OCWEN FINANCIAL CORP
Form 10-Q
May 10, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2006

OR

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

Commission File No. 1-13219

Ocwen Financial Corporation
(Exact name of registrant as specified in its charter)

Florida	65-0039856
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1661 Worthington Road, Suite 100, West Palm Beach, Florida 33409
(Address of principal executive offices) (Zip Code)

(561) 682-8000
(Registrant's telephone number, including area code)

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 [X] No [ ].

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

Large Accelerated filer [ ]   Accelerated filer [X]   Non-accelerated filer [ ]

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

Number of shares of Common Stock, $0.01 par value, outstanding as of May 5, 2006: 63,396,645 shares.

OCWEN FINANCIAL CORPORATION
FORM 10-Q

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PART I - FINANCIAL INFORMATION
ITEM 1. INTERIM FINANCIAL STATEMENTS (Unaudited)

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except share data)

	March 31, 2006	Decem 2
Assets		
Cash	$ 183,813	$
Trading securities, at fair value		
Investment grade	33,215	
Subordinates and residuals	45,992	
Loans held for resale, at lower of cost or market value	364,924	
Advances	238,920	
Match funded advances	357,828	
Mortgage servicing rights	146,993	
Receivables	62,025	
Premises and equipment, net	39,947	
Other assets	80,903	
Total assets	$ 1,554,560	$ 1,
Liabilities and Stockholders' Equity		
Liabilities		
Match funded liabilities	$ 322,757	$
Servicer liabilities	218,088	
Lines of credit and other secured borrowings	405,385	
Debt securities	150,329	
Other liabilities	89,918	
Total liabilities	1,186,477	1,
Minority interest in subsidiaries	1,943	
Commitments and Contingencies (Note 7)		
Stockholders' Equity		
Common stock, $.01 par value; 200,000,000 shares authorized; 63,358,780 and 63,133,471 shares issued and outstanding at March 31, 2006 and December 31, 2005, respectively	634	
Additional paid-in capital	186,095	
Retained earnings	179,731	
Accumulated other comprehensive loss, net of taxes	(320)	
Total stockholders' equity	366,140	
Total liabilities and stockholders' equity	$ 1,554,560	$ 1,

The accompanying notes are an integral part of these consolidated financial statements

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Dollars in thousands, except share data)

For the three months ended March 31,

	2006	2005
Revenue		
Servicing and subservicing fees	$ 80,084	$ 72,380
Process management fees	19,312	16,952
Other revenues	3,053	2,156
Total revenue	102,449	91,488
Operating expenses		
Compensation and benefits	25,701	24,371
Amortization of servicing rights	26,288	25,115
Servicing and origination	13,197	14,033
Technology and communications	6,639	7,399
Professional services	7,779	5,018
Occupancy and equipment	4,976	4,242
Other operating expenses	2,522	4,511
Total operating expenses	87,102	84,689
Other income (expense)		
Interest income	18,113	6,332
Interest expense	(17,254)	(8,440)
Loss on trading securities	(374)	(1,398)
Gain (loss) on loans held for resale, net.	2,216	--
Other, net	3,410	(356)
Other income (expense), net	6,111	(3,862)
Income before income taxes	21,458	2,937
Income tax expense	4,925	550
Net income	$ 16,533	$ 2,387
Earnings per share		
Basic	$ 0.26	$ 0.04
Diluted	$ 0.24	$ 0.04
Weighted average common shares outstanding		
Basic	63,247,835	62,743,287
Diluted	72,041,171	64,018,882

The accompanying notes are an integral part of these consolidated financial statements

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in thousands)

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Net income	$
Other comprehensive income, net of taxes:	
Change in unrealized foreign currency translation income arising during the period (net of tax benefit (expense) of $(214) and $(574)) ...	
Less: Reclassification adjustment for foreign currency translation gains included in net income (net of tax benefit of $396)	
Net change in unrealized foreign currency translation adjustment arising during the period	
Comprehensive income	$

The accompanying notes are an integral part of these
consolidated financial statements

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OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
FOR THE THREE MONTHS ENDED MARCH 31, 2006
(Dollars in thousands)

	Common Stock		Additional	
	Shares	Amount	Paid-in Capital	Retained Earnings
Balance at December 31, 2005	63,133,471	$ 631	$ 184,262	$ 163,19
Net income	--	--	--	16,53
Issuance of common stock awards to employees	46,326	1	403	-
Exercise of common stock options	178,983	2	843	-
Excess tax benefits from the exercise of stock options...................	--	--	331	-
Employee compensation - common stock options	--	--	246	-
Director's compensation - common stock	--	--	10	-
Other comprehensive income (loss), net of taxes	--	--	--	-
Balance at March 31, 2006	63,358,780	$ 634	$ 186,095	$ 179,73

The accompanying notes are an integral part of these consolidated financial statements

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OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

Cash flows from operating activities
Net income ....
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities
    Net cash provided (used) by trading activities ....
    Purchases of loans held for resale ....
    Originations of loans held for resale ....
    Principal payments received on loans held for resale ....
    Proceeds from sales of loans held for resale ....
    Premium amortization (discount accretion) on securities, net ....
    Amortization of servicing rights ....
    Depreciation and other amortization ....
    Provision for bad debts ....
    Loss (gain) on trading securities ....
    Gain on loans held for resale, net...
    Loss (gain) on investment in affordable housing properties ....
    Excess tax benefits from the exercise of stock options.....................................
    Decrease (increase) in advances and match funded advances ....
    Decrease (increase) in receivables and other assets, net ....
    Increase (decrease) in servicer liabilities ....
    Increase (decrease) in other liabilities, net ....
    Other ....

Net cash provided (used) by operating activities ....

Cash flows from investing activities
    Principal payments received on match funded loans ....
    Purchase of mortgage servicing rights ....
    Principal payments received on loans ....
    Purchases, originations and funded commitments on loans ....
    Additions to premises and equipment ....
    Proceeds from the sale of a subsidiary ....
    Net cash from consolidated VIE ....

Net cash provided (used) by investing activities ....

Cash flows from financing activities
    Increase (decrease) in deposits and escrow deposits ....
    Proceeds from (repayments of) lines of credit and other secured borrowings, net ....
    Proceeds from (repayments of) match funded liabilities, net ....
    Issuance (repurchase) of debt securities ....
    Excess tax benefits from the exercise of stock options.....................................
    Exercise of common stock options ....

Net cash provided (used) by financing activities	
Net increase (decrease) in cash	
Cash at beginning of period	
Cash at end of period	

The accompanying notes are an integral part of these consolidated financial statements

OCWEN FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2006
(Dollars in thousands)

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Ocwen Financial Corporation ("OCN"), through its subsidiaries, is engaged in business activities related to residential and commercial servicing, consumer unsecured debt collections, loan origination services and business process outsourcing. At March 31, 2006, OCN owned all of the outstanding stock of its primary subsidiaries, Ocwen Loan Servicing, LLC ("OLS"), Investors Mortgage Insurance Holding Company and Ocwen Financial Solutions, Private Limited ("India"). OCN also owns 70% of Global Servicing Solutions, LLC ("GSS") with the remaining 30% minority interest held by ML IBK Positions, Inc. ("Merrill Lynch"). Effective June 30, 2005, Ocwen Federal Bank FSB (the "Bank"), a wholly owned subsidiary, voluntarily terminated its status as a federal savings bank and dissolved, a process we referred to as "debanking".

