards be made at fair value on the date of grant, which is interpreted to be the previous day's closing price or the current day's closing price of the Company's common stock on NASDAQ. We have primarily used the current day's close price in determining the exercise price of stock options. When applying the methodologies above, if an option was granted at the previous day's closing price, we recorded compensation expense for the difference between the previous day's closing price and the closing price on the date of grant.

The aggregate amount of additional compensation expense related to the grants awarded during the Investigation Period, which the Company should have recorded in prior periods, is \$37.4 million, excluding income tax effects.

During the period from October 8, 1998 to September 17, 2001, we had 7 grants to officers and non-officers, excluding new hire awards. These 7 awards had exercise prices that were at or near the lowest common stock price of the Company during the 90 day period after the Original Measurement Date. For 6 of these awards representing 5.8 million stock-based awards, the grant occurred either on or within 13 days of a regularly scheduled meeting of the Board of Directors. Compensation expense of approximately \$28.6 million has been recorded as part of the restatement for these 6 awards. The other award represented approximately 789,000 stock-based awards for which \$1.5 million of compensation expense has been recorded as part of the restatement.

Based on the findings discussed above, the Company has restated its reported results for prior periods to reflect the impact of the additional stock-based compensation by year. The fiscal years ended December 31, 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, and 2003 are referred to as 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002 and 2003, respectively, in the tables that follow. The fiscal years ended December 25, 2004, December 31, 2005 and December 30, 2006 are referred to as 2004, 2005 and 2006, respectively.

### *Sensitivity Analysis*

Many of our Revised Measurement Date conclusions are dependent on the facts and circumstances of each stock-based award and the available documents. As discussed above, we used a variety of document types to determine the Revised Measurement Dates including emails, spreadsheets, minutes of Board of Director and Compensation Committee meetings, filings with the Securities and Exchange Commission and other available documents. However, because of the passage of time since the Original Measurement Dates, in many instances we did not have a definitive set of documents to determine the Revised Measurement Dates and, therefore judgment was used to determine the Revised Measurement Dates. To evaluate the results from the decision criteria we established, we performed an analysis to compare the compensation expense which resulted from selecting measurement dates based upon the methodology described above to what the compensation expense would have been had we selected alternative measurement dates. In selecting an alternative measurement date to perform this analysis, we considered whether it was possible that the actual stock-based award grant was finalized before or after the date selected as the Revised Measurement Date (the sensitivity period). The end of the sensitivity period is considered to be the latest possible measurement date or the no later than date. For example, for certain grants, we used the date a Form 4 was filed with the Securities and Exchange Commission as the Revised Measurement Date and we used the closing price of our common stock on that date in computing the compensation expense. Since the Form 4 contains all of the key information for a stock-based award, we know the criteria for determining a measurement date had been met when the Form 4 was filed. However, it is possible the grant was finalized before the Form 4 was filed. As a result, the sensitivity period for such a grant would be from the Original Measurement Date to the Revised Measurement Date.

For purposes of our sensitivity analysis, we therefore computed the compensation expense assuming that 1) the Revised Measurement Date was the date that the Company's stock price was the highest during the

**Table of Contents**

sensitivity period, 2) the Revised Measurement Date was the date that the Company's stock price was the lowest during the sensitivity period and 3) the Revised Measurement Date was an average of the Company's stock price during the sensitivity period. The sensitivity analysis methodology we used to perform this comparison is dependent on the nature of the individual award but can be categorized as follows:

For non-officer awards that the Revised Measurement Date is the date on the document from the product line managers which provides evidence that the allocation of the pool was substantially complete, the sensitivity period is from the Revised Measurement Date to the date of the Company's next Form 10-K filing with the SEC.

For non-officer awards that the Revised Measurement Date is the date of the filing of the Company's next Form 10-K due to the fact that the only evidence supporting the finality of the pool allocation was incomplete documents from the product line managers, the sensitivity period is from the date of the incomplete documents from the product line managers to the Revised Measurement Date.

For awards that the Revised Measurement Date is the date of a final accounting record, the date of the filing of the Company's Form 10-K or the date of the filing by the officer of a Form 4 with the SEC, the sensitivity period is from the Original Measurement Date to the Revised Measurement Date.

For awards that the Revised Measurement Date is the date of fully executed minutes of Board of Director or Compensation Committee meetings which document or clarified stock-based awards granted with an Original Measurement Date prior to the date of such meeting, the sensitivity period is from the Original Measurement Date to the Revised Measurement Date.

For awards to Group B officers that the Revised Measurement Date is the same date as awards to Group A officers, the sensitivity period is from the Revised Measurement Date to the date of the Company's next Form 10-K filing with the SEC or the date of the filing by the officer of a Form 4 with the SEC.

The table below shows the additional stock-based compensation expense by year from 1995 through 2005 which we recorded using the Revised Measurement Date methodology and what the compensation expense would be based on the sensitivity analysis using the date the Company's stock price was the highest during the sensitivity period (in millions):

	1995	1996	1997	1998	1999	2000	2001
Recorded compensation expense, excluding tax impacts	\$	\$ 0.2	\$ 1.7	\$ 1.9	\$ 4.6	\$ 5.8	\$ 8.2
Compensation expense assuming the Revised Measurement Date was when the Company's stock price was the highest during the sensitivity period	\$	\$ 0.2	\$ 1.9	\$ 2.2	\$ 15.1	\$ 21.9	\$ 26.4

	2002	2003	2004	2005	Total
Recorded compensation expense, excluding tax impacts	\$ 6.5	\$ 5.3	\$ 2.5	\$ 0.7	\$ 37.4
Compensation expense assuming the Revised Measurement Date was when the Company's stock price was the highest during the sensitivity period	\$ 18.1	\$ 14.3	\$ 4.8	\$ 1.2	\$ 106.1

The compensation expense would be \$6.7 million and \$48.4 million had we used as the Revised Measurement Date the date the Company's stock price was the lowest during the sensitivity period and the average of the Company's stock price during the sensitivity period, respectively.

In reviewing the results of the sensitivity analysis above we noted that one stock option award made in 1999 had a significant impact on the overall results. As noted above, we recorded an aggregate compensation expense, excluding income tax effects, of \$37.4 million, which included \$10.5 million specifically for the 1999 award. In performing the sensitivity analysis, we noted that approximately \$47.7 million of the total \$106.1 million noted above in the sensitivity analysis is attributed to this 1999 award. The Revised Measurement Date for the awards granted to officers in this 1999 award was determined to be December 8, 1999, the date of the fully executed



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## **Table of Contents**

minutes of a Board of Directors meeting which documented the discussions of a previously held Compensation Committee meeting. The officers filed Form 4s with the SEC on February 14, 2000. The sensitivity period for the awards made to the officers in this 1999 award is from October 29, 1999 to February 14, 2000. The Revised Measurement Date for awards granted to non-officers was determined to be January 10, 2000, the date of the documentation from the Company's product line general managers that contained allocation of the pool for a significant percentage of the pool that was approved by the Board of Directors or the Compensation Committee. The sensitivity period for the awards made to the non-officers in this 1999 award is from January 10, 2000 to the date of the Company's next Form 10-K filing, March 30, 2000.

We believe our methodology is based on the best available evidence and results in appropriate measurement dates under US GAAP then applicable for our historical stock-based awards during the Investigation Period.

### *Tax Adjustments*

#### *Withholding Taxes*

In addition to the stock-based compensation charges, we also have recorded payroll tax-related expense related to our stock-based awards. We have determined that numerous stock options previously classified as incentive stock options (ISO) did not meet the criteria to qualify as ISOs since they were issued in the money based on the Revised Measurement Dates. As we mistakenly believed those options were ISOs, we did not withhold and pay certain employee income and payroll taxes on their exercise. Consequently, we have recorded additional expense, along with penalties and interest, in the periods of exercise. These expenses have been reversed in the period when the statute of limitations expired. Tax-related liabilities related to the disqualification of the ISO status of stock options and withholding taxes were approximately \$80,000 at December 30, 2006.

#### *Section 409A*

Under Section 409A of the Internal Revenue Code (Section 409A), individuals who received option grants with an exercise price below the fair market value of the underlying stock at the Revised Measurement Date may be subject to additional taxes and interest with respect to options that vest after December 25, 2004. Absent corrective action by December 31, 2008 (or exercise, if earlier) holders of these stock options will be required to recognize ordinary income for federal income tax purposes as those options vest. Pursuant to interim Internal Revenue Service guidance, applicable to 2005 and 2006, the income is calculated as the difference between the fair market value of the underlying stock and the exercise price as of December 31 of the year of vesting. The individual must also recognize, in each subsequent year until the option is fully exercised or expires, ordinary income equal to the excess of the fair market value of the underlying stock over the sum of the exercise price and any previously recorded income. In addition to ordinary income taxes, an additional 20% penalty tax on the resulting ordinary income is levied on the individual, plus in certain instances interest on any tax to be paid. Certain states (e.g. California) take or may take the position that some or all of the same consequences, including the 20% penalty tax, will also apply for state purposes.

We intend to reimburse our employees and former employees for the additional taxes arising under Section 409A due to the exercise of certain stock options in 2006. As a result, we anticipate incurring expenses of approximately \$10,000. In order to avoid future tax consequences of 409A, we anticipate executing a tender offer to repurchase options which will give rise to taxes under 409A following the filing of this Form 10-K. We estimate the aggregate cash payments to option holders under the program to be in the range of \$200,000 to \$500,000.

#### *Income Taxes*

Due to our net operating loss position and full valuation against our deferred tax assets, there was no income tax impact related to this restatement.

**Table of Contents***Other Adjustments*

The restatement of prior year financial statements includes adjustments in 2005 and 2004 of \$372,000 and \$303,000, respectively, for other errors identified in those periods, however such errors were not previously recorded as we concluded the amount of such errors, both individually and in the aggregate, were not material to the consolidated financial statements of any period. These errors related to inventory reserves and incentive and other miscellaneous accruals. In preparation for the adoption of FIN 48, we performed a review of our tax attributes and made adjustments to such attributes in the appropriate period. As a result of the valuation allowance against the deferred tax assets there was no impact to the consolidated balance sheet. We corrected certain interim period statements of cash flows to reflect construction in progress accrued but not paid at the end of the period as a non-cash item. We also determined we have two reportable segments. Accordingly, we have corrected our disclosures in the notes to the Consolidated Financial Statements.

The following reflects the additional stock-based compensation expense, payroll tax expense and other adjustments recorded by us for the restatement described above (in thousands):

	Change in Stock-Based Compensation Expense Related to Restatement	Payroll Taxes	Change in Net Loss (Income) Related to Restatement of Stock-Based Compensation	Other Adjustments	Change in Net Loss (Income) Related to Restatement	Stock-Based Compensation Expense, Net of Tax, as Previously Reported	Stock-Based Compensation Expense, Net of Tax, As Restated
1995	\$	\$	\$	\$	\$	\$ 131	\$ 131
1996	197		197		197	67	264
1997	1,666	103	1,769		1,769	76	1,742
1998	1,860	37	1,897		1,897	67	1,927
1999	4,646	631	5,277		5,277	55	4,701
2000	5,834	2,442	8,276		8,276	55	5,889
2001	8,209	582	8,791		8,791	55	8,264
2002	6,489	(609)	5,880		5,880		6,489
2003	5,263	(2,502)	2,761		2,761	20	5,283
Cumulative Expense	34,164	684	34,848		34,848		
2004	2,458	(614)	1,844	(303)	1,541	505	2,963
2005	749	46	795	372	1,167	1,298	2,047
2006(1)	41	4	45		45		
	\$ 37,412	\$ 120	\$ 37,532	\$ 69	\$ 37,601		

(1) For the period January 1, 2006 to July 1, 2006.

The cumulative impact to net (loss) income for the years ended December 31, 1995 through 2003 is reflected as an increase to additional paid-in-capital of \$37.6 million, an increase of deferred compensation of \$3.4 million, an increase in other accrued liabilities of \$0.7 million, and an increase to accumulated deficit of \$34.8 million as of January 1, 2004. The payroll tax adjustment in 2002 includes \$383,000 of additional taxes resulting from the failure to withhold taxes upon the exercise of non-qualified options.

*Expenses*

We incurred approximately \$3.7 million in costs for legal fees, external audit firm fees, and external consulting fees in the twelve months ended December 30, 2006 related to the investigation and restatement of our financial statements.





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## **Table of Contents**

### **Critical Accounting Policies and Estimates**

Management's discussion and analysis of our financial condition and results of operations are based upon our audited consolidated financial statements. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to bad debts, inventories, investment valuations, recoverability of deferred tax assets and contingencies. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities that are not apparent from other sources. Actual results may differ from these estimates under different assumptions.

We believe the following critical accounting policies are most affected by our more significant judgments and estimates used in the preparation of our consolidated financial statements:

#### *Revenue Recognition*

We recognize revenue in accordance with Securities and Exchange Commission (SEC) Staff Accounting Bulletin No. 104, Revenue Recognition (SAB 104). SAB 104 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred and services rendered; (3) the price to the buyer is fixed or determinable; and (4) collectability is reasonably assured. We do not recognize revenue for products prior to customer acceptance unless we believe the product meets all customer specifications and has a history of consistently achieving customer acceptance of the product. Provisions for product returns and allowances are recorded in the same period as the related revenues. We analyze historical returns, current economic trends and changes in customer demand and acceptance of product when evaluating the adequacy of sales returns and other allowances. Certain product sales are made to distributors under agreements allowing for a limited right of return on unsold products. Sales to distributors are primarily made for sales to the distributors' customers and not for stocking of inventory. We delay revenue recognition for our estimate of distributor claims of right of return on unsold products based upon our historical experience with our products and specific analysis of amounts subject to return based upon discussions with our distributors or their customers.

We recognize revenues from long-term research and development contracts on the percentage-of-completion method of accounting as work is performed, based upon the ratio of costs or hours already incurred to the estimated total cost of completion or hours of work to be performed. Revenue recognized at any point in time is limited to amounts earned under milestones included in contracts, if such provisions exist. We account for product development and research contracts that have established prices for distinct phases as if each phase were a separate contract. We classify amounts earned on contracts in progress that are in excess of amounts billed as unbilled receivables and we classify amounts received in excess of amounts earned as billings in excess of revenues earned. We invoice based on dates specified in the related agreement or in periodic installments based upon our invoicing cycle. We recognize the entire amount of an estimated ultimate loss in our financial statements at the time the loss on a contract becomes known. If our estimate of total contract costs or our determination of whether the customer agrees that a milestone is achieved is incorrect, our revenue could be overstated and profits would be negatively impacted.

#### *Bad Debt*

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. This estimate is based on an analysis of specific customer creditworthiness and historical bad debts experience. If the financial condition of our customers were to deteriorate, resulting in their inability to make future payments, additional allowances may be required.

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**Table of Contents***Inventory*

We provide a reserve for estimated obsolete or unmarketable inventory based on assumptions about future demand and market conditions and our production plans. Inventories that are obsolete or slow moving are generally fully reserved as such information becomes available. Our III-V products are made to each customer's unique specifications and are generally produced upon receipt of a customer order. The manufacturing time to make our III-V products is less than one day; accordingly our III-V inventory consists primarily of raw material, primarily gallium arsenide wafers, or finished products. The finished product may be at our facilities or at our customer's facilities under consignment programs. Our display products are manufactured based upon production plans whose critical assumptions include non binding demand forecasts provided by our customers, lead times for raw materials, lead times for wafer foundries to perform circuit processing and yields. If a customer were to cancel an order or actual demand was lower than forecasted demand, we could not sell the excess III-V inventory and we may not be able to sell the excess display inventory and additional reserves would be required. If we were unable to sell the excess inventory, we would establish reserves to reduce the inventory to its estimated realizable value (generally zero).

*Investment Valuation*

We hold a minority investment in Micrel, Incorporated, a publicly traded company whose share prices may be highly volatile. We consider this investment to be available for sale and accordingly account for fluctuations in the value of this investment in accumulated other comprehensive income. If, however, we were to determine that the fair value of this investment had been other than temporarily impaired, we would be required to charge the loss directly to the statement of operations. This investment had a fair market value of \$2.2 million at December 30, 2006, which was in excess of our carrying value at that date. The determination that a decline is other-than-temporary is subjective and influenced by many factors. When assessing a publicly-traded investment for an other-than-temporary decline in value, we consider such factors as, among other things, how significant the decline in value is as a percentage of the original cost, how long the market value of the investment has been less than its original cost, the performance of the investee's stock price in relation to the stock price of its competitors within the industry and the market in general and analyst recommendations. We also review the financial statements of the investee to determine if the investee is experiencing financial difficulties. In the event our judgments change as to other-than-temporary declines in value, we may record an impairment loss, which could have an adverse impact on our results of operations.

We periodically make equity investments in private companies, accounted for on the cost or equity method, whose values are difficult to determine. When assessing investments in private companies for an other-than-temporary decline in value, we consider such factors as, among other things, the share price from the investee's latest financing round, the performance of the investee in relation to its own operating targets and its business plan, the investee's revenue and cost trends, the liquidity and cash position, including its cash burn rate and market acceptance of the investee's products and services. We provide for an impairment valuation if we believe a decline in the value of an investment is other-than-temporary.

*Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed of*

In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, we periodically review the carrying value of our long-lived assets to determine if facts and circumstances suggest that they may be impaired or that the amortization or depreciation period may need to be changed. The carrying value of a long-lived asset is considered impaired when the anticipated identifiable undiscounted cash flows from such asset are less than its carrying value. For assets that are to be held and used, impairment is measured based upon the amount by which the carrying amount of the asset exceeds its fair value. If our estimates of anticipated future cash flows or market conditions were incorrect, additional impairment charges may be required. During fiscal years 2005 and 2004, we recognized \$0.5 million and \$5.3 million, respectively, of impairment charges related to assets held for use or being transferred to the KoBrite joint venture and long-lived assets supporting the III-V business. We did not incur any impairment charges in 2006.

## **Table of Contents**

### *Product Warranty*

We generally sell products with a limited warranty of product quality and a limited indemnification of customers against intellectual property infringement claims related to our products. We accrue for known warranty and indemnification issues if a loss is probable and can be reasonably estimated. As of December 30, 2006, we had a warranty reserve of \$1.0 million, which represents the estimated liabilities for warranty claims in process, potential warranty issues customers have notified us about and an estimate based on historical failure rates. For the fiscal years 2006, 2005 and 2004, our warranty expense was approximately \$0.4 million, \$0.8 million, and \$1.0 million, respectively. If our estimates for warranty claims are incorrect, our revenue could be overstated and profits would be negatively impacted.

### *Income Taxes*

The Company has historically incurred domestic operating losses for book and taxable income. We establish valuation allowances if it appears more likely than not that our deferred tax assets will not be realized. These judgments are based on our projections of taxable income and the amount and timing of our tax operating loss carryforwards and other deferred tax assets. Given our federal operating tax loss carryforwards, we do not expect to pay domestic federal taxes in the near term. It is possible that we could pay domestic alternative minimum taxes and state income taxes. We are also subject to foreign taxes from our Korean subsidiary operations.

Our income tax provision is based on calculations and assumptions that will be subject to examination by tax authorities. Despite our history of operating losses there can be exposures for state taxes, federal alternative minimum taxes or foreign tax that may be due. We regularly assess the potential outcomes of these examinations and any future examinations for the current or prior years in determining the adequacy of our provision for income taxes. Should the actual results differ from our estimates, we would have to adjust the income tax provision in the period in which the facts that give rise to the revision become known. Such adjustment could have a material impact on our results of operations. We also establish valuation allowances when recovery of such net deferred tax assets is not considered more likely than not. These judgments consider our historical results and forecasts of future results. Because of our history of operating losses, our net operating loss carryforwards have had a full valuation allowance associated with them.

### *Stock Compensation*

Effective January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R), using the modified-prospective-transition method. Under this transition method, compensation cost recognized includes compensation costs for all share-based payments granted prior to, but not yet vested as of December 31, 2005 based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and compensation cost for all share-based payments granted subsequent to December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. Prior period amounts have not been restated.

We estimate the fair value of each stock-based award on the date of grant using the Black-Scholes-Merton option valuation model. The Black-Scholes-Merton option valuation model incorporates assumptions as to stock price volatility, the expected life of options, a risk-free interest rate and dividend yield. Many of these assumptions are highly subjective and require the exercise of management judgment. Our management must also apply judgment in developing an estimate of awards that may be forfeited. If our actual experience differs significantly from our estimates and we choose to employ different assumptions in the future, the stock-based compensation expense that we record in future periods may differ materially from that recorded in the current period.

**Table of Contents***Results of Operations*

We are a leading developer and manufacturer of advanced semiconductor materials and miniature displays. We use our proprietary semiconductor material technology to design, manufacture and market our III-V and CyberDisplay products for use in highly demanding commercial wireless communications and high-resolution portable consumer electronic applications. Our products enable our customers to develop and market an improved generation of products for these target applications.

Our fiscal year ends on the last Saturday in December. The fiscal year ended December 31, 2005 includes 53 weeks and the fiscal years ended December 30, 2006 and December 25, 2004 each include 52 weeks. The fiscal years ended December 30, 2006, December 31, 2005 and December 25, 2004 are referred to as fiscal years 2006, 2005 and 2004, respectively, herein.

We have two principal sources of revenues: product revenues and research and development revenues. Product revenues consist of sales of our III-V products, principally gallium arsenide ( GaAs ) HBT transistor wafers, and CyberDisplay products. Research and development revenues consist primarily of development contracts with agencies of the U.S. government. Research and development revenues were \$5.2 million, or 7% of total 2006 revenues, \$5.0 million, or 6% of total revenues in 2005, and \$2.1 million, or 2% of total revenues in 2004.

In the fourth quarter of 2004, we entered into a joint venture, KoBrite Corp (KoBrite), with a Taiwanese-based light emitting diode (LED) manufacturer, Kopin Taiwan Corporation (a Taiwanese-based III-V manufacturer), and financial investors, in which we agreed to transfer our CyberLite LED technology and production know-how and \$3.0 million of cash for a 23% interest in KoBrite. Subsequent to its formation, KoBrite entered into agreements with us to purchase certain equipment and have us perform research and training activities with KoBrite employees until KoBrite's facilities were constructed and ready to receive the equipment. Under the agreements, KoBrite agreed to pay us an estimated net \$5.8 million for the equipment and \$1.7 million for research and training activities and reimbursement for costs incurred in the transfer of the equipment. In the year ended December 31, 2005, we had received the approximately \$5.8 million for the equipment. In the years ended December 30, 2006 and December 31, 2005, we received approximately \$0.8 and \$0.7 million respectively, for the research and training activities. We have discontinued manufacturing and development efforts for CyberLite LEDs. We retain the right to market KoBrite's LEDs in the United States and to certain Japanese customers. For the fiscal years 2006, 2005 and 2004, our CyberLite LED revenues, including product sales and research and development revenues were \$0.8 million, \$1.3 million and \$2.3 million, respectively.

Kowon, our Korean subsidiary and one of our reportable segments, provides back-end packaging services related to our CyberDisplay products to us as well as selling displays to other customers.

***Fiscal Year 2006 Compared to Fiscal Year 2005***

*Revenues.* Our revenues, which include product sales and amounts earned from research and development contracts, for fiscal years 2006 and 2005, were as follows:

<b>Revenues</b>	<b>2006</b>	<b>2005</b>
III-V	\$ 43.9	\$ 42.7
CyberDisplay	27.2	47.6
<b>Total</b>	<b>\$ 71.1</b>	<b>\$ 90.3</b>

The increase in our III-V revenues resulted from a net increase in unit demand for our HBT transistor wafers from customers that use them in wireless handset applications, which was partially off set by price declines of our HBT products and a decline in our CyberLite revenues, which were \$0.8 million and \$1.3 million for the years ended 2006 and 2005, respectively. Our CyberLite revenues declined because we transferred the product line to the KoBrite joint venture discussed above. The decrease in display revenues in fiscal year 2006 compared

**Table of Contents**

to fiscal year 2005 resulted from a decline in sales of our CyberDisplay products to customers that use them for camcorder applications partially offset by an increase in military application sales. For 2006 we had anticipated that sales of our displays to customers who buy our displays for camcorder applications would decrease as compared to the prior year but this would be partially offset by an increase in sales to customers who purchased our displays for military applications as compared to the prior year. Although the sales of our displays to customers for camcorder applications did decline in 2006, shipments of our displays to customers for military applications occurred sporadically during the year as our customers worked to get their products qualified with the U.S. military and therefore sales of our products for military applications was lower than we anticipated. In addition, sales of our displays for use in consumer electronic applications were lower than in 2005. Display sales for consumer and military applications for 2006 and 2005 were as follows:

<b>CyberDisplay Revenues by Category</b>	<b>2006</b>	<b>2005</b>
Consumer Electronic Applications	\$ 9.0	\$ 31.6
Military Application	11.3	10.0
Eyewear Application	3.3	1.8
Research & Development	3.6	4.2
<b>Total</b>	<b>\$ 27.2</b>	<b>\$ 47.6</b>

Revenues of our Korean subsidiary, Kowon, are included in CyberDisplay revenues and declined from \$26.3 million in 2005 to \$8.9 million in 2006. Kowon's sales are primarily to us and Samsung Electronics for camcorder applications and declined as a result of lesser demand from camcorder customers. Kowon's sales to us for 2006 and 2005 were \$2.9 million and \$12.0 million, respectively.

Based on current discussions with our customers and certain contractual obligations, we expect the prices of certain of our products to decline in fiscal year 2007 and 2008. We anticipate the average selling price of our HBT transistor wafers and display products sold to customers for consumer electronics applications will decline approximately 5% to 10% during fiscal year 2008 relative to 2007 and 2006. The overall increase or decrease in the average sales price of our display will be dependent on the sales mix of commercial and military display sales.