Basis of presentation

The accompanying unaudited interim consolidated financial statements have been prepared in conformity with the instructions to Form 10-Q and Article 10, Rule 10-01 of Regulation S-X for interim financial statements. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In our opinion, the accompanying unaudited financial statements contain all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation. The results of operations and other data for the three months ended March 31, 2006 are not necessarily indicative of the results that may be expected for any other interim period or for the entire year ending December 31, 2006. The unaudited consolidated financial statements presented herein should be read in conjunction with the audited consolidated financial statements and related notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2005.

In preparing the consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets and liabilities at the dates of the balance sheet and revenues and expenses for the periods covered. Material estimates that are particularly significant in the near or medium term relate to our valuation of securities, servicing rights, intangibles and deferred tax assets, as well as to our determination of valuation allowances for other asset categories. Actual results could differ from those estimates and assumptions.

Prior to debanking, our consolidated financial statements followed the presentation requirements of Securities and Exchange Commission ("SEC") Regulation S-X, Article 9, Bank Holding Companies. As a result of debanking, effective December 31, 2005, we revised the presentation of our consolidated financial statements to better align our presentation with the growth and significance of loan servicing and loan origination and outsourcing services, our principal businesses. The principal change in our consolidated financial statements for the periods presented as compared to the presentation in prior periods are in the format of our consolidated statement of operations. In adopting the new format for our consolidated statement of operations, we have made a number of reclassifications of expenses. The most significant of these reclassifications has been to report as operating expenses amounts that were netted against the revenues that were previously reported as servicing and related fees. These expenses are directly related to the generation of revenues and are reported in our consolidated statement of operations as amortization of servicing rights and as components of servicing and origination. Servicing and origination includes expenses of approximately $8,600 for the quarter ended March 31, 2005 that had previously been netted against revenues reported in servicing and other fees. Similarly, expenses previously included in loan expenses on the consolidated statement of operations are also principally reported as components of servicing and origination expense.

Revenues that are associated with our Residential Origination Services and Business Processing Outsourcing business segments are reported in a separate revenue category, process management fees. These revenues were previously reported as a component of servicing and related fees. Other categories of income, including interest income and interest expense, which were previously reported as revenues but which were not related to the operations of our principal business segments, are reported in other income (expense).

In addition, we created a new liability caption, servicer liabilities, in our consolidated balance sheet. This caption represents amounts that we have collected from borrowers that will be remitted to off-balance sheet custodial accounts, paid directly to investment trusts or refunded to borrowers. Previously, the amounts included in servicer liabilities had been reported either as escrow deposits or as reductions of our cash balances.

Amounts included in our 2005 consolidated financial statements have been reclassified to conform to these changes in presentation in our consolidated statement of operations as well as to conform to certain other, less significant, reclassifications that have been made in our consolidated financial statements in 2006.

Principles of Consolidation

We evaluate special purpose entities first for classification as a "qualifying special purpose entity" ("QSPE") as specified by Statement of Financial Accounting Standards No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities" ("SFAS No. 140"). Where we determine that a special purpose entity is classified as a QSPE, it is excluded from our consolidated financial statements. Where we determine that a special purpose entity is not classified as a QSPE, it is further evaluated for classification as a variable interest entity ("VIE") as specified by Financial Accounting Standard Board ("FASB") Interpretation No. 46, "Consolidation of Variable Interest Entities", as revised. When a special purpose entity meets the definition of a VIE, and OCN is identified as the primary beneficiary of the entity, it is included in our consolidated financial statements.

Our consolidated balance sheets at March 31, 2006 and December 31, 2005 include the assets and liabilities of VIEs. We have determined that we hold a variable interest in these VIEs and have also determined that we are the primary beneficiary. The VIEs are engaged in the origination, acquisition and subsequent securitization or sale of subprime single family residential loans. As a result of consolidation, total assets include $126,642 of loans held for sale that are pledged to secure collateralized borrowings of $123,243. OCN is a party to two agreements whereby it has guaranteed repayment of certain obligations of the VIEs up to 100% under one agreement and up to a maximum of 5% under the second agreement. Other than with respect to these guaranties, the creditors of the VIEs have no recourse against OCN.

All material intercompany accounts and transactions have been eliminated in consolidation. We report minority interests in our majority-owned subsidiaries as a separate item on our consolidated balance sheets. Minority interest in our earnings is included in other income (expense), net, on our consolidated statements of operations.

NOTE 2 CURRENT ACCOUNTING PRONOUNCEMENTS

SFAS No. 123(R), "Share-Based Payment" and Staff Accounting Bulletin No. 107 (SAB 107),"Share-Based Payment". SFAS No. 123(R) requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. That cost is recognized over the period during which an employee is required to provide service in exchange for the award - the requisite service period. The determination of compensation expense under SFAS 123(R) also includes the estimation of expected forfeitures, which we previously recognized as incurred. Prior to January 1, 2006, we followed the guidance of Accounting Principles Board ("APB") Opinion No. 25, which provided for accounting for share-based compensation using the intrinsic value method and recognizing compensation costs for such stock options to the extent that the exercise price was less than the price of the stock at the grant date.

Effective January 1, 2006, we adopted the provisions of SFAS No. 123(R), using the modified prospective method. Accordingly, results for prior periods have not been restated. Compensation and benefits expense for the three months ended March 31, 2006 includes $246 ($160 after tax) related to stock options. As a result of adopting FAS 123(R), incremental compensation expense related to stock options for the three months ended March 31, 2006 was $98 ($64 after tax).

There were no new grants during the three months ended March 31, 2006, however, 178,983 stock options were exercised and 13,911 were forfeited during that period. At March 31, 2006, a total of 4,037,581 stock options were outstanding, of which 3,190,600 were exercisable. Cash received from the exercise of stock options during the three months ended March 31, 2006 was $665. Financing cash inflows include $331 of tax benefits arising from related tax deductions that reduce the amount of income taxes that would otherwise be payable. The total intrinsic value of stock options exercised, which is defined as the amount by which the market value of the stock on the date of exercise exceeds the exercise price, was $1,124 for the three months ended March 31, 2006. As of March 31, 2006, unrecognized compensation costs related to non-vested stock options amounted to $2,522, which will be recognized over a weighted-average remaining requisite service period of approximately 2.9 years.

SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments." In February 2006, the FASB issued SFAS No. 155 as an amendment to SFAS No. 133 and SFAS No. 140. SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. The standard also: a) Clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133; b) Establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation; c) Clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and d) Amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006.

SFAS No. 156, "Accounting for Servicing of Financial Assets-an amendment of FASB Statement No. 140." FASB issued SFAS No. 156 in March 2006 as an amendment to SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", with respect to the accounting for separately recognized servicing assets and liabilities. Recognition of a servicing asset or liability would be required each time an entity commits to service a financial asset through a servicing contract that: a) represents a transfer of the servicer's financial assets that meets the requirements for sale accounting, b) represents a transfer of the servicer's financial assets to a qualifying special-purpose entity in a guaranteed mortgage

securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities in accordance with SFAS 115. "Accounting for Certain Investments in Debt and Equity Securities", or c) represents an acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer or its consolidated affiliates.