During fiscal year 2006, we acquired metal organic chemical vapor deposition (MOCVD) reactors, which can produce our HBT products on either four or six inch gallium arsenide (GaAs) wafers. However, we acquired the reactors primarily for their ability to process six inch GaAs wafers. We currently have other reactors which also can manufacture HBTs using either four or six inch GaAs wafers and we sell HBT products on both four and six inch GaAs wafers. We believe the industry will migrate to six inch wafers over the next several years. Our largest customer, who accounted for approximately 49% of our 2006 total revenues (see Item 1A, Risk Factors for explanation of percent of revenue calculation), purchases our HBT products on four inch GaAs wafers and we expect this customer will migrate to using six inch GaAs wafers in its manufacturing process. If we are unable to get the new reactors and our other reactors qualified by our largest and other customers or if we are able to get the reactor qualified but can not manufacture the quantity our customers require or can not manufacture on six inch GaAs wafers in a cost effective manner, our revenues and results of operations could decline significantly.

Our Purchase and Supply Agreement with our largest HBT transistor wafer customer, who accounted for approximately 49% of our 2006 total revenues, terminates in July 2008. We are currently renegotiating this agreement; however, if we are unable to renew this agreement or we renew it on less favorable terms our revenue and results of operations may decline.

International sales represented 35%, 44% and 50% of revenues for fiscal years 2006, 2005 and 2004, respectively. The decrease in international sales is primarily attributable to increase in domestic sales of our HBT products and military sales of our display products and a decrease in our international CyberDisplay sales for camcorder applications and our CyberLite LED sales. International sales are primarily sales of CyberDisplay

**Table of Contents**

products to consumer electronic manufacturers primarily located in Japan, Korea and China and CyberLite LED sales to Japan and China. Our international sales are primarily denominated in U.S. currency. Consequently, a strengthening of the U.S. dollar could increase the price in local currencies of our products in foreign markets and make our products relatively more expensive than competitors' products that are denominated in local currencies, leading to a reduction in sales or profitability in those foreign markets. In addition, sales of our CyberDisplay products in Korea are transacted through our Korean subsidiary, Kowon Technology Co., LTD. Kowon's sales are primarily denominated in U.S. dollars. However, Kowon's local operating costs are primarily denominated in Korean won. Kowon also holds U.S. dollars in order to pay various expenses. As a result, our financial position and results of operations are subject to exchange rate fluctuation in transactional and functional currency. We have not taken any protective measures against exchange rate fluctuations, such as purchasing hedging instruments with respect to such fluctuations, because of the historically stable exchange rate between the Japanese yen, Korean won and the U.S. dollar.

*Cost of Product Revenues.*

	2006	2005
Cost of product revenue (in millions)	\$ 49.3	\$ 55.0
Cost of product revenue as a % of revenues	74.7%	64.4%

Cost of product revenues, which is comprised of materials, labor and manufacturing overhead related to our products, decreased approximately \$5.6 million or 10% from 2005 to 2006. Cost of sales of CyberLite products for fiscal year was \$1.0 million for fiscal year 2005. Our gross margin is affected by sales price declines of our products, changes in raw material prices, unit volume of sales, manufacturing efficiencies and the mix of products sold. As discussed above our sales prices historically decline on an annual basis. Our strategy to offset the impact of the sales price declines has been to increase the unit volume of sales, improve manufacturing efficiencies and increase the sales of products which have higher margins, specifically military products. Our overhead costs and, to a lesser extent, our labor costs are normally stable and do not fluctuate significantly during a three or twelve month period. Essentially, we consider labor and overhead costs to be fixed in nature over the short term and therefore profitability is based on the amount of variable margin we can generate to cover these fixed costs. Variable margin is the product of the number of units sold and the difference between a unit's selling price and its material cost. Gross margins declined in 2006, as compared to 2005, because of a decline in the average unit selling prices of our III-V and display products as compared to 2005 and the impact of the decline in display unit sales in 2006, while the costs of labor and overhead remained approximately the same as 2005. In addition, 2006 cost of product revenues includes approximately \$0.3 million in stock compensation expense resulting from our adoption of SFAS 123R.

There are a number of different display technologies which can produce displays in small form factors. We believe one of the benefits of our display technology is the ability to produce high resolution displays in small form factors. The camcorder and digital still camera markets are mature and the majority of these devices use low-resolution display products which results in our having limited, if any, competitive advantage over our competitors and therefore the ability to sell displays into these markets is very price dependent. Accordingly for us to generate display revenues with above average gross margins, we will need to increase sales to customers who buy our higher resolution display products, such as the military, or develop new categories such as eyewear.

As we discussed above, we expect the sales prices of our products to decline in the future. In addition, we installed a new manufacturing line for our displays and new MOCVD reactors to manufacture our HBT products. These capital equipment investments will increase our depreciation expense by approximately \$2.2 million in 2008. If we are unable to sell higher margin products, primarily displays for military applications, reduce raw material cost or increase manufacturing efficiencies to offset the effects of lower sales price and higher depreciation expense our gross margins will decline.

**Table of Contents**

*Research and Development.* Research and development expenses or R&D are incurred in support of internal display and III-V product development programs or programs funded by agencies of the U.S. government and commercial partners. Research and development costs include staffing, purchases of materials and laboratory supplies, circuit design costs, fabrication and packaging of display products, and overhead. 2006 R&D expense also includes approximately \$0.1 million in stock compensation expense resulting from our adoption of SFAS 123R. For fiscal years 2006 and 2005, R&D expense was as follows (in millions):

<b>Research and development expense</b>	<b>2006</b>	<b>2005</b>
Funded	\$ 4.9	\$ 6.5
Internal	5.3	5.8
<b>Total</b>	<b>\$ 10.2</b>	<b>\$ 12.3</b>

Funded R&D expense decreased in 2006 as compared to the prior year primarily because of the discontinuance of light emitting diode research in 2005 which was partially offset by an increase in R&D expenses for military programs. For fiscal 2005 funded R&D included \$2.0 million to support the KoBrite joint venture.

Internal research and development expenses were \$5.3 million in fiscal year 2006 compared to \$5.8 million for fiscal year 2005. The decrease in internal research and development expenses was primarily attributed to the lower development cost for our CyberLite products offset by development efforts for III-V and display products. During fiscal year 2005, we spent approximately \$0.1 million, including allocated overhead, on CyberLite LED research and development costs.

*Selling, General and Administrative.* Selling, general and administrative (S,G&A) expenses consist of the expenses incurred by our sales and marketing personnel and related expenses, and administrative and general corporate expenses. S,G&A expenses were \$19.3 million in fiscal year 2006 and \$14.1 million for fiscal year 2005. The increase in S,G&A expenses is attributable to increases of approximately \$3.7 million for professional fees associated with the stock option practice investigation, \$0.8 million for stock based compensation expense associated with the vesting of restricted stock awards and \$0.4 million for recurring professional fees. Included in the fiscal year 2006 stock compensation expense is approximately \$1.3 million in stock compensation expense resulting from our adoption of SFAS 123R.

In fiscal years 2006 and 2005, we issued 596,750 and 607,500 restricted stock awards, respectively, to certain of our employees. Each award requires the employee to fulfill certain obligations including continued employment with us for periods of either two or four years (the Restriction Period). In connection with the issuance of the awards, we recorded deferred compensation expenses of \$2.0 million and \$2.9 million for 2006 and 2005, respectively, which are amortized over the Restriction Period, or earlier if the vesting accelerates due to meeting performance conditions. Included in S,G&A expenses for fiscal year 2006 and 2005 was non-cash amortization expense of \$0.6 million and \$1.3 million, respectively.

*Impairment Charge.* In fiscal year 2005, as part of discontinuing our CyberLite LED product line, we terminated the employment of approximately 40 employees and also recorded an additional impairment charge of \$0.5 million.

*Other Income and Expense, Net.* Other income and expense, net was income of \$5.6 million for fiscal year 2006 compared to income of \$3.3 million for 2005. Other income and expense, net includes interest and miscellaneous income of \$5.3 million, \$1.2 million of gain on the sale of Micrel stock, \$0.8 million of foreign exchange losses and \$0.1 million of miscellaneous bank fees and other expense for fiscal year 2006. For fiscal year 2005, other income and expense, net also includes interest and miscellaneous income of \$3.7 million, \$0.2 million of foreign exchange losses and \$0.1 million of miscellaneous bank fees and other expense.



**Table of Contents**

Equity losses in unconsolidated affiliates consist of our approximate 25% share of the losses of KoBrite totaling \$0.6 million in 2006 and \$0.2 million in 2005.

*Minority interest in (loss) income of subsidiary.* We own approximately 73% of the equity of Kowon Technology Co. Ltd. (Kowon). Minority interest on the Consolidated Statement of Operations represents the portion of the results of operations of Kowon which is allocated to the shareholders of the approximately 27% of Kowon not owned by us. The change in the Minority Interest is the result of the change in the results of operations of Kowon.

*Tax (provision) benefit.* The benefit for income taxes for fiscal year 2006 represents the expiration of tax contingencies of \$0.3 million, a tax benefit from a loss carryback of \$0.5 million offset by alternative minimum taxes of \$0.1 million and the write-off of deferred tax assets of \$0.4 million. The fiscal year 2005 provision for taxes represents the expiration of tax contingencies of \$0.4 million partially offset by alternative minimum taxes of \$0.2 million and foreign taxes owed of \$0.5 million.

*Cumulative effect of accounting change.* As of December 31, 2005, the Company adopted Financial Accounting Standards Board (FASB) Interpretation No. 47 (FIN 47) Accounting for Conditional Asset Retirement Obligations an interpretation of Statement of Financial Accounting Standards No. 143. This interpretation clarifies the timing of liability recognition for legal obligations associated with an assets retirement when the timing and or method of settling the obligation are conditional on a future event that may or may not be within the control of the entity. The impact of adopting FIN 47 was to record a cumulative effect of accounting change charge of \$0.4 million to recognize the accumulated depreciation as of the date of adoption related to the obligation for restoration of facilities leased by the Company. Total obligations as of December 30, 2006 are estimated to be \$0.8 million.

**Fiscal Year 2005 Compared to Fiscal Year 2004**

*Revenues.* Our revenues for fiscal years 2005 and 2004 were as follows:

Revenues	2005	2004
III-V	\$ 42.7	\$ 38.2
CyberDisplays	47.6	49.1
<b>Total</b>	<b>\$ 90.3</b>	<b>\$ 87.3</b>

The increase in III-V revenues resulted from an increase in demand for our HBT transistor wafers from customers that use them in wireless handset applications. The increase in demand for our HBT transistor wafers was offset by a reduction in our CyberLite revenues, which were \$0.7 million and \$2.3 million, for the years ended 2005 and 2004, respectively. The decrease in display revenues, which include both product and research and development contract revenue, in fiscal year 2005 compared to fiscal year 2004 resulted from a decline in sales of our CyberDisplay products to customers that use them for camcorder applications, partially offset by an increase in military application sales.

Revenues of our Korean subsidiary, Kowon, are included in CyberDisplay revenues and declined from \$30.6 million in 2004 to \$26.3 million in 2005. Kowon's sales are primarily to us and Samsung Electronics. Kowon's revenues declined because of lower sales prices and lower demand from camcorder customers. Kowon's sales to us for 2005 and 2004 were \$12.0 million and \$5.0 million, respectively.

International sales represented 44% and 50% of product revenues for fiscal years 2005 and 2004, respectively. The decrease in international sales is primarily attributable to increase in domestic sales of our HBT products and military sales of our display products and a decrease in our international CyberDisplay sales for camcorder applications and our CyberLite LED sales. International sales are primarily sales of CyberDisplay products to consumer electronic manufacturers primarily located in Japan, Korea and China and CyberLite LED sales to Japan. Our international sales are primarily denominated in U.S. currency. Consequently, a strengthening

**Table of Contents**

of the U.S. dollar could increase the price in local currencies of our products in foreign markets and make our products relatively more expensive than competitors' products that are denominated in local currencies, leading to a reduction in sales or profitability in those foreign markets. In addition, sales of our CyberDisplay products in Korea are transacted through our Korean subsidiary Kowon Technology Co., LTD. Kowon's sales are primarily denominated in U.S. dollars. However, Kowon's local operating costs are primarily denominated in Korean won. Kowon also holds U.S. dollars in order to pay various expenses. As a result, our financial position and results of operations are subject to exchange rate fluctuation in transactional and functional currency. We have not taken any protective measures against exchange rate fluctuations, such as purchasing hedging instruments with respect to such fluctuations, because of the historically stable exchange rate between the Japanese yen, Korean won and the U.S. dollar.