SFAS 156 also requires all separately recognized servicing assets and liabilities to be initially measured at fair value, if practicable, and allows an entity to chose from two subsequent measurement methods for each class of separately recognized servicing assets and liabilities. The two methods are: a) the amortization method which amortizes servicing assets or liabilities in proportion to and over the period of estimated net servicing income or net servicing loss and assesses servicing assets or liabilities for impairment or increased obligation based on fair value at each reporting date, and b) the fair value measurement method which measures servicing assets or liabilities at fair value each reporting date and reports changes in fair value in earnings in the period in which the changes occur.

A prospective application of SFAS 156 is required as of the beginning of an entity's first fiscal year that begins after September 15, 2006. As of March 31, 2006, the estimated fair value of our mortgage servicing rights was $197,731 as compared to a carrying value of $146,993.

NOTE 3 BASIC AND DILUTED EARNINGS PER SHARE

We are required to present both basic and diluted earnings per share ("EPS") on the face of our statement of operations. Basic EPS excludes common stock equivalents and is calculated by dividing net income by the weighted average number of common shares outstanding during the year. We calculate diluted EPS by dividing net income, as adjusted to add back interest expense on the 3.25% Contingent Convertible Senior Unsecured Notes due 2024 ("Convertible Notes"), by the weighted average number of common shares outstanding including the potential dilutive common shares related to outstanding stock options, restricted stock awards and the Convertible Notes.

The following is a reconciliation of the calculation of basic EPS to diluted EPS for the three months ended March 31:

	2006	2005
Basic EPS:		
Net income	$ 16,533	$ 2,387
Weighted average shares of common stock	63,247,835	62,743,287
Basic EPS	$ 0.26	$ 0.04
Diluted EPS:		
Net income	$ 16,533	$ 2,387
Interest expense on Convertible Notes, net of income tax (1)	792	--
Adjusted net income	$ 17,325	$ 2,387
Weighted average shares of common stock	63,247,835	62,743,287
Effect of dilutive elements:		
Convertible Notes (1)	7,962,205	--
Stock options (2)	775,358	915,196
Common stock awards	55,773	360,399
Dilutive weighted average of common stock	72,041,171	64,018,882
Diluted EPS	$ 0.24	$ 0.04

(1) The effect of our Convertible Notes on diluted EPS is computed using the if-converted method. Interest expense and related amortization costs applicable to the Convertible Notes, net of income tax, is added back to net income. Conversion of the Convertible Notes into shares of common stock has not been assumed for purposes of computing diluted EPS for the first quarter of 2005 because the effect would be anti-dilutive. The effect is anti-dilutive whenever interest expense on the Convertible Notes, net of income tax, per common share obtainable on conversion exceeds basic EPS.

(2) Excludes an average of 1,085,903 and 1,632,039 of options that were anti-dilutive for the first quarter of 2006 and 2005, respectively, because their exercise price was greater than the average market price of our stock.

At OCN's Annual Meeting on May 5, 2006, the shareholders approved a proposal to amend OCN's Articles of Incorporation to effect a 1-for-10 reverse stock split, followed immediately by a 10-for-1 forward stock split (the "Reverse/Forward Split"). We currently expect to complete the Reverse/Forward Split on May 12, 2006 (the "Effective Date").

As a result of the Reverse/Forward Split, accounts with less than ten shares of common stock will be converted on the Effective Date into the right to receive a cash payment for each share held equal in value to the average official closing price of the common stock on The New York Stock Exchange over the ten trading days immediately preceding the Effective Date. All shareholder accounts holding ten shares or more will be unaffected, and the total number of shares held by such accounts will not change.

The Reverse/Forward Split is intended to reduce our administrative cost associated with the maintenance of nominal shareholder accounts while at the same time providing shareholders holding fewer than ten shares with a cost-effective way to liquidate their investment without incurring fees.

While we cannot currently determine the effect that the Reverse/Forward Split will have on EPS, we do not anticipate that the effect will be material.

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NOTE 4 FOREIGN CURRENCY EXCHANGE RATE RISK MANAGEMENT

Foreign Currency Exchange Rate Risk Management

Our derivative contracts are exchange-traded; therefore, holders of these instruments look to the exchange for performance under these contracts and not to the holders of the offsetting futures contracts. Using exchange-traded instruments minimizes our exposure to risk from nonperformance under these contracts. The notional amount of our contracts does not represent our exposure to credit loss.

We entered into foreign currency derivatives to hedge our net investment in a foreign subsidiary that owns residual securities backed by subprime residential loans originated in the United Kingdom ("UK"). Our remaining principal exposure to foreign currency exchange rates exists primarily with the British Pound versus the U.S. Dollar. Our policy is to periodically adjust the amount of foreign currency derivative contracts we have entered into in response to changes in our recorded investment as well as to changes in our assets denominated in a foreign currency. Our net exposure is subject to gain or loss if the foreign currency exchange rate fluctuates. Currency futures are commitments to either purchase or sell foreign currency at a future date for a specified price. We have determined that the local currency of our investment in UK residuals is the functional currency. The foreign currency derivative financial instrument related to our foreign subsidiary that owns the residual securities was designated as a hedge. Accordingly, for this instrument we include the gains or losses in the net unrealized foreign currency translation in accumulated other comprehensive income in stockholders' equity.

The following table sets forth the terms and values of the British Pound foreign currency futures at the dates indicated:

	Position	Maturity	Notional Amount	Strik
March 31, 2006:				
British Pound currency futures (1)	Short	June 2006	(pound) 13,438	$
December 31, 2005:				

British Pound currency futures (1)	Short	March 2006	(pound) 13,438	$

(1) The U.S. Dollar equivalent notional amount of the British Pound currency futures was $23,343 and $23,148 at March 31, 2006 and December 31, 2005, respectively.

Beginning in the second quarter of 2005, Bankhaus Oswald Kruber GmbH & Co. KG ("BOK"), entered into Euro foreign exchange forward ("FX Forward") contracts in order to hedge its investment in U.S. dollar-denominated servicing advances that it acquired from OLS. The remaining advances were repurchased by OLS in the second quarter of 2006. The following table sets forth the terms and value of the foreign exchange forward contracts as at the dates indicated:

Maturity	Notional Amount Sell	Notional Amount Buy	Contract Rate	Fai
March 31, 2006:				
April to August 2006	$ 7,464	(euro) 6,111	1.1854 to 1.2590	$
December 31, 2005:				
April to August 2006	$ 7,464	(euro) 6,111	1.1854 to 1.2590	$

The fair value of our FX Forward contracts represents the estimated amount that we would receive or pay to terminate these agreements taking into account current interest rates. Since the FX Forward contracts were not designated as hedges, changes in the fair value of the contracts and gains and losses from these instruments are included in earnings in the period in which they occur, and we report them as a component of other income (expense), net. The net realized and unrealized gains (losses) included in earnings to record these contracts at fair value were $153 during the first quarter of 2006.

Interest Rate Risk Management

In connection with our Residential Origination Services business, we acquire certain mortgage loan portfolios with the intention of securitizing them within a short period of time. Since the value of the mortgage loans are subject to interest rate risk prior to being securitized, we have sold short a series of three-month Eurodollar interest rate futures contracts to hedge the exposure to interest rate risk represented by our loans held for resale. Our policy is to adjust the amount of Eurodollar futures contracts that we sell short to accommodate changes in the amount of our mortgage loans held for resale. Since the Eurodollar interest rate futures contracts were not designated as hedges, changes in the fair value of the contracts and gains and losses from these instruments are included in earnings in the period in which they occur, and we report them as a component of other income (expense), net.

The following table sets forth the terms and values of our Eurodollar interest rate futures contracts as at the dates indicated:

Position	Maturity	Notional Amount	Contract Price
March 31, 2006:			
Short	June 2006 to December 2010	$ 2,206,000	94.75 to 95.40
December 31, 2005:			
Short	March 2006 to September 2010	$ 3,261,000	94.92 to 95.46

The fair value of our Eurodollar interest rate futures contracts represents the estimated amount that we would receive or pay to terminate these agreements taking into account current interest rates. The net realized and unrealized gains (losses) included in earnings to record these contracts at fair value were $1,647 during the first quarter of 2006. The following table summarizes our use of interest rate risk management instruments:

	Notional Amount Short Euro Dollar Interest Rate Futures
Balance at December 31, 2005....................	$ 3,261,000
Sales......................................	1,229,000
Maturities.................................	(340,000)
Terminations...............................	(1,944,000)
Balance at March 31, 2006	$ 2,206,000

NOTE 5 REGULATORY MATTERS

Effective June 30, 2005, the Bank terminated its status as a federal savings bank. Prior to returning its original thrift charter to the Office of Thrift Supervision ("OTS"), the Bank operated as a federal savings bank, and OCN was a registered savings and loan holding company. Our primary regulatory authority was the OTS.

Pursuant to the conditions set forth in the OTS Approval, OCN entered into an agreement (the "Guaranty") in favor of the OTS and any holders of claims with respect to liabilities assumed by OLS from the Bank (the "Assumed Liabilities"). Assumed Liabilities include all legal actions against the Bank. The Guaranty contains affirmative covenants relating to the maintenance of a $5,000 cash collateral account, reporting requirements, transactions with affiliates, preservation of the existence of our subsidiaries and maintenance of not less than $35,000 of unencumbered financial assets. Pursuant to the Guaranty, we have also agreed to certain limits on the incurrence of debt, merger or sale transactions, disposition of assets and payment of dividends. As of March 31, 2006, we were in compliance with all of the covenants specified in the Guaranty.

The Guaranty will remain in effect until the later of (a) the sixth anniversary of the date on which the Bank's federal bank charter was cancelled or (b) the date on which we have paid in full (i) any obligations that arise out of the Assumed Liabilities with respect to which a claim has been asserted on or prior to the sixth anniversary of the date on which the Bank's federal bank charter was cancelled and (ii) all other amounts payable by us under the Guaranty.

Effective June 30, 2005, the Supervisory Agreement that the Bank and OTS had entered into on April 19, 2004 terminated because we were no longer a FDIC - insured institution. The OTS retains, for a period of six years after termination of the Supervisory Agreement, the right to bring enforcement actions in respect of any breach or noncompliance by the Bank with the Supervisory Agreement, or other applicable regulations, that may have occurred prior to debanking.

We have continued the Bank's residential mortgage servicing business under OLS, which is a licensed servicer in all fifty states, the District of Columbia and Puerto Rico. As a result of debanking, we are no longer able to accept deposits in the U.S or benefit from federal preemption with regard to post-debanking activities. OLS is subject to the rules and regulations of various Federal agencies, Fannie Mae, Freddie Mac, Ginnie Mae and state regulatory authorities

BOK is licensed as a credit institution (Kreditinstitut) under the laws of the Federal Republic of Germany and is supervised and regulated in Germany by the German Federal Financial Supervisory Authority (Bundesanstalt fur Finanzdienstleistungsaufsicht, or BaFin), the German Central Bank (Deutsche Bundesbank) and, in respect of minimum reserves on deposits, the European Central Bank. BOK, under its license, may engage not only in a number of traditional banking activities such as deposit and lending business, but also in investment banking, underwriting and securities trading transactions, both for its own account and for customers. BOK is currently not material to our operations.

NOTE 6 BUSINESS SEGMENT REPORTING

A brief description of our business segments, aligned within our two areas of focus, is as follows:

Servicing

- Residential Servicing. Through this business we provide loan servicing including asset management and resolution services to third party owners of subprime residential mortgage and high loan-to-value loans for a fee. We acquire the rights to service loans by purchasing them or by entering into subservicing contracts. This segment also includes our residential loan servicing system product (REALServicing).

- Commercial Servicing. This segment includes the results of both our domestic and international servicing of commercial assets (loans and real estate), as well as our commercial loan servicing product (REALSynergy). International servicing is conducted through GSS.

- Ocwen Recovery Group. This business primarily conducts collection activities for third party owners of unsecured receivables and for a portfolio of unsecured credit card receivables that we acquired in 1999 and 2000.

Loan Processing and Origination Services

- Residential Origination Services. This business provides various loan origination services, including residential property valuation services, mortgage due diligence, title services and loan refinancing for Residential Servicing customers. This segment also includes our internet-based vendor management system product (REALTrans) and our subprime residual trading securities.

- Business Process Outsourcing. This business segment began operations in December 2002. Business Process Outsourcing provides outsourcing services to third parties including mortgage underwriting, data entry, call center services and mortgage research.

Corporate Items and Other. This segment includes items of revenue and expense that are not directly related to a business, including business activities that are individually insignificant, interest income on short-term investments of cash and the related costs of financing these investments and certain other corporate expenses.

We allocate interest income and expense to each business segment for the investment of funds raised or funding of investments made. We also make allocations of non-interest expense generated by corporate support services to each business segment.

Financial information for our segments is as follows for the dates indicated:

	Total Assets	
	March 31, 2006	December 31, 2005
Residential Servicing	$ 784,218	$ 783,560
Commercial Servicing	7,360	6,433
Ocwen Recovery Group	1,541	1,002
Residential Origination Services	431,779	679,432
Business Process Outsourcing	1,114	1,193
	1,226,012	1,471,620
Corporate Items and Other (1)	328,548	382,513
	$ 1,554,560	$ 1,854,133

(1) Includes cash of $178,901 and $264,373 at March 31, 2006 and December 31, 2005, respectively.