*Cost of Product Revenues.*

	2005	2004
Cost of product revenue (in millions)	\$ 55.0	\$ 73.2
Cost of product revenue as a % of revenues	64.4%	85.9%

Cost of product revenues, which is comprised of materials, labor and manufacturing overhead related to our products, decreased approximately \$18.3 million or 25% from 2004 to 2005. The decrease in cost of product revenues as a percentage of product sales primarily resulted from an improvement in manufacturing yields, a reduction in cost of sales of our optical product line as a result of the transfer of the optical assets to the KoBrite joint venture, lower costs for certain raw materials, and \$0.7 million from the sale of inventory previously written off. Yield improvements were driven by improved efficiencies from higher volumes and favorable sales mix. Cost of sales of CyberLite products for fiscal year 2005 was \$1.0 million versus \$6.8 million for fiscal year 2004. The decrease was due to the sale of certain CyberLite LED assets to the KoBrite joint venture and the discontinuation of the use of the remaining CyberLite LED assets, including equipment. Gross margin percentage was further increased because of higher military sales, which have higher margins, and a reduction in depreciation expense of approximately \$2.2 million.

*Research and Development.* Research and development expenses are incurred in support of internal display and III-V product development programs or programs funded by agencies of the U.S. government and commercial partners. Research and development costs include staffing, purchases of materials and laboratory supplies, circuit design costs, fabrication and packaging of display products, and overhead. Funded research and development expenses were \$6.5 million in fiscal year 2005 as compared to \$2.3 million for fiscal year 2004, an increase of \$4.2 million. The increase resulted primarily from contracts with the U.S. Military to support advanced multi-spectral imaging displays.

Internal research and development expenses were \$5.8 million in fiscal year 2005 compared to \$12.7 million for fiscal year 2004. The decrease in internal research and development expenses was primarily attributed to the lower development cost for our CyberLite products offset by development efforts for III-V and display products. During fiscal year 2005 and 2004, we spent approximately \$0.1 million and \$6.2 million, respectively, including allocated overhead, on CyberLite LED research and development costs.

*Selling, General and Administrative.* Selling, general and administrative (S,G&A) expenses consist of the expenses incurred by our sales and marketing personnel and related expenses, and administrative and general corporate expenses. S,G&A expenses were \$14.1 million in fiscal year 2005 and \$10.2 million for fiscal year 2004. The increase in S,G&A expenses is attributable to an increase of approximately \$3.0 million of deferred stock compensation associated with the vesting of restricted stock awards, \$0.4 million for professional fees and \$0.3 million for reimbursement to KoBrite for equipment damaged in transit to KoBrite facilities. Further affecting the comparison between 2005 and 2004 was that in 2004 we recorded credits of \$0.9 million to bad debt expense as a result of improved credit profile of our receivables and \$3.5 million for the reversal of accruals for withholding taxes.

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**Table of Contents**

In fiscal years 2005 and 2003, we issued 607,500 and 272,500 restricted stock awards, respectively, to certain of our employees. Each award requires the employee to fulfill certain obligations including continued employment with us for periods of either two or four years (the Restriction Period). In connection with the issuance of the awards we recorded deferred compensation expenses of \$2.9 million and \$1.4 million for 2005 and 2003, respectively, which are amortized over the Restriction Period, or earlier if the vesting accelerates due to meeting performance conditions. Included in S,G&A expenses for fiscal year 2005 and 2004 was non-cash amortization expense of \$1.3 million and \$0.5 million, respectively.

*Other.* Other expenses, primarily amortization of patents and licenses, were \$0 for fiscal year 2005 compared to \$0.2 million for fiscal year 2004.

*Impairment Charge.* In connection with the KoBrite joint venture agreement discussed above, we entered into an agreement to transfer certain assets of its CyberLite LED product line and discontinued the use of the remaining CyberLite LED product line assets. As a result of these actions we recorded a charge of approximately \$2.1 million in the fourth quarter of fiscal year 2004 to reduce the equipment to its estimated fair value of \$5.8 million. In addition, because the CyberLite LED product line assets were operated in a facility with some of the HBT transistor product line assets, the facility assets (primarily leasehold improvements) were grouped with all HBT product line assets and evaluated for future recovery based on the cash flows anticipated to be generated by the HBT product line assets. Based on this evaluation, we recorded a \$3.2 million impairment charge to reduce the HBT product line assets to their estimated fair value. The \$2.1 million equipment write-down and the \$3.2 million impairment charge are shown as a \$5.3 million impairment charge in the 2004 statement of operations. In fiscal year 2005, as part of discontinuing our CyberLite LED product line, we terminated the employment of approximately 40 employees and also recorded an additional impairment charge of \$0.5 million.

*Other Income and Expense, Net.* Other income and expense, net was income of \$3.3 million for fiscal year 2005 compared to income of \$1.9 million for 2004. Other income and expense, net includes interest and miscellaneous income of \$3.7 million, \$0.2 million of foreign exchange losses and \$0.1 million of miscellaneous bank fees and other expense for fiscal year 2005. For fiscal year 2004, other income and expense, net includes interest and miscellaneous income of \$3.0 million, \$1.0 million of foreign exchange losses and \$0.1 million of miscellaneous bank fees and other expense.

Equity losses in unconsolidated affiliates includes our approximate 23% share of the losses of KoBrite totaling \$0.2 million in 2005 and our approximate 40% share of the losses of Kopin Taiwan Corporation of \$0.9 million in 2004.

*Minority interest in (loss) income of subsidiary.* We own approximately 73% of the equity of Kowon Technology Co. Ltd. (Kowon). Minority interest on the Consolidated Statement of Operations represents the portion of the results of operations of Kowon which is allocated to the shareholders of the approximately 27% of Kowon not owned by us. The change in the Minority Interest is the result of the change in the results of operations of Kowon.

*Tax (provision) benefit.* The provision for taxes for fiscal year ended 2005 represents the expiration of tax contingencies of \$0.4 million partially offset by alternative minimum taxes owed to U.S. federal and state taxing authorities of \$0.2 million and foreign taxes on the income of our subsidiary Kowon of \$0.5 million. The benefit for income taxes for fiscal year ended 2004 represents the expiration of tax contingencies of \$0.3 million partially offset by foreign taxes on the income of our subsidiary Kowon \$0.1 million.

*Cumulative effect of accounting change.* As of December 31, 2005, the Company adopted FIN 47. The impact of adopting FIN 47 was to record a cumulative effect of accounting change charge of \$0.4 million to recognize the accumulated depreciation as of the date of adoption related to the obligation for restoration of facilities leased by the Company. Total obligations as of December 31, 2005 are estimated to be \$0.7 million.

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**Table of Contents**

**Liquidity and Capital Resources**

We have financed our operations primarily through public and private placements of our equity securities, research and development contract revenues, and sales of our III-V and CyberDisplay products. In November 2001, we filed a registration statement using a shelf registration process that allowed us to offer shares of common stock or debt securities, the aggregate total of which will not exceed \$150.0 million. Under the shelf registration statement, we issued an aggregate of 3,000,000 shares for an aggregate of \$42.0 million under this registration statement. The shelf registration statement has expired and no further securities may be issued pursuant to it. We believe our available cash resources will support our operations and capital needs for at least the next twelve months.

As of December 30, 2006, we had cash and equivalents and marketable securities of \$105.4 million and working capital of \$116.3 million compared to \$119.8 million and \$129.0 million, respectively, as of December 31, 2005. The decrease in cash and equivalents and marketable securities was primarily due to cash provided by operating activities of \$0.6 million, proceeds from the sale of investments of \$3.0 million and proceeds from the exercise of stock options of \$0.5 million, offset by capital expenditures of \$7.8 million, additional investments in equity and cost basis affiliates (KoBrite, Kenet and AWSC) totaling \$5.0 million and repurchases of our common stock of approximately \$7.3 million.

As of September 29, 2007, we had cash and equivalents and marketable securities of \$94.1 million and working capital of \$109.2 million compared to \$105.4 million and \$116.3 million, respectively, as of December 30, 2006. The decrease in cash and equivalents and marketable securities was primarily due to cash used in operating activities of \$5.7 million, capital expenditures of \$5.7 million, additional investments Kowon of \$1.0 million offset by proceeds from the exercise of stock options of \$0.3 million and the effect of exchange rates on cash of \$.3 million.

In December 2005, we amended a purchase and supply agreement with a significant HBT customer that now expires in July 2008, excluding a last time buy option contained in the agreement. Under the terms of this agreement, we have agreed to maintain capacity levels for manufacturing HBT wafers and we committed to a pricing schedule under certain circumstances. The agreement also requires us to give prior notice if we exit our HBT product line. In consideration for this agreement, the customer agreed to source 100% of its HBT wafer needs from us subject to the customer's right to source HBT wafers from other sources if we are unable to meet their requirements under certain circumstances. We agreed that failure to meet our supply obligations under the agreement would allow our customer to obtain court ordered specific performance and if we do not perform we could then be liable for monetary damages up to a maximum of \$45 million.

We lease facilities located in Taunton and Westborough, Massachusetts, and Scotts Valley, California, under non-cancelable operating leases. We have two Taunton facilities, one whose lease expires in 2010 and the other in 2012. The Taunton lease expires in 2010 and may be extended twice for individual 10 year terms. The Westborough and Scotts Valley leases expire in 2012.

We expect to expend between \$5.0 and \$9.0 million on capital expenditures over the next twelve months, primarily for the acquisition of equipment to increase capacity in our III-V product line and implement the 8" production line for our CyberDisplay products.

On October 9, 2002, we authorized the repurchase of up to \$15.0 million of our common stock over a two year period. Through September 23, 2004, we repurchased 103,200 shares of our common stock under this program for \$378,319, an average of \$3.67 per share. Subsequently, our Board of Directors authorized an extension of this stock repurchase program for up to \$14,621,682 of our common stock through October 2006. In fiscal year 2006, under this program, we repurchased 1,670,000 shares of our common stock for \$6,933,899, an average of \$4.15 per share. The total of our repurchased shares, under this program, as of December 30, 2006 is 3,563,200 shares for \$14,275,139, an average of \$4.01 per share.

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## **Table of Contents**

As of December 30, 2006, we had substantial tax loss carry-forwards, which may be used to offset future federal taxable income. We may be subject to alternative minimum taxes, foreign taxes and state income taxes depending on our taxable income and sources of taxable income.

### **Recent Accounting Pronouncements**

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 151, *Inventory Costs*. SFAS No. 151 requires abnormal amounts of inventory costs related to idle facility, freight handling and wasted material expenses to be recognized as current period charges. Additionally, SFAS 151 requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The adoption did not have a material impact on our results of operations and financial condition.

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), which requires the recognition of compensation cost for all share-based payments (including employee stock options) at fair value. The Company adopted SFAS No. 123R using the modified prospective application transition method. Under this method, compensation cost is recognized for the unvested portion of share-based payments granted before December 31, 2005 and all share-based payments granted subsequent to December 31, 2005 over the related vesting period. Prior to January 1, 2006, the Company applied the intrinsic values based method prescribed in the Accounting Principle Board Opinion No. 25 in accounting for employee stock-based compensation. Prior period results have not been restated as a result of this change. Due to the adoption of SFAS No. 123R, the Company results from continuing operations for fiscal year 2006 include incremental share-based compensation expense totaling \$1.8 million. As such, basic and fully diluted earnings per share from continuing operations were impacted by \$0.03.

On November 10, 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position No. FAS 123R-3, *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards*. The Company elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of stock-based compensation pursuant to SFAS No. 123R in the fourth quarter of fiscal 2006. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee stock-based compensation awards that are fully vested and outstanding upon adoption of SFAS No. 123R. The adoption did not have a material impact on our consolidated results of operations and financial condition.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48), which clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 prescribes a two-step process to determine the amount of tax benefit to be recognized. First, the tax position must be evaluated to determine the likelihood that it will be sustained upon external examination. If the tax position is deemed more-likely-than-not to be sustained, the tax position is then assessed to determine the amount of benefit to recognize in the financial statements. The amount of the benefit that may be recognized is the largest amount that has a greater than 50% likelihood of being realized upon ultimate settlement. The Company adopted FIN 48 on January 1, 2007. The adoption of FIN 48 did not have a material impact on our consolidated results of operations or financial condition.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which enhances existing guidance for measuring assets and liabilities at fair value. SFAS No. 157 defines fair value, establishes a framework for measuring fair value and expands disclosure about fair value measurements. SFAS No. 157 is

**Table of Contents**

effective for the Company's fiscal year beginning December 30, 2008. We are currently assessing the impact, if any, that SFAS No. 157 will have on the results of our operations, financial position or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 permits an entity to choose, at specified election dates, to measure eligible financial instruments and certain other items at fair value that are not currently required to be measured at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. SFAS No. 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those financial years. At the effective date, an entity may elect the fair value option for eligible items that exist at that date. The entity shall report the effect of the first remeasurement to fair value as a cumulative-effect adjustment to the opening balance of retained earnings. We are currently evaluating the impacts and disclosures of this standard, but would not expect SFAS No. 159 to have a material impact on our consolidated results of operations or financial condition.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. SFAS No. 160 amends Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, to establish accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. SFAS No. 160 is effective for the Company on December 28, 2008, except for the presentation and disclosure requirements which will be applied retrospectively for all periods presented.