	Revenue	Operating Expenses	Other Income (Expense)
For the Three Months Ended March 31, 2006			
Residential Servicing	$ 79,941	$ 55,630	$ (6,443)
Commercial Servicing	3,115	2,849	(1)
Ocwen Recovery Group	2,201	2,633	82
Residential Origination Services	14,574	20,548	10,997
Business Process Outsourcing	2,723	2,725	(10)
	102,554	84,385	4,625
Corporate Items and Other	(105)	2,717	1,486
	$ 102,449	$ 87,102	$ 6,111

For the Three Months Ended March 31, 2005			
Residential Servicing	$ 68,446	$ 61,396	$ (4,103)
Commercial Servicing	4,441	4,373	(46)
Ocwen Recovery Group	3,812	3,398	89
Residential Origination Services	12,267	11,081	1,648
Business Process Outsourcing	2,586	2,455	(33)
	91,552	82,703	(2,445)
Corporate Items and Other	(64)	1,986	(1,417)
	$ 91,488	$ 84,689	$ (3,862)

NOTE 7 COMMITMENTS AND CONTINGENCIES

At March 31, 2006, we had commitments of $44,381 to fund loans secured by mortgages on single family residential properties. We also have commitments to sell $17,195 of loans held for resale generally within 30 days of funding.

Through our investment in subordinated residual securities, which had a fair value of $45,992 at March 31, 2006, we support senior classes of securities. Principal from the underlying mortgage loans generally is allocated first to the senior classes, with the most senior class having a priority right to the cash flow from the mortgage loans until its payment requirements are satisfied. To the extent that there are defaults and unrecoverable losses on the underlying mortgage loans, resulting in reduced cash flows, the most subordinate security will be the first to bear this loss. Because subordinate and residual interests generally have no credit support, to the extent there are realized losses on the mortgage loans comprising the mortgage collateral for such debt securities, we may not recover our remaining investment.

Under the terms of the sales agreements entered into in connection with the sale of certain of our affordable housing properties, we have a commitment to fund cash deficits that may arise from the operations of those properties. The remaining term of these commitments ranges from two to five years. The obligation under these commitments was $4,373 as of March 31, 2006. Any operating deficits we fund are supported by a promissory note to be repaid to us from future cash flows of the property. In addition, we have provided to the purchasers of certain affordable housing properties guaranties against the possible recapture of future tax credits. We have never experienced a recapture of tax credits on any of the affordable housing properties in which we invested or sold. We have not recognized these guaranties as a liability because the probability of recapture is considered remote.

Under the terms of the Assignment and Assumption agreement, OLS has become the successor to the Bank with respect to all legal actions. Therefore, any references to the Bank in connection with the following legal matters pertain to OLS as successor.

On April 13, 2004, the United States Judicial Panel on Multi-District Litigation granted our petition to transfer and consolidate a number of lawsuits against the Bank, OCN and various third parties arising out of the servicing of plaintiffs' mortgage loans into a single case to proceed in the United States District Court for the Northern District of Illinois under caption styled: In re Ocwen Federal Bank FSB Mortgage Servicing Litigation, MDL Docket No. 1604 (the "MDL Proceeding"). The consolidated lawsuits in which we are defendants involve 60 mortgage loans currently or previously serviced. Additional similar lawsuits have been brought in other courts, some of which may be transferred to and consolidated in the MDL Proceeding. The borrowers in these lawsuits seek class action certification. No class has been certified in the MDL Proceeding or any related lawsuits. On August 23, 2004, plaintiffs filed a Consolidated Complaint containing various claims under federal statutes, including the Real Estate Settlement Procedures Act and Fair Debt Collection Practices Act, state deceptive trade practices statutes and common law. The claims are generally based on allegations of improper loan servicing practices, including (i) charging borrowers allegedly improper or unnecessary fees such as breach letter fees, hazard insurance premiums, foreclosure-related fees, late fees and property inspection fees; (ii) untimely posting and misapplication of borrower payments; and (iii) improperly treating borrowers as in default on their loans. While the Consolidated Complaint does not set forth any specific amounts of claimed damages, plaintiffs are not precluded from requesting leave from the court to amend the Consolidated Complaint or otherwise seeking damages should the matter proceed to trial. On April 25, 2005, the court entered an Opinion and

Order granting us partial summary judgment finding that, as a matter of law, the mortgage loan contracts signed by plaintiffs authorize the imposition of breach letter fees and other legitimate default or foreclosure related expenses. The court explained that its ruling was in favor of defendants to the specific and limited extent that plaintiffs' claims challenge the propriety of the above-mentioned fees. On March 22, 2006, the court denied defendants' motions to dismiss various portions of the Consolidated Complaint on federal preemption and procedural grounds, as well as our motion to dismiss OCN from the case for lack of personal jurisdiction. The court has not ruled on class certification. We cannot currently determine the ultimate outcome of the MDL Proceeding or the other matters described above and have not established a reserve in respect thereof. We believe the allegations in the MDL Proceeding are without merit and will continue to vigorously defend against them.

On November 3, 2004, the trial judge in litigation brought by Cartel Asset Management, Inc. ("Cartel") against OCN, the Bank and Ocwen Technology Xchange, Inc. ("OTX"), a subsidiary that has been dissolved, in federal court in Denver, Colorado entered final judgment in the amount of $520 against OTX and nominal damages of two dollars against the Bank. In the November 3, 2004 order, the judge reduced a prior jury verdict in the amount of $9,320 after trial on this matter involving allegations of misappropriation of trade secrets and contract-related claims brought by a former vendor. The litigation does not relate to our Residential Servicing business. Notwithstanding the nominal damage award against the Bank, it was assessed a statutory award to Cartel of attorneys' fees in an additional amount of $170, and the Bank and OTX were further assessed costs in the amount of $9. Cartel and defendants are pursuing cross-appeals in the United States Court of Appeals for the Tenth Circuit. We intend to continue to vigorously defend this matter.

On February 8, 2005, a jury in Circuit Court for Palm Beach County, Florida returned verdicts of $1,000 and $1,056 in compensatory damages in favor of two former employees of the Bank in a lawsuit against OCN and the Bank. The jury rejected plaintiffs' request for punitive damages. The plaintiffs brought claims under the Florida Civil Rights Act, the Florida Whistleblower Act and state tort law, arising out of an alleged invasion of privacy and related incidents allegedly committed by other former employees of the Bank in 1998 for which plaintiffs sought to hold the Ocwen defendants vicariously liable. We believe the verdicts, which were reduced to final judgments on May 20, 2005, as well as an additional award of $900 in plaintiffs' attorneys' fees, are against the weight of evidence and contrary to law. Our appeals therefrom have been taken to the Florida Court of Appeals for the Fourth District. We intend to continue to vigorously defend this matter.

On November 29, 2005, a jury in County Court for Galveston County, Texas, returned a verdict of $11,500 in compensatory and punitive damages and attorneys' fees against Ocwen in favor of a plaintiff borrower who defaulted on a mortgage loan we serviced. The plaintiff claimed that Ocwen's foreclosure on the loan violated the Texas Deceptive Trade Practices Act and other state statutes and common law. On February 9, 2006, the trial court reduced the jury verdict and entered judgment in the amount of $1,830 which was comprised of $5 in actual damages, approximately $675 in emotional distress, statutory and other damages and interest, and $1,150 for attorneys' fees. We believe the judgment was against the weight of evidence and contrary to law and have asked the trial court to set it aside. We intend to continue to vigorously defend this matter and have taken an appeal to the Texas Court of Appeals.

OCN is subject to various other pending legal proceedings. In our opinion, the resolution of these proceedings will not have a material effect on our financial condition, results of operations or cash flows. We continuously monitor the status of our litigation, including advice from external legal counsel, and perform periodic assessments of our litigation for potential loss accrual and disclosure. We accrue for judgments and maintain litigation reserves when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (Dollars in thousand, except share data)

The following discussion of our results of operations, consolidated financial condition and capital resources and liquidity should be read in conjunction with our Selected Consolidated Financial Information, Consolidated Financial Statements and the related notes, all included elsewhere herein.

RISK FACTORS AND CRITICAL ACCOUNTING POLICIES

Risk Factors

We include a discussion of the principal risks and uncertainties that affect or could affect our business operations under Item 1A on pages 8 through 12 of our Annual Report on Form 10-K for the year ended December 31, 2005. There have been no material changes to this information during the first quarter of 2006.

Critical Accounting Policies

Our ability to measure and report our operating results and financial position is heavily influenced by the need to estimate the impact or outcome of risks in the marketplace or other future events. Our critical accounting policies are those that relate to the estimation and measurement of these risks. Because they inherently involve significant judgments and uncertainties, an understanding of these policies is fundamental to understanding Management's Discussion and Analysis of Results of Operations and Financial Condition. Our significant accounting policies are discussed in detail on pages 17 through 19 of Management's Discussion and Analysis of Results of Operations and Financial Condition and in Note 1 of our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2005. There have been no material changes to this information during the first quarter of 2006.

Forward Looking Statements

This Quarterly Report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including, but not limited to the following:

- projections for growth of the residential loan servicing business and business opportunities in other core businesses;
- assumptions related to the sources of liquidity and the adequacy of financial resources;
- estimates regarding interest rates and foreign currency transactions; and
- expectations related to pending litigation.

Forward-looking statements are not guarantees of future performance, and involve a number of assumptions, risks and uncertainties that could cause actual results to differ materially. Important factors that could cause actual results to differ materially from those suggested by the forward-looking statements include, but are not limited to, the following:

- general economic and market conditions,
- prevailing interest or currency exchange rates,
- availability of servicing rights for purchase,
- governmental regulations and policies,
- international political and economic uncertainty,
- availability of adequate and timely sources of liquidity,
- uncertainty related to dispute resolution and litigation, and
- real estate market conditions and trends.

Further information on the risks specific to our business are detailed within this report and our other reports and filings with the Securities and Exchange Commission, including our periodic report on Form 10-K for the year ended December 31, 2005 and our Forms 8-K filed during 2006. The forward-looking statements speak only as of the date they are made and should not be relied upon. OCN undertakes no obligation to update or revise the forward-looking statements.

OVERVIEW

Changes in Financial Condition

Total assets declined to $1,554,560 during the first three months of 2006, as compared to $1,854,133 as of December 31, 2005. This $299,573 decrease is primarily due to a $259,747 decrease in loans held for resale. The net decline in loans held for resale is largely due to a securitization transaction that closed in the first quarter, offset in part by the acquisition of additional loans in the first quarter. Also, cash and investment grade securities declined by $54,268. Partially offsetting these declines was a $15,715 increase in subordinate and residual securities that primarily resulted from securities we retained in connection with the first quarter loan securitization transaction.

Total liabilities decreased to $1,186,477 at March 31, 2006 as compared to $1,504,873 at December 31, 2005. This $318,396 decrease is largely the result of a $221,063 decline in amounts due under lines of credit and other secured borrowings, primarily reflecting reduced funding requirements on a lower balance of loans held for resale. Also, servicer liabilities, which primarily represent borrower payments held by us prior to their transfer to custodial accounts, declined by $80,804 during the first three months of 2006.

At March 31, 2006, we had $183,813 of cash, $486,445 of unused borrowing capacity on our existing lines and $366,140 of equity.

Results of Operations

We recorded net income of $16,533 for the first quarter of 2006 as compared to $2,387 for the first quarter of 2005. Our basic earnings per share were $0.26 and $0.04 for the first quarter of 2006 and 2005, respectively. Pre-tax income was $21,458 and $2,937 for the first quarter of 2006 and 2005, respectively.

Our first quarter 2006 results reflect a strong performance in our Residential Servicing segment whose pre-tax income of $17,868 represents a $14,921, or 506% increase as compared to the first quarter of 2005. This increase primarily reflects increased servicing fees on a larger servicing portfolio, the positive impact of rising short-term interest rates on our revenue from custodial accounts ("float earnings") and a reduction in total operating expenses, including a reduction in interest paid to investors related to loan pay-offs. Pre-tax income for Residential Origination Services improved to $5,023 in the first quarter of 2006, a $2,189 or 77% improvement over the first quarter of 2005. This improvement primarily reflects a gain from the securitization of loans and an increase in net interest earnings on loans as a result of higher volumes, partially offset by losses of a VIE that we began to consolidate as of the end of 2005. Ocwen Recovery Group incurred a pre-tax loss of $(350) as compared to pre-tax income of $503 during the first quarter in 2005, primarily reflecting a continuing shift in revenue from maturing proprietary assets to lower yielding third-party contracts.

We provide additional financial information and discuss our segment results in the following section.

SEGMENTS

The following section provides a discussion of the changes in financial condition of our business segments during the three months ended March 31, 2006 and a discussion of pre-tax results of operations of our business segments for the three-month periods ended March 31, 2006 and 2005.

The following table presents the assets and liabilities of each of our business segments at March 31, 2006:

	Residential Servicing	Commercial Servicing	Ocwen Recovery Group	Residential Origination Services	Busin Proc Outsou
Assets					
Cash	$ --	$ 4,248	$ --	$ 664	$
Trading securities:					
Investment grade	--	--	--	--	
Subordinates and residuals	--	--	--	45,111	
Loans held for resale	--	--	--	364,924	
Advances	234,618	267	--	3,018	
Match funded advances	357,828	--	--	--	
Mortgage servicing rights ..	146,993	--	--	--	
Receivables	19,014	2,450	819	13,525	
Premises and equipment	1,807	237	685	757	
Other assets	23,958	158	37	3,780	
Total assets	$ 784,218	$ 7,360	$ 1,541	$ 431,779	$
Liabilities					
Match funded liabilities ...	$ 322,757	$ --	$ --	$ --	$
Servicer liabilities	218,088	--	--	--	

Lines of credit and other secured borrowings	104,954	--	--	285,844	
Debt securities	--	--	--	--	
Other liabilities	33,032	3,540	3,275	7,250	
Total liabilities	$ 678,831	$ 3,540	$ 3,275	$ 293,094	$

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The following table presents the pre-tax statement of operations for each of our business segments for the quarter ended March 31, 2006:

	Residential Servicing	Commercial Servicing	Ocwen Recovery Group	Residential Origination Services	Busin Proc Outsou
Revenue					
Servicing and subservicing fees	$ 76,013	$ 2,008	$ 2,201	$ --	$
Process management fees	2,068	--	--	14,488	
Other revenues	1,860	1,107	--	86	
Total revenue	79,941	3,115	2,201	14,574	
Operating expenses					
Compensation and benefits	7,845	1,702	1,128	7,265	
Amortization of servicing rights	26,288	--	--	--	
Servicing and origination	6,110	7	126	6,954	
Technology and communications .	4,976	391	479	1,734	
Professional services	3,049	98	70	2,333	
Occupancy and equipment	2,691	171	257	606	
Other operating expenses	4,671	480	573	1,656	
Total operating expenses	55,630	2,849	2,633	20,548	
Other income (expense)					
Interest income	117	7	--	15,698	
Interest expense	(6,562)	(4)	(13)	(10,082)	
Gain (loss) on trading securities....................	--	--	--	135	
Gain (loss) on loans held for for resale, net...............	--	--	--	2,216	
Other, net	2	(4)	95	3,030	
Other income (expense), net .	(6,443)	(1)	82	10,997	
Pre tax income (loss)	$ 17,868	$ 265	$ (350)	$ 5,023	$