Also in December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*. SFAS No. 141(R) requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. It requires acquisition-related costs and restructuring costs that the acquirer expects but is not obligated to incur to be recognized separately from the acquisition. SFAS No. 141(R) modifies the criteria for the recognition of contingencies as of the acquisition date. It also provides guidance on subsequent accounting for acquired contingencies. SFAS No. 141(R) is effective for business acquisitions for which the acquisition date is on or after December 28, 2008. We may not apply it before that date. SFAS 141(R) will not impact our accounting for prior acquisitions.

**Seasonality**

The markets we sell into are traditionally seasonal and we would expect that as our business matures, our third quarter would be our strongest sales quarter followed by our second quarter then our fourth quarter and our first quarter would be our lowest sales quarter.

**Inflation**

We do not believe our operations have been materially affected by inflationary forces.

**Contractual Obligations**

The following is a summary of our contractual payment obligations for operating leases as of December 30, 2006:

<b>Contractual Obligations</b>	<b>Total</b>	<b>Less than 1 year</b>	<b>1-3 Years</b>	<b>3-5 years</b>	<b>More than 5 years</b>
Operating Lease Obligations	\$ 6,631,636	\$ 1,264,130	\$ 2,731,549	\$ 2,133,442	\$ 502,515

## **Table of Contents**

### **Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

We invest our excess cash in high-quality government, government-backed and corporate debt instruments, which bear lower levels of relative risk. We believe that the effect, if any, of reasonably possible near-term changes in interest rates on our financial position, results of operations, and cash flows should not be material to our cash flows or income. It is possible that interest rate movements would increase our unrecognized gain or loss on interest rate securities. Included in other assets is an equity investment in Micrel, Incorporated (Micrel) totaling approximately \$2.2 million which is subject to changes in value because of either specific operating issues at Micrel or overall changes in the stock market. We are exposed to changes in foreign currency exchange rates primarily through our translation of our foreign subsidiary's financial position, results of operations, and transaction gains and losses as a result of non-U.S. dollar denominated cash flows related to business activities in Asia, and remeasurement of United States dollars to the functional currency of our Kowon subsidiary. We do not currently hedge our foreign currency exchange rate risk. We estimate that any market risk associated with our international operations is unlikely to have a material adverse effect on our business, financial condition or results of operation. Our portfolio of marketable debt securities is subject to interest rate risk although our intent is to hold securities until maturity. The credit rating of our investments may be affected by the underlying financial health of the guarantors of our investments. We use gallium arsenide and silicon wafers and demand is expected to grow due to new technologies such as solar cells. We do not enter into forward or futures hedging contracts.

### **Item 8. *Financial Statements and Supplementary Data***

The financial statements required by this Item are included in this Report on pages 88 through 133 Reference is made to Item 15 of this Report.

### **Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure***

Not Applicable.

### **Item 9A. *Controls and Procedures***

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15 as of the end of the period covered by this report.

#### **Evaluation of Disclosure Controls and Procedures**

We conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (Disclosure Controls) as of the end of the period covered by this Form 10-K. The controls evaluation was conducted under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer. Disclosure Controls are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Exchange Act, such as this Form 10-K, is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission's (SEC's) rules and forms. Disclosure Controls are also designed to reasonably assure that such information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Our quarterly evaluation of Disclosure Controls includes an evaluation of some components of our internal control over financial reporting, and internal control over financial reporting is also separately evaluated on an annual basis for purposes of providing the management report which is set forth below.

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**Table of Contents**

The evaluation of our Disclosure Controls included a review of the controls' objectives and design, our implementation of the controls and the effect of the controls on the information generated for use in this Form 10-K. During the course of our evaluation of our internal control over financial reporting, we advised the Audit Committee of our Board of Directors that we had identified material weaknesses as defined under standards established by the Public Company Accounting Oversight Board (United States). A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. The material weaknesses we identified are discussed in Management's Report on Internal Control Over Financial Reporting below. A significant deficiency is defined as a control deficiency, or combination of deficiencies, that adversely affects our ability to initiate, authorize, record, process or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of our financial statements that is more than inconsequential will not be prevented or detected. Our Chief Executive Officer and Chief Financial Officer have concluded that as a result of the material weaknesses, as of the end of the period covered by this Annual Report on Form 10-K, our disclosure controls and procedures were not effective.

**Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Our management assessed the effectiveness of our internal control over financial reporting as of December 30, 2006, based on the criteria outlined in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis. Based on our assessment, we identified the following material weaknesses in our internal control over financial reporting as of December 30, 2006. The nature of each of these material weaknesses in our internal control over financial reporting is described below along with the actual or potential effects on our financial statements as issued during the existence of the material weakness.

***Inadequate resources and technical accounting expertise.*** The Company's resources and level of technical accounting expertise within the accounting function were insufficient to properly evaluate and account for non-routine or complex transactions. Consequently, the Company's controls over the selection and application of accounting policies in accordance with generally accepted accounting principles were inadequate and constitute a material weakness in the design of internal control over financial reporting.



## **Table of Contents**

***Inadequate controls over the accounting for stock-based compensation.*** The Company did not have effective controls and procedures designed to provide reasonable assurance that stock-based compensation related to grants of stock-based awards was accurately and properly recorded in the general ledger and financial statements. As a result of this material weakness, material adjustments were necessary to present the accompanying consolidated financial statements in accordance with generally accepted accounting principles. These adjustments had the effect of materially increasing stock-based compensation and decreasing additional paid-in capital.

Because of the material weaknesses described above, management concluded that, as of December 30, 2006, our internal control over financial reporting was not effective based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Our independent registered public accounting firm, Deloitte & Touche LLP, has issued an attestation report on management's assessment of our internal control over financial reporting. This report appears below.

### **Remediation Plan for Material Weaknesses in Internal Control over Financial Reporting**

As noted in Management's Report on Internal Control Over Financial Reporting above, management has concluded that we lacked sufficient technical accounting personnel possessing competencies commensurate with our financial reporting requirements, which constitutes a material weakness in our internal control over financial reporting. In response to this condition, first noted in 2004, we have recruited additional experienced accounting professionals and increased the levels of training for our accounting staff. We are evaluating the effectiveness of the steps taken and the need for additional resources. We anticipate that we will report that this material weakness described above continues to exist in each of our fiscal year 2007 Quarterly Reports on Form 10-Q. We also concluded that we lacked sufficient internal controls and procedures to provide reasonable assurance that stock-based compensation related to grants of stock options was accurately and properly recorded in our general ledger and financial statements. As noted above it is no longer our practice to issue stock options; however, the Company may do so in the future. In addition, we currently issue restricted stock awards. In the fourth quarter of 2006, the Company implemented new policies and procedures for the issuance of stock-based awards. We believe with the adoption of these policies and procedures our internal controls and procedures should provide reasonable assurance that stock-based compensation related to grants of restricted stock are accurately recorded in our general ledger and financial statements. We will evaluate whether the controls implemented as part of our restricted stock award program are sufficient for the issuance of stock option awards.

### **Changes in Internal Control Over Financial Reporting**

Except for changes made to our internal controls, as discussed herein, in preparation for our management report on internal control over financial reporting, particularly additional controls over our issuance of stock-based awards, no significant changes were made to our internal controls during our most recent quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**Table of Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of

Kopin Corporation

Taunton, Massachusetts

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Kopin Corporation and subsidiaries (the Company) did not maintain effective internal control over financial reporting as of December 30, 2006, because of the effect of the material weaknesses identified in management's assessment based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weaknesses have been identified and included in management's assessment:

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**Table of Contents**

***Inadequate resources and technical accounting expertise.*** The Company's resources and level of technical accounting expertise within the accounting function were insufficient to properly evaluate and account for non-routine or complex transactions. Consequently, the Company's controls over the selection and application of accounting policies in accordance with generally accepted accounting principles were inadequate and constitute a material weakness in the design of internal control over financial reporting.

***Inadequate controls over the accounting for stock-based compensation.*** The Company did not have effective controls and procedures designed to provide reasonable assurance that stock-based compensation related to grants of stock-based awards was accurately and properly recorded in the general ledger and financial statements. As a result of this material weakness, material adjustments were necessary to present the accompanying consolidated financial statements in accordance with generally accepted accounting principles. These adjustments had the effect of materially increasing stock-based compensation and decreasing additional paid-in capital.

These material weaknesses were considered in determining the nature, timing, and extent of audit tests applied in our audit of the consolidated financial statements and financial statement schedule as of and for the year ended December 30, 2006 of the Company and this report does not affect our report on such financial statements and financial statement schedule.

In our opinion, management's assessment that the Company did not maintain effective internal control over financial reporting as of December 30, 2006, is fairly stated, in all material respects, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, because of the effect of the material weaknesses described above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 30, 2006, based on the criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended December 30, 2006, of the Company and our report dated March 17, 2008 expressed an unqualified opinion on those financial statements and financial statement schedule and included explanatory paragraphs relating to the adoption of Statement of Financial Accounting Standard No. 123(R), Share-Based Payment, discussed in Note 1 and the restatement of the Company's consolidated financial statements discussed in Note 2.

/s/ DELOITTE & TOUCHE LLP

Boston, Massachusetts

March 17, 2008

**Item 9B.**

None

**Table of Contents****Part III****Item 10. Directors and Executive Officers of the Registrant**

(a) *Directors.* Set forth below are the name and age of each Director and certain executive officers of the Company at December 29, 2007. The Director position is elected annually.

Name	Age	Served as Director Since	Position and Offices with the Company
John C.C. Fan	63	1984	President, Chief Executive Officer, Director and Chairman of the Board
James K. Brewington	63	2006	Director
David E. Brook	66	1984	Secretary and Director
Andrew H. Chapman	52	1985	Director
Morton Collins	71	1985	Director
Chi Chia Hsieh	62	1995	Director
Michael J. Landine	54	2003	Director
Richard A. Sneider	47	n/a	Treasurer and Chief Financial Officer
Bor-Yeu Tsaur	51	n/a	Executive Vice President Display Operations
Hong Choi	56	n/a	Chief Technology Officer and Vice President
Daily S. Hill	50	n/a	Senior Vice President Gallium Arsenide Operations
Michael Presz	53	n/a	Vice President Government Programs and Special Projects

The following table provides membership information for 2006 for each of the committees:

Name	Audit	Compensation	Corporate Governance and Nominating
John C.C. Fan			
James K. Brewington			
David E. Brook			X
Andrew H. Chapman	X	X	
Morton Collins	X	X	
Chi Chia Hsieh			X
Michael J. Landine	X		

**Background of Directors and Certain Officers**

John C.C. Fan, President, Chief Executive Officer, Chairman of the Board. Dr. Fan has served as Chief Executive Officer and Chairman of the Board since the Company's organization in April 1984. He has also served as President of the Company since July 1990. Prior to July 1985, Dr. Fan was Associate Leader of the Electronic Materials Group at MIT Lincoln Laboratory. Dr. Fan is the author of numerous patents and scientific publications. Dr. Fan received a Ph.D. in Applied Physics from Harvard University.

James K. Brewington, Director. Mr. Brewington has served as a Director of the Company since 2006. Mr. Brewington retired as President of Developing Markets at Lucent Technologies in 2007. Prior to heading Lucent's Developing Markets group, Mr. Brewington served as president of the company's Mobility Solutions Group, where he was responsible for all wireless infrastructure for the mobility segment, including global wireless development and product architecture, project management, and business and product management. He began his career at AT&T in 1968, and over the ensuing years he has held various executive management positions in the telecommunications industry, including overseeing Bell Telephone Wireless Laboratories.

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**Table of Contents**

David E. Brook, Secretary and Director. Mr. Brook has served as a Director since 1984. Mr. Brook is a founder and principal of the intellectual property law firm of Hamilton, Brook, Smith & Reynolds P.C. in Concord, Massachusetts.

Andrew H. Chapman, Director. Mr. Chapman has served as a Director of the Company since 1985. From 2003 to the present, Mr. Chapman has been a private investor. Mr. Chapman has founded, managed, been a director of and or invested in numerous technology start-up companies over the past 20 years.

Morton Collins, Director. Mr. Collins has served as a Director of the Company since 1985. Mr. Collins has been a member of BVP Partners, LLC, since 2003. BVP Partners, LLC is the management company of Battelle Ventures, L.P., a venture capital limited partnership. Mr. Collins is also a member of BVP GP, LLC which is the general partner of Battelle Ventures, L.P. Before that Mr. Collins had been a General Partner of DSV Partners III, a venture capital limited partnership, since 1981, and a General Partner of DSV Management Ltd. since 1982. Since 1985, DSV Management Ltd. has been the General Partner of DSV Partners IV, a venture capital limited partnership. In 1997, Mr. Collins became a Special Limited Partner of Cardinal Partners, the successor to the DSV series of partnerships. From 1968 to 1974, he was the Founder and Chief Executive Officer of Data Science Ventures, Inc. (DSV I). Mr. Collins serves as a Director of Strategic Diagnostics, Inc. a company listed on NASDAQ; Ventaira, Inc. (Chairman); Pharos LLC; PD-LD Inc. (Chairman); Sypherlink Inc. (Chairman); Viral Genomics Inc.; Advanced Cerametrics, Inc.; ImageTree Corporation; CDI Bioscience, Inc. (Chairman) and is a member of the Executive Committee of Battelle Memorial Institute. Mr. Collins is Chairman of the Advisory Council to the Chemical Engineering Department at the University of Delaware; Chairman of the Graduate School Advisory Council at Princeton University; a member of the Leadership Council of the School of Engineering and Applied Sciences at Princeton University and a member of the Systems Biology Advisory Council at the Institute for Advanced Study, Princeton, N.J. Mr. Collins is a Member of the Research Roundtable of the National Academy of Sciences.

Chi Chia Hsieh, Director. Dr. Hsieh has served as a Director of the Company since December 1995. Dr. Hsieh is currently the Vice Chairman and was previously the President of Microelectronics Technology, Inc., a Taiwan corporation publicly traded on the Taiwan Stock Exchange. Dr. Hsieh is also Chairman of the Board of Directors of Kopin Taiwan Corporation, a Taiwan corporation in which the Company is a shareholder.

Michael J. Landine, Director. Mr. Landine has served as a Director of the Company since 2003. Mr. Landine is Senior Vice President of Corporate Development of Alkermes, Inc., where he has worked for the past 19 years. Mr. Landine served for 10 years as the Chief Financial Officer and Treasurer of Alkermes. Mr. Landine also serves as an advisor to Walker Magnetics Group, an international manufacturer of industrial equipment. From 1976 to 1983, Mr. Landine worked for the international accounting firm Touche Ross & Co. Mr. Landine currently serves on the board of directors of GTC Biotherapeutics Inc., a publicly-traded biotechnology company, where he also serves on the Audit Committee.

*Richard A. Sneider, Treasurer and Chief Financial Officer.* Mr. Sneider has served as our Treasurer and Chief Financial Officer since September 1998. Mr. Sneider is a Certified Public Accountant and was formerly a partner of the international public accounting firm, Deloitte & Touche LLP, where he worked for sixteen years.

*Bor-Yeu Tsaur, Executive Vice President Display Operations.* Dr. Tsaur joined us as Executive Vice President Display Operations in July 1997. From 1993 to 1997, Dr. Tsaur served as Group Leader, Electronic Material Group, at MIT Lincoln Laboratory. Dr. Tsaur received a Ph.D. in Electrical Engineering from the California Institute of Technology.

*Hong Choi, Chief Technology Officer and Vice President.* Dr. Choi joined us as Chief Technology Officer in July 2000. Previously, Dr. Choi served as Senior Staff Member at MIT Lincoln Laboratory, where he worked for seventeen years. Dr. Choi received a Ph.D. in Electrical Engineering from the University of California, Berkeley.

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## **Table of Contents**

*Daily S. Hill, Senior Vice President Gallium Arsenide Operations.* Mr. Hill has served as Vice President Gallium Arsenide Operations since July 1997 and was promoted to Senior Vice President in 2002. From December 1995 to June 1997, Mr. Hill served as our Director of Gallium Arsenide Operations. From November 1987 to January 1995, Mr. Hill served as a manager of our HBT transistor wafer product group.

*Michael Presz, Vice President Government Programs and Special Projects.* Mr. Presz joined us in November 1994 as General Manager of Display's Visual Products Group and was promoted to Vice President in April 2005. Prior to joining us, Mr. Presz worked for 6 years at Kaiser Electronics and 15 years at General Electric Aerospace.

### ***Section 16(a) Beneficial Ownership Reporting Compliance***

Based solely on a review of reports furnished to the Company or written representations from the Company's directors and executive officers, the Company believes that none of the Company's directors, executive officers and 10% stockholders failed to file on a timely basis the reports required to be filed pursuant to Section 16 of the Exchange Act during the 2006 fiscal year.

### ***Corporate Governance***

The Board has adopted charters for each of its Audit Committee, Compensation Committee and Nominating and Corporate Governance Committee. The Board also has adopted corporate governance guidelines, a code of business conduct and ethics for employees, executive officers and directors and a whistleblower policy regarding the treatment of complaints on accounting, internal accounting controls and auditing matters. All of these documents are available on the Company's website at [www.kopin.com](http://www.kopin.com) under the heading Investors: Corporate Governance. A copy of any of these documents may be obtained, without charge, upon written request to the Company, c/o Investor Relations, 200 John Hancock Road, Taunton, MA 02780.

In the past year, there have been no material changes to the procedures by which stockholders may recommend nominations to the Board.

### ***Audit Committee***

The Company has established a separately designated Audit Committee as defined by Section 3(a)(58)(A) of the Securities Exchange Act of 1934, as amended. The Audit Committee is composed of three directors, Morton Collins, Andrew H. Chapman and Michael J. Landine, each of whom the Board has determined is independent under the NASDAQ Rules and the applicable SEC rules and regulations. The Board has determined that Mr. Landine is an audit committee financial expert as defined by Item 407(d)(5)(ii) of Regulation S-K of the Exchange Act. Our Board adopted an Audit Committee Charter and a copy of this charter is available on our website at [www.kopin.com](http://www.kopin.com) under the heading Investors: Corporate Governance.

## **Item 11. Executive Compensation**

### ***a) Director Compensation***

The Board approved compensation for outside directors of an annual retainer of \$15,000 and \$2,000 per meeting attended, including any special meeting not held on the same day as a regularly scheduled meeting of the Board. Each non-employee Director is also entitled to receive an initial restricted stock award for 10,000 shares of the Company's Common Stock on the date of his or her initial election to the Board and a subsequent annual restricted stock award grant for 10,000 shares of the Company's Common Stock. The Company also pays expenses for attendance at meetings of the Board and committees thereof.

**Table of Contents**

The following table sets forth certain information regarding the compensation earned by or awards to each non-employee director who served on our Board of Directors in fiscal year 2006. Dr. John Fan, who is an employee of Kopin, is not compensated for his services.

**Director Summary Compensation Table for 2006**

Name	Total	Fees Earned or Paid in Cash	Restricted Stock Awards(1)	Option Awards(1)	Non-Equity Incentive Compensation(2)	Change in Pension Value and Nonqualified Deferred Compensation Earnings(2)	All Other Compensation(2)
James K. Brewington(3)	\$ 23,463	\$ 13,000	\$ 10,463				
David E. Brook(4)	\$ 103,407	\$ 25,000	\$ 4,075	\$ 74,332			
Andrew H. Chapman(4)	\$ 103,407	\$ 25,000	\$ 4,075	\$ 74,332			
Morton Collins(4)	\$ 103,407	\$ 25,000	\$ 4,075	\$ 74,332			
Chi Chia Hsieh(5)	\$ 107,078	\$ 25,000	\$ 4,075	\$ 78,003			
Michael J. Landine(6)	\$ 91,863	\$ 25,000	\$ 4,075	\$ 62,788			
Michael Wall(7)	\$ 14,043	\$ 9,083		\$ 4,960			

The amounts included in the Restricted Stock Awards and Option Award columns in the table above reflect the dollar amounts recognized for financial statement reporting purposes for the fiscal year ended December 30, 2006 for restricted stock and option awards in accordance with Statement of Financial Accounting Standards 123R.

- (1) The amounts in the column reflect the dollar amount recognized for financial statement reporting purposes for the fiscal year ended December 30, 2006, in accordance with Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), *Share-Based Payment* (SFAS No. 123(R)), excluding forfeitures. The compensation expense for the restricted stock awards is computed by multiplying the number of shares of restricted stock issued by the closing price of the Company's common stock on NASDAQ on the day of grant, dividing this amount by the number of months in service period and multiplying the monthly cost by the number of months of service in 2006. The compensation expense for the option awards was determined by computing the fair market value of the option using the Black-Scholes-Merton option pricing model and dividing the fair market value by the number of months in the service period and multiplying the monthly cost by the number of months of service in 2006. See note 1 of the consolidated financial statements, regarding assumptions underlying valuation of equity awards.
- (2) No, non-equity incentive compensation, pension, non qualified deferred compensation or other compensation payments were made as compensation for director services in fiscal year 2006 or are contemplated under our current compensation plan.
- (3) The Director has 20,000 shares of restricted stock awards at December 30, 2006
- (4) The Director has 10,000 restricted stock awards and 91,000 stock option awards outstanding at December 30, 2006
- (5) The Director has 10,000 restricted stock awards and 107,000 stock option awards outstanding at December 30, 2006
- (6) The Director has 10,000 restricted stock awards and 65,000 stock option awards outstanding at December 30, 2006
- (7) Michael Wall participated in the first Board of Directors meeting and then did not stand for reelection.

The amounts included in the Restricted Stock Awards and Option Award columns in the Director Summary Compensation table reflects the dollar amounts recognized for financial statement reporting purposes for the fiscal year ended December 30, 2006 for restricted stock and option awards in accordance with Statement of Financial Accounting Standards.

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## **Table of Contents**

### ***b) Executive Compensation***

#### **Compensation Discussion and Analysis**

*The following compensation discussion and analysis summarizes our philosophy and objectives regarding the compensation of our named executive officers, including how we determine elements and amounts of executive compensation. The following compensation discussion and analysis should be read in conjunction with our tabular disclosures regarding the compensation of our named executive officers in the year ended December 30, 2006 and the report of the Compensation Committee of our Board of Directors, which can be found on pages 73-74 of this Form 10-K.*

#### **Compensation Philosophy**

We believe that our named executive officers play a critical role in the operational and financial performance of our Company that creates long-term value for our stockholders. Accordingly, our executive compensation philosophy is to reward our executives for individual performance and for contributions to our performance. We believe that the Company is still in its early stages of development and accordingly we have placed a higher priority on executive retention objectives and, to a lesser extent, pay-for-performance. We believe that we accomplish this by compensating our executives with a combination of base salary, performance bonus awards and long-term equity-based incentive compensation. There is no pre-established policy or target for the allocation between either cash or non-cash compensation.

#### **Compensation Objectives**

We believe that the quality, commitment and performance of our executives are critical factors affecting the long-term value of the Company. Accordingly, our executive compensation objectives include:

retaining our executives and aligning their interests with stockholder interests;

rewarding our executives for individual performance; and

rewarding our executives for contributions to Company performance, including achievements of both financial and non-financial objectives.

In addition, we use benchmarks and peer group comparisons to assist us in determining whether our executive compensation is appropriate in light of our compensation objectives and general market conditions.

#### **Role of the Compensation Committee**

The Compensation Committee (Committee) of our Board of Directors sets our executive compensation policies and determines the amounts and elements of compensation for our executive officers. As set forth in the Compensation Committee's written charter, its responsibilities include establishing compensation policies for our directors and executive officers; reviewing and approving our Chief Executive Officer's annual compensation; approving employment agreements or arrangements with executive officers; administering our 2001 Equity Incentive Plan and 2001 Supplemental Equity Plan (the 2001 Plans) and approving grants under the 2001 Plans; and making recommendations regarding any other incentive compensation or equity-based plans. The Compensation Committee may delegate authority with respect to compensation matters to executive officers of the Company.

A copy of the Compensation Committee charter is posted on our public website, [www.kopin.com](http://www.kopin.com) under the heading *Investors: Corporate Governance*. Our Compensation Committee consisted of Mr. Mort Collins (Chair) and Mr. Andrew Chapman, each of whom is an independent Director as determined by our Board of Directors, based upon the NASDAQ Rules and our independence guidelines.



**Table of Contents****Role of the Compensation Consultant**

In making its determinations with respect to executive compensation, the Compensation Committee has periodically engaged the services of a compensation consultant to provide input on trends in executive compensation, obtain an outside perspective on our executive compensation practices, and assist with our peer group benchmarking analysis. In 2004, the Company retained Longnecker & Associates and in 2005 the Committee retained the services of Pearl Meyer & Partners, a Clark Consulting Practice (Pearl Meyer) to assist with its review of overall compensation for our executive officers.

**Compensation Determinations**

In making determinations with respect to amounts and elements of executive compensation, the Committee evaluates the overall performance of the Chief Executive Officer, Chief Financial Officer and the Company relative to annual goals and objectives; obtains input from the Chief Executive Officer on the performance reviews of the other executive officers; evaluates the potential for future contributions by each executive to our long-term success; and periodically compares the Company's executive compensation against a benchmarking analysis of a group of peer companies. The annual goals relate primarily to product development and business expansion and to a lesser extent financial results.

***Peer Group Benchmarking***

In evaluating the total executive compensation for each year, the Committee periodically reviews compensation for executives in comparable positions with other Companies they are affiliated with and a peer group of other companies. The Committee does not believe a formal annual peer group assessment by an independent third party is necessary unless either internal factors, such as employee turn-over, or external factors, such as published reports in industry periodicals, indicate significant changes in executive compensation have taken place. The Committee does not target officer compensation for specific percentile ranges against the peer group but instead uses the information to assist in their discretionary setting of officer compensation levels.