Residential Servicing

Comparative selected balance sheet data is as follows:

	March 31, 2006	December 31, 2005
Total assets	$ 784,218	$ 783,560
Advances	234,618	215,207
Match funded advances	357,828	377,105
Mortgage servicing rights	146,993	148,663
Receivables	19,014	23,323
Total liabilities	$ 678,831	$ 745,760
Match funded liabilities	322,757	339,292
Servicer liabilities	218,088	298,892
Lines of credit and other secured borrowings	104,954	81,218

Advances. During any period in which the borrower is not making payments, we are required under certain servicing agreements to advance our own funds to meet contractual principal and interest remittance requirements for investors, pay property taxes and insurance premiums and process foreclosures. Advances on loans serviced for others consist of the following:

	March 31, 2006	December 31, 2005
Principal and interest	$ 58,548	$ 40,201
Taxes and insurance	89,562	98,331
Other	86,508	76,675
	$ 234,618	$ 215,207

We are entitled to recover advances from borrowers for reinstated and performing loans and from investors for foreclosed loans. We record a charge to earnings to the extent that advances are uncollectible under provisions of the servicing contracts, taking into consideration historical loss and delinquency experience, length of delinquency and the amount of the advance. Advances on loans serviced for others are net of reserves of $583 and $570 as of March 31, 2006 and December 31, 2005, respectively.

Match Funded Advances. Match funded advances consist of the following:

	March 31, 2006	December 31, 2005
Principal and interest	$ 151,278	$ 174,252
Taxes and insurance	131,641	129,700
Other	74,909	73,153
	$ 357,828	$ 377,105

Match funded advances on loans serviced for others resulted from our transfers of residential loan servicing related advances to third parties in exchange for cash. We retain control of the advances, and therefore the transfers do not qualify as sales for accounting purposes. As a result, we report the amount of proceeds received from the transfers as secured borrowings with a pledge of collateral (match funded liabilities). Match funded advances are owned by special purpose entities and are, therefore, not available to satisfy general claims of creditors.

Mortgage Servicing Rights. The unamortized balance of mortgage servicing rights is primarily related to subprime residential loans. Mortgage servicing rights declined during the first three months of 2006 as amortization exceeded purchases.

Balance at December 31, 2005	$ 148,663
Purchases	24,618
Amortization	(26,288)
Balance at March 31, 2006	$ 146,993

Purchases during the first quarter of 2006 include $2,739 of servicing rights retained in connection with the securitization of loans held for resale. At March 31, 2006, we serviced loans under 455 servicing agreements for 30 investors. This compares to 466 servicing agreements for 22 investors at December 31, 2005.

Receivables. Receivables related to the Residential Servicing business include $9,016 and $15,674 at March 31, 2006 and December 31, 2005, respectively, representing fees earned from the servicing of loans and real estate. The remaining balance consists principally of reimbursable expenses due from loan servicing investors. The total balance of receivables for this segment is net of reserves of $6,198 and $6,509 at March 31, 2006 and December 31, 2005, respectively.

Match Funded Liabilities. Match funded liabilities are obligations secured by the collateral underlying the related match funded assets, and are repaid through the cash proceeds arising from those assets. We account for and report match funded liabilities as secured borrowings with pledges of collateral.

			Balance Outstandin	
Collateral	Interest Rate	Unused Borrowing Capacity	March 31, 2006	Decembe 200
Advances (1)	See (1) below	$ 52,341	$ 222,659	$ 23
Advances (2)	1-Month LIBOR + 175 basis points	24,902	100,098	10
		$ 77,243	$ 322,757	$ 33

(1) In November 2004, we executed a servicing advance securitization. This transaction involved the issuance of a term note for $100,000 and a one-year variable funding note for a maximum of $75,000. On March 31, 2005, we executed an indenture supplement to the November 2004 securitization with a closing date of April 6, 2005. This supplement included the issuance of a second term note for $75,000. In addition, the maximum amount of the variable funding note was increased to $100,000. The original term note bears interest at LIBOR plus 50 basis points, and the second term note bears interest at LIBOR plus 40 basis points. The variable funding note bears interest at a commercial paper

rate plus a margin that approximates LIBOR plus 50 basis points. The original term note under this facility has a stated maturity of October 2013, and the second term note has a stated maturity of March 2014. The variable funding note has a stated maturity of November 2011.The variable funding note has a stated maturity of November 2010. The 1-Month LIBOR was 5.00% and 4.39% at March 31, 2006 and December 31, 2005, respectively.

(2) Under the terms of the agreement, we are eligible to finance additional advances on loans serviced for others up to a maximum balance of $125,000. This facility will mature in January 2007.

Servicer Liabilities. Servicer liabilities represent amounts we have collected, primarily from Residential Servicing borrowers, that will be deposited in custodial accounts and excluded from our balance sheet, paid directly to an investment trust or refunded to borrowers. The principal components of servicer liabilities are as follows:

	March 31, 2006	December 31, 2005
Borrower payments due to custodial accounts	$ 170,921	$ 225,862
Escrow payments due to custodial accounts	8,065	22,573
Partial payments and other unapplied balances	39,102	50,457
	$ 218,088	$ 298,892

The decline in the amount of borrower payments held by us prior to their transfer to collection accounts is primarily due to slower mortgage prepayment speeds, partially offset by the increase in the average balance of loans serviced.

Lines of Credit and Other Secured Borrowings. Secured line of credit arrangements are as follows:

Borrowing Type	Interest Rate	Maturity	Unused Borrowing Capacity	Ba March 31, 2
Senior secured credit agreement (1)	1-Month LIBOR + 162.5 or 225 basis points	June 2006	$ 35,046	$ 104,9

(1) Secured by mortgage servicing rights and advances on loans serviced for others. Borrowing secured by mortgage servicing rights is at LIBOR plus 225 basis points. Borrowing secured by other acceptable collateral is at LIBOR plus 162.5 basis points. The interest rate may be reduced to 1.625% or 2.25% to the extent that we have available balances on deposit with the lender.