In 2005, Pearl Meyer assisted the Committee in selecting the peer group and preparing the peer group analysis. The Committee considered a peer group consisting of companies in two sub peer groups, semiconductor and display companies with comparable revenues and market capitalizations. The peer group included the following companies:

**Semiconductor Companies**

ADE Corp	Cree, Inc.	Rudolph Technologies, Inc.
Anadigics	Emcore Corp	Semitool, Inc
Applied Micro Circuits Corp.	Pixelworks Inc.	Ultratech, Inc.
Atheros Communications, Inc.		

**Display Companies**

Brilliant Corp	International Displayworks, Inc	Trans-Lux Corp.
Daktronics	Microvision, Inc.	Universal Display Corp.
eMagin Corp	Spatialight, Inc.	

The peer group may change from year to year depending on changes in the marketplace and the business focus of the Company.

Pearl Meyer's analysis involved a comparison of total compensation for each of our executives against that of executives in similar positions in the peer group companies, as well as an analysis of each component of compensation. The specific components of total compensation reviewed by Pearl Meyer included base salaries, total cash payments (salary plus bonus) and long-term incentives. The benchmarking data indicated that our compensation is more weighted to base pay and less to incentive pay as compared to the peer group.

## **Table of Contents**

Based on the evaluation and performance review process, the Committee members personal experience and the peer group benchmarking analysis described above, the Committee will consider the amounts and elements of compensation for our executive officers, both for the past fiscal year in determining cash bonus and equity awards and for the upcoming fiscal year in setting base salaries, cash bonus and equity award targets. For all executive officers other than our Chief Executive Officer and Chief Financial Officer, the Committee will establish and approve the compensation determinations based on recommendations from the Chief Executive Officer. With respect to compensation of our Chief Executive Officer and Chief Financial Officer, the Committee will establish and approve the compensation determinations based on the Committee's evaluation and performance reviews of our Chief Executive Officer and Chief Financial Officer.

### **Elements of Compensation**

We use five compensation and benefits elements to provide a competitive overall compensation and benefits package that is tied to creating shareholder value and supporting the execution of our business strategies, as follows:

Annual Base Salary;

Annual Cash Bonus Awards;

Stock Options;

Restricted Stock Awards; and

401(k) and other benefits also provided to the broader employee population.

The combination and allocation of the components and the target amount of each component is influenced by the role of the executive officer in Kopin, market practices, the total value of all the compensation and benefits available to the individual executive officers. The Compensation Committee reviews and considers each component for each executive officer before making compensation decisions.

We do not provide extensive perquisites to our executive officers. In addition, our executives are only offered the same defined contribution retirement plan, health care, insurance and other welfare and employee-benefit programs that we offer to all of our eligible employees.

### ***Annual Base Salary***

We believe that establishing an appropriate level of annual base salary for our executives is an important element in retaining and motivating our executive officers. In determining base salaries for our executive officers, the Committee considers the responsibilities of each position and the skills and experience required for each job. The Committee's determinations are influenced heavily by the evaluations and performance reviews for each executive officer by the recommendations presented to the Committee and its Chairperson by our Chief Executive Officer, as discussed above. In addition, the Committee reviews the peer group benchmarking analysis if performed, and finally, reviews total compensation for reasonableness prior to making any final determinations.

In furtherance of our executive retention goals, we allocated a substantial portion of total cash compensation to our executives in the form of base salary in 2006. We historically have established a base salary for our executives that represent approximately eighty to ninety percent of their total annual cash payments, with cash bonus representing approximately ten to twenty percent.

### ***Annual Cash Bonus Awards***

We believe that annual cash bonus awards are an important tool in motivating our executives but the not primary tool to attract, retain and motivate executives. We believe that there are larger companies who have a wider-range and more sophisticated reward programs which, due to the Company's size, we can not offer. We



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## **Table of Contents**

believe our executive officers are drawn to a smaller company such as ours for the potential wealth that can be created by growing the Company. This potential wealth is more likely created through our long-term incentive compensation plan. We therefore use cash bonus awards to provide some element of a more immediate reward to motivate employees as the Company executes on its longer term goals.

Generally, our Chief Executive Officer is eligible to receive a specific cash bonus award amount. The other executives are eligible to receive a cash bonus reward which is the same amount for all of the executives except the Chief Executive Officer. For 2006, the Chief Executive Officer's cash bonus target was \$100,000 and the other officers' cash bonus target was \$25,000. There are no partial payments or additional amounts to be earned, either the performance goals are met and the cash payment is made or they are not met and no payment is made. However, the Committee will factor in unforeseen events. In 2006, we spent approximately \$3.7 million on our stock option review. The 2006 bonus amounts would be earned by the executive officers if the Company was profitable for 2006, excluding the impact from the adoption of SFAS 123(R). The goal was met and the bonuses earned.

### ***Stock Options and Restricted Stock Awards***

We believe that including an equity-based incentive component of compensation is the critical tool for motivating our executives and certain employees. We believe that granting stock options and restricted stock to our executives serves to align executive compensation with long-term stockholder value. By awarding executive officers with stock options and restricted shares of our Common Stock that vest over time, we believe that our executive officers will have a continuing stake in the long-term success of the Company. We may issue equity awards to an employee upon the commencement of their employment with the Company and we typically issue equity awards to certain employees as part of the year compensation practice.

We historically have weighted our total executive compensation heavily towards either stock options or more recently, restricted stock awards, which vest over time. While our management can improve the financial performance of the Company through the sales of our current products, cost reduction efforts, process improvements and other short-term advancements, we believe that our executive officers' focus on long-term achievements, particularly increasing our product portfolio, will create the greatest stockholder value for the Company. We believe that by granting our executives meaningful levels of equity grants, they will have a greater incentive to focus on long-term results. In determining the size of each stock option and restricted stock award to our executive officers, the Committee considers the amount previously awarded on an annual basis to the executive, the total value of unvested stock options and restricted shares held by the executive, the executive's overall performance, the performance of the Company during the year and the dilution to the shareholders.

On December 28, 2005, the Compensation Committee granted to Dr. Fan, Mr. Sneider, Dr. Tsaur, Mr. Hill and Dr. Choi restricted stock awards for the purchase of 150,000, 40,000, 40,000, 20,000 and 17,000, respectively, shares of Common Stock of the Company. Out of the total award, 25% of the restricted stock award vests on the first four anniversary dates following the grant date (December 28, 2005). However, the vesting of the stock award will accelerate if the Company achieves the following performance milestones; if the Company is profitable for the fiscal year ending 2006, the restricted stock will vest at the rate of 33% on the first three anniversary dates of the grant date; if the Company is profitable for both fiscal years 2006 and 2007 the stock will be 100% vested at the end of fiscal 2007; and if the Company is not profitable for the fiscal year 2006 but is profitable for fiscal year 2007 the stock will vest as if the stock had vested at the rate of 33% per year on the first three anniversary dates on date of grant. The Company met the 2006 milestone but did not meet the 2007 milestone. The closing price of the Company's stock on December 28, 2005, the date of grant, was \$5.54 and the value of the stock grant was the number of shares granted multiplied by \$5.54.

On December 11, 2006, in connection with annual performance reviews, the Committee awarded restricted stock awards to each of our executive officers based on their performance for the year ended December 30, 2006 and expected future contributions to the Company. The Committee approved 150,000, 60,000, 40,000, 40,000, and 30,000 shares of restricted stock to Dr. John Fan, Dr. Boryeu Tsaur, Mr. Richard Sneider, Mr. Daily Hill, Dr. Hong Choi, respectively. Each of these restricted stock awards vests 25% on the anniversary date of the award over four years, commencing one year from the date of the award.

## **Table of Contents**

### ***Chief Executive Officer Compensation***

We have historically compensated our Chief Financial Officer more than the other executive officers due to our belief that his overall responsibilities are greater than the other officers and that his association with the Company has a greater impact to the perception and reputation of the Company.

### ***Perquisites***

We do not believe in providing extensive perquisites to our executive officers. Our healthcare, insurance, and other welfare and employee-benefit programs are the same for all eligible employees, including executive officers, and include health and dental coverage, group term life insurance, disability programs and matching contributions to our 401(k) plan. We share the cost of health and welfare benefits with our employees, a cost that is dependent on the level of benefits coverage that each employee elects. We have no outstanding loans of any kind to our executive officers.

### **Employment and Other Agreements**

We typically do not offer employment agreements and the only current employee with such an agreement is our Chief Executive Officer. The agreement with Dr. Fan will terminate on December 31, 2010 and in the event Dr. Fan is terminated without cause or in the event of a change in control of the Company and Dr. Fan's position, compensation or responsibilities change, Dr. Fan and his spouse will receive post-retirement monthly supplemental health benefits for the difference between cost of the coverage the Company provides and benefits provided by the U.S. government for ten years, severance pay of \$600,000 per year payable monthly for two years and his unvested stock awards will immediately vest. Furthermore, if the parties fail to extend or renew the agreement, the Company and Dr. Fan shall negotiate a mutually agreeable consulting agreement or retirement benefit. The agreement also contains covenants not to compete, non-solicitation clauses and the rights of the Company to inventions by Dr. Fan.

Our 2001 Plans provide for the acceleration of the vesting of unvested stock options and restricted stock awards in the event of a change in control of the Company.

### **Policies Regarding Stock Ownership and Related Matters**

We believe that by holding shares of our stock and options to purchase our Common Stock, our executives will have interests that are more closely aligned with those of our stockholders. Although we do not have a formal stock ownership policy, we encourage our executives to hold shares or vested options so that they share in the sentiments of our stockholders as our stock price increases or decreases.

We have an Anti-Insider Trading Policy that governs our executive officers, directors and other persons considered to be insiders under the policy. The policy imposes limits as to when and how our executives can engage in transactions in our securities and prohibits short sales of our Common Stock by all Company personnel. We do not currently have a policy that imposes restriction on our executives from entering into hedging transactions with respect to our stock.

### **Tax and Accounting Implications**

#### ***Deductibility of Executive Compensation***

As part of its role, the Compensation Committee reviews and considers the deductibility of executive compensation under Section 162(m) of the Internal Revenue Code, as amended (the Code), which generally disallows a tax deduction to public companies for certain compensation in excess of \$1.0 million paid in any year to a company's chief executive officer and the four other most highly compensated officers. Certain compensation, including qualified performance based compensation, will not be subject to the deduction

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**Table of Contents**

limitation if certain requirements are met. Although the Committee has not adopted any specific policy with respect to the application of Section 162(m), we generally seek to structure any long-term incentive compensation granted to our executive officers in a manner that is intended to avoid disallowance of deductions under Section 162(m). In 2006, as a result of our stock option review, our Chief Executive Officer earned more than \$1.0 million in cash salary and bonus payments.

***Accounting for Stock-Based Compensation***

As discussed in our Annual Report on Form 10-K for the year ended December 30, 2006, beginning on January 1, 2006, we began accounting for stock-based awards in accordance with the requirements of Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS No. 123R), which requires the measurement and recognition of compensation expense based on the fair value of all share-based payment awards made to employees and directors, including stock options and employee stock purchases under employee stock purchase plans. Under SFAS No. 123R, we are required to account for share-based compensation transactions using a fair value method and recognize the related expense associated with share-based payments in our statement of operations. Under the fair value recognition provision of SFAS No. 123R, stock-based compensation cost is measured at the accounting measurement date based on the fair value of the award and is recognized as expense over the service period, which generally represents the vesting period. The expense recognized over the service period is required to include an estimate of the awards that will be forfeited. We determined the fair value of the stock option using a Black-Scholes-Merton option-pricing model that takes into account the stock price at the accounting measurement date, the exercise price, the expected life of the option, the volatility of the underlying stock and its expected dividends, and the risk-free interest rate over the expected life of the option. We have changed our equity award granting practices in anticipation of the implementation of SFAS No. 123R. Historically we had a broad-based stock option program in which all employees could and usually did participate. All employees are eligible to participate in our equity award program but the number of employees who actually participate annually has been reduced and does not typically include employees who are paid on an hourly basis or are below the level of Director.

On November 1, 2006, in response to a derivative lawsuit filed against the Company related to the Company's employee stock option granting practices and accounting (see Item 3 Legal Proceedings ), our Board of Directors appointed a Special Investigation Committee (Special Committee) composed solely of an independent director who was not on the Company's Board of Directors and who had no affiliation with the Company during the Complaint Period to conduct a comprehensive investigation of our historical stock option practices.

**Compensation Committee Report**

The Compensation Committee of the Company's Board of Directors reviewed the Compensation Discussion and Analysis for the year ended December 30, 2006 and discussed this Compensation Discussion and Analysis with the Company's management. Based on this review and its discussions with management, the Compensation Committee recommended to the Company's Board of Directors that the Compensation Discussion and Analysis be included in this Proxy Statement for the 2007 Annual Meeting of Stockholders.

By the Compensation Committee of the Board of Directors of Kopin Corporation.

COMPENSATION COMMITTEE

Mort Collins, Chairperson

Andrew Chapman

January 31, 2007

**Table of Contents**

The following table summarizes the total compensation for the years ended December 30, 2006, December 31, 2005 and December 27, 2004 of those persons who served as our principle executive officer, our principal financial officer and our three most highly compensated executive officers if the fiscal year ended December 30, 2006 (Fiscal 2006). We refer to these individuals in this proxy as our named executive officers.

Name and Principle Position	Year	Salary (\$)	Bonus (\$)	Restricted Stock Awards (\$)(1)	Option Awards (\$)(1)	Non-equity Incentive Plan Compensation (\$)(2)	Change in Pension Value and Non-Qualified Deferred Compensation (\$)(3)	All Other Compensation (\$)(4)	Total
John C.C. Fan	2006	\$ 495,000		\$ 379,075	\$ 600,023	\$ 100,000		\$ 4,092	\$ 1,578,190
	2005	\$ 450,000		\$ 531,128		\$ 100,000		\$ 3,150	\$ 1,084,278
	2004	\$ 450,000		\$ 158,700				\$ 3,000	\$ 611,700
Richard A. Sneider	2006	\$ 280,000		\$ 102,217	\$ 89,606	\$ 25,000		\$ 4,039	\$ 500,862
	2005	\$ 265,000		\$ 164,371		\$ 25,000		\$ 2,625	\$ 456,996
	2004	\$ 265,000		\$ 52,900				\$ 3,000	\$ 320,900
Boryeu Tsaar	2006	\$ 310,000		\$ 103,167	\$ 89,606	\$ 25,000		\$ 4,092	\$ 531,865
	2005	\$ 300,000		\$ 164,371		\$ 25,000		\$ 3,150	\$ 492,521
	2004	\$ 285,000		\$ 52,900				\$ 3,000	\$ 340,900
Daily S. Hill	2006	\$ 240,000		\$ 48,752	\$ 59,042	\$ 25,000		\$ 3,934	\$ 376,728
	2005	\$ 230,000		\$ 82,693		\$ 25,000		\$ 3,150	\$ 340,843
	2004	\$ 190,000		\$ 27,111				\$ 2,849	\$ 219,960
Hong Choi	2006	\$ 210,000		\$ 46,043	\$ 69,993	\$ 25,000		\$ 3,591	\$ 354,627
	2005	\$ 200,000		\$ 78,499		\$ 25,000		\$ 2,308	\$ 305,807
	2004	\$ 190,000		\$ 30,418				\$ 2,850	\$ 223,268

- (1) The amounts in the column reflect the dollar amount recognized for financial statement reporting purposes for the fiscal year ended December 30, 2006, in accordance with Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS No. 123(R)), excluding forfeitures. See notes 1 and 5 of the consolidated financial statements, regarding assumptions underlying valuation of equity awards.
- (2) The amounts reflect payments anticipated to be paid in 2008 with respect to annual performance bonuses for services performed in 2006.
- (3) We do not maintain any pension or non-qualified deferred compensation plan.
- (4) Amounts represent the Company's matching contributions under the Company's 401(k) Plan ranging from \$3,037 to \$3,300 per and premiums paid for life insurance.

**Table of Contents****Grants of Plan-Based Awards for 2006**

The following table sets forth information relating to options granted pursuant to our 2001 Equity Incentive and 2001 Supplemental Plans and annual performance bonuses awarded during the year ended December 30, 2006 to each of our named executive officers:

Name	Grant Date	Estimated Future Payouts under Non-Equity Incentive Plan Awards			Estimated Future Payouts Under Equity Incentive Plan Awards			All other Stock Awards: Number of Shares of Stock or Units (#)(2)	All Other Option Awards: Number of Securities Underlying Options (#)	Exercise or Base Price of Option (\$/sh)(2)	Grant Date Fair Value of Stock Awards (2)(3)
		Threshold (\$)	Target (\$)(1)	Maximum (\$)	Threshold (#)	Target (#)	Maximum (#)				
John C.C. Fan	12/11/2006		\$ 100,000					150,000		\$ 3.42	\$ 513,000
Richard A. Sneider	12/11/2006		\$ 25,000					40,000		\$ 3.42	\$ 136,800
Boryeu Tsaur	12/11/2006		\$ 25,000					60,000		\$ 3.42	\$ 205,200
Daily S. Hill	12/11/2006		\$ 25,000					40,000		\$ 3.42	\$ 136,800
Hong Choi	12/11/2006		\$ 25,000					30,000		\$ 3.42	\$ 102,600

- (1) For the fiscal year December 30, 2006 our Compensation Committee approved a cash bonus plan under which each of our executive officers listed above was eligible for a cash bonus payment provided they remained an employee of the Company through fiscal 2007.
- (2) On December 11, 2006, the Compensation Committee granted to Dr. Fan, Mr. Sneider, Dr. Tsaur, Mr. Hill and Dr. Choi restricted stock award for the purchase of 150,000, 40,000, 60,000, 40,000 and 30,000, respectively, shares of our Common Stock. Out of each total award 25% of the restricted stock award vests on the first four anniversary dates of the grant date (December 11, 2006). The NASDAQ closing price of the Company's Common Stock on December 11, 2006, the date of grant, was \$3.42 and the value of the stock grant equals the number of shares granted multiplied by \$3.42
- (3) The amounts reflect the grant date fair value for the fiscal year ended December 30, 2006, in accordance with SFAS 123(R) of awards granted in 2006. See Notes 1 and 5 of the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 30, 2006 regarding assumptions underlying valuation of equity awards.

**Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table**

The compensation paid to our named executive officers in 2006 summarized in the Summary Compensation Table for 2006 was determined by our Compensation Committee. We enter into agreements with our named executive officers that define the criteria to earn their performance bonuses, terms of their restricted stock awards and, for our Chief Executive Officer, post-employment compensation. The material terms of these agreements are discussed under the caption Compensation Discussion and Analysis Employment and Other Agreements and under the caption Executive Employment Agreement /Other Potential Post-Employment Compensation below.

The equity restricted stock awards granted to our named executive officers in 2006 summarized in the table Grants of Plan-Based Awards for 2006 were granted pursuant to our 2001 Plans. These equity awards vest annually as to 25% of the original grant amount commencing one year from the date of grant and have a ten year term. The holder of a share of restricted stock is entitled to the same rights as a holder of unrestricted stock, including the right to vote the share and the right to receive dividends, except they do not have the right to sell the share of restricted stock until it has vested.

We have no specific parameters as to what proportion of a named executive officer's compensation is base wages and how much is performance based. Base wage is typically determined by reference to the prior year's base wage and what the Compensation Committee believes is an appropriate increase based on market conditions and the performance of the Company and the named officer. As discussed in our Compensation Discussion and Analysis the Compensation Committee determines the size of each equity award to our executive officers is determined based upon the amount previously awarded on an annual basis to the executive, the total value of unvested stock options and restricted shares held by the executive, the executive's overall performance, the performance of the Company during the year and the dilution to the shareholders.



**Table of Contents****Perquisites and Benefits**

We provide benefit programs to executive officers and to other employees. The Board of Directors and executive management believe that perquisites for executive officers should be extremely limited in scope and value. As a result, Kopin has historically given nominal perquisites. The following table generally identifies such benefit plans and who may be eligible to participate.

<b>Benefit Plan</b>	<b>Executive Officers</b>	<b>Certain Managers</b>	<b>Full Time Domestic Employees</b>	<b>Full Time Foreign Employees</b>
401(k)	Yes	Yes	Yes	Not Offered
Defined Contribution to Retirement Plan	Not Offered	Not Offered	Not Offered	Yes(1)
Medical/Dental/ Vision Plans	Yes	Yes	Yes	Not Offered
Life and Disability Insurance(2)	Yes	Yes	Yes	Not Offered
Short Term Incentive Plan	Yes(3)	Yes(3)	Yes(4)	Not Offered
Equity Incentive Plan	Yes	Yes	Yes	Not Offered
Automobile Allowance	Not Offered	Not Offered	Not Offered	Not Offered
Income Tax Planning services	Not Offered	Not Offered	Not Offered	Not Offered
Supplemental Early Retirement Plan	Not Offered	Not Offered	Not Offered	Not Offered
Employee Stock Purchase Plan	Not Offered	Not Offered	Not Offered	Not Offered
Deferred Compensation Plan	Not Offered	Not Offered	Not Offered	Not Offered
Supplemental Early Retirement Plan	Not Offered	Not Offered	Not Offered	Not Offered
Employee Stock Ownership Plan	Not Offered	Not Offered	Not Offered	Not Offered
Defined Benefit Pension Plan	Not Offered	Not Offered	Not Offered	Not Offered
Financial Planning Allowance	Not Offered	Not Offered	Not Offered	Not Offered
Country Club Memberships	Not Offered	Not Offered	Not Offered	Not Offered
Dwellings for Person Use(5)	Not Offered	Not Offered	Not Offered	Not Offered

- (1) Kopin's Korean subsidiary, Kowon, contributes to a government sponsored retirement program for its employees.
- (2) Kopin pays for life insurance equal to an employee's base salary for domestic employees.
- (3) Kopin has a short term incentive plan pursuant to which certain officers and certain managers are paid a bonus if they remain with the company during the next fiscal year.
- (4) The Board of Directors has historically provided for a discretionary bonus award at the end of the fiscal year.
- (5) Kopin does not provide dwellings for personal use other than for temporary job relocation.

**Pension Benefits**

The Company does not provide any benefits which are required to be disclosed in this table.

**Table of Contents****Executive Employment Agreement/Other Potential Post-Employment Compensation**

As discussed above in our Compensation Discussion and Analysis, our Chief Executive Officer has potential post-employment benefits as a result of an employment agreement. In addition, our 2001 Plans having provisions which may result in the acceleration of vesting of equity awards as a result of a change in control of the Company. We have summarized the effects on the compensation of our named executive officers if the provisions of the employment agreement and 2001 Plans had occurred on December 29, 2007.

Name	Value of Equity Awards if a Change in Control Occurs on 12/30/06(1)	Health Care Benefits(2)	Severance Payments(2)
John C.C. Fan	\$ 492,000	\$ 149,000	\$ 1,200,000
Richard A. Sneider	\$ 131,000		
Boryeu Tsaur	\$ 177,000		
Daily S. Hill	\$ 111,000		
Hong Choi	\$ 85,000		

- (1) Our 2001 Plans provide for the acceleration of the vesting of our equity awards in the event of a change in control of the Company. The amounts in this column represent the value the executive officer would have received if there were a change of control of the Company on December 29, 2007. This value is the sum of the value of the unvested restricted stock awards and the stock option awards as of December 29, 2007. For the restricted stock award the value is computed by multiplying the number of unvested shares of restricted stock at December 29, 2007 by the closing price of the Company's Common Stock on the NASDAQ on December 28, 2007 (\$3.03). The value of the stock options was computed by multiplying the number of unvested option awards by the difference between the grant price and the closing price of the Company's Common Stock on the NASDAQ on December 28, 2007.
- (2) The Company has entered into an employment agreement with the Company's Chairman and Chief Executive Officer, Dr. John C.C. Fan, pursuant to which the Company has agreed to employ Dr. Fan as Chief Executive Officer. The agreement will terminate on December 31, 2010. In the event Dr. Fan is terminated without cause or in the event of a change in control of the Company and Dr. Fan's position, compensation or responsibilities change Dr. Fan and his spouse will receive post-retirement monthly supplemental health benefits for the difference between cost of the coverage the Company provides and benefits provided by the U.S. government for ten years, severance pay of \$600,000 per year payable monthly for two years and his unvested stock awards will immediately vest. Furthermore, if the parties fail to extend or renew the employment agreement, the Company and Dr. Fan shall negotiate a mutually agreeable consulting agreement or retirement benefit. The employment agreement also contains covenants not to compete, non-solicitation clauses and the rights of the Company to inventions by Dr. Fan. The present value of the supplemental health benefits for Dr. Fan and his wife if triggered under this agreement is \$208,000, assuming the Company retains its current level of health care benefits.

**Table of Contents****OUTSTANDING EQUITY AWARDS AT FISCAL YEAR-END**

The following table discloses information concerning stock options and unvested stock awards held by our named executive officers as of December 29, 2007 pursuant to the Company's 2001 Plans. The table does not incorporate the impact of the cancellation of options resulting from our stock option review or the repricing of such options. Market value information is determined by multiplying the number of shares by the closing price of the Company's common stock on NASDAQ on the last trading day of 2007 fiscal year (\$3.03).

Name	Option Awards					Stock Award			Equity Incentive Plan Awards; Market or Payout Value of Unearned Shares, Units or Other Rights That have Not Vested (\$)
	Number of Securities Underlying Unexercised Options (#) Exercisable	Number of Securities Underlying Unexercised Options (#) Unexercisable	Equity Incentive Plan Awards: Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date	Number of Shares or Units of Stock That Have Not Vested (#)	Market Value of Shares or Units of Stock That Have Not Yet Vested (#)	Equity Incentive Plan Awards: Number of Unearned Shares, Units or Other Rights That Have Not Vested (#)	
John C.C. Fan	40,000		40,000	\$ 4.75	10/8/2008				
John C.C. Fan	100,779		100,779	\$ 5.48	6/15/2009				
John C.C. Fan	600,000		600,000	\$ 45.50	10/29/2009				
John C.C. Fan	160,000		160,000	\$ 27.75	4/12/2010				