Comparative selected operations data is as follows:

At or For the three
ended March 3

	2006	
Unpaid principal balance of loans serviced at March 31	$ 42,855,463	$ 37
Number of loans serviced at March 31	377,540	
Average unpaid principal balance of loans serviced during the quarter	$ 43,038,004	$ 36
Pre-tax income	$ 17,868	$
Revenue:		
Servicing and subservicing fees	$ 76,013	$
Process management fees	2,068	
Other	1,860	
Total revenue	$ 79,941	$
Operating expenses:		
Compensation and benefits	$ 7,845	$
Amortization of servicing rights	26,288	
Servicing and origination	6,110	
Technology and communications	4,976	
Professional services	3,049	
Occupancy and equipment	2,691	
Other	4,671	
Total operating expenses	$ 55,630	$
Other income (expense):		
Interest income	$ 117	$
Interest expense	(6,562)	
Other	2	
Total other income (expense)	$ (6,443)	$

Servicing and Subservicing Fees. The principal components of servicing and subservicing fees are provided in the table below:

	For the three months ended March 31,	
	2006	2005
Servicing and subservicing fees	$ 50,264	$ 43,508
Late charges	9,191	9,126
Revenue from custodial accounts (float earnings)	8,821	6,507
Prepayment and collection related fees	2,467	2,225
Other fees	5,270	4,152
	$ 76,013	$ 65,518

The increase in servicing and subservicing fees in the first quarter of 2006 as compared to the first quarter of 2005 is primarily due to the increase in the average balance of loans serviced. The increase in the average balance is due to growth in the loan servicing portfolio and reduced run-off of the existing portfolio due to slower prepayment speeds. First quarter 2006 prepayment speeds fell to 30% as compared to 36% in the first quarter of 2005, largely due to rising mortgage interest rates. The increase in loan servicing fees was partially offset by a decline in real estate property management fees associated with our contract with the VA due to lower transaction volumes. The VA fees amounted to $2,955 and $3,952 during the first quarter of 2006 and 2005, respectively.

Increases in short-term interest rates have had a positive impact on float earnings. Although the average balance of funds that we have received from borrowers that are held in custodial accounts until remitted to investors has declined in the first quarter of 2006, the average yield we earned on these funds increased to 3.79% during the first quarter of 2006 as compared to 2.58% during the first quarter of 2005. Custodial accounts are excluded from our balance sheet. The average balances held in these custodial accounts were approximately $930,100 and $1,008,700 for the first three months of 2006 and 2005, respectively. The decline in the average balance in the first quarter of 2006 is primarily due to a decline in mortgage prepayment speeds offset by the increase in the average balance of loans serviced. The underlying servicing agreements restrict the investment of float balances to certain types of instruments. We are responsible for any losses incurred on the investment of these funds; although to date, we have not incurred any such losses.

The following table sets forth information regarding residential loans and real estate serviced for others:

	Loans (1)(2)(3)		Real Estate (4)		To
	Amount	Count	Amount	Count	Amount
March 31, 2006					
Performing	$ 36,394,277	306,623	$ --	--	$ 36,394,277
Non-Performing ...	5,293,625	57,087	1,167,561	13,830	6,461,186
	$ 41,687,902	363,710	$ 1,167,561	13,830	$ 42,855,463
December 31, 2005:					
Performing	$ 36,532,664	297,649	$ --	--	$ 36,532,664
Non-performing ...	5,125,116	57,420	1,121,268	13,733	6,246,384
	$ 41,657,780	355,069	$ 1,121,268	13,733	$ 42,779,048

(1) At March 31, 2006 we serviced 277,630 subprime loans with a total unpaid principal balance of $33,849,536 as compared to 304,234 subprime loans with an unpaid principal balance of $37,429,090 at December 31, 2005. Subprime loans represent residential loans we service that were made by others to borrowers who generally did not qualify under guidelines of Fannie Mae and Freddie Mac ("nonconforming loans").

(2) Non-performing loans have been delinquent for 90 days or more. Performing loans are current or have been delinquent for less than 90 days.

(3) We serviced under subservicing contracts 109,690 residential loans with an unpaid principal balance of $10,541,890 as of March 31, 2006. This compares to 105,873 residential loans with an unpaid principal balance of $10,983,237 serviced under subservicing contracts at December 31, 2005.

(4) Real estate includes $701,426 and $683,193 of foreclosed residential properties serviced for the VA at March 31, 2006 and December 31, 2005, respectively.

Compensation and Benefits Expense. The decrease in compensation expense and benefits in the first quarter of 2006 as compared to the first quarter of 2005 has occurred primarily due to a decline in the average number of employees in the U.S. as a result of cost reduction initiatives put in place in 2005, including a greater utilization of the lower cost workforce in India. Although average employment in India increased in the first quarter of 2006, total average employment declined, and the ratio of India employment to total employment increased as compared to the first quarter of 2005.

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Average employment in the Residential Servicing segment is as follows:

	For the three months ended March 31,	
	2006	2005
India	913	881
United States	441	611
	1,354	1,492

Amortization of Servicing Rights. First quarter 2006 amortization increased $1,173 or 5% as compared to the first quarter of 2005. This increase is due to an increase in our investment in mortgage servicing rights, offset by a reduction in the rate of amortization as a result of slower prepayment speeds.

Servicing and Origination Expenses. The principal components of servicing and origination expenses are as follows:

	For the three months ended March 31,	
	2006	2005
Compensating interest expense	$ 3,015	$ 5,656
Satisfaction expense	1,595	1,521
Other	1,500	1,684
	$ 6,110	$ 8,861

Mortgage prepayments generally create an obligation for us to pay compensating interest to the securitization trusts for the full month of interest on loans that were repaid before the end of a calendar month. The primary reason for the decline in compensating interest expense in the first quarter of 2006 as compared to the first quarter of 2005 is a shift towards a higher percentage of loans serviced under a mid-month structure versus a calendar month structure. Under a calendar month structure, compensating interest is paid on all loans that prepay during the month, whereas under a mid-month structure we are not obligated to pay compensating interest on prepayments that occur during the first half of the month. The effect on compensating interest expense of the lower prepayment speeds experienced in the first quarter of 2006 was largely offset by the increase in the average size of the loan servicing portfolio.

Other Operating Expenses. Other primarily consists of overhead allocation charges and bad debt expense. The $1,880 decrease in other operating expenses in the first quarter of 2006 is mostly due to a $1,864 decrease in bad debt expense. The higher bad debt expense in 2005 was primarily the result of providing for aged reimbursable expenses that may be uncollectible. Bad debt expense amounted to $261 and $2,125 in the first quarter of 2006 and 2005, respectively.

Commercial Servicing

Comparative selected balance sheet data is as follows:

	March 31, 2006	December 31, 2005
Total assets	$ 7,360	$ 6,433
Cash	4,248	3,057
Receivables	2,450	2,508
Total liabilities	$ 3,540	$ 3,220

Comparative selected operations data is as follows:

	For the three months ended March 31, 2006	2005
Pre-tax income (loss)	$ 265	$ 22
Revenue:		
Servicing and subservicing fees	$ 2,008	$ 3,086
Other	1,107	1,355
Total revenue	$ 3,115	$ 4,441
Operating expenses	$ 2,849	$ 4,373

Servicing Fees. The principal components of servicing and subservicing fees are as follows:

	For the three months ended March 31, 2006	2005
International servicing fees	$ 1,398	$ 1,730
Domestic servicing fees	610	1,356
	$ 2,008	$ 3,086

The decline in international servicing fees in the first quarter of 2006 reflects the sale of our Japan operations in December 2005. The decline in domestic servicing fees in the first quarter of 2005 is primarily due to a decline in asset resolution fees.

The following table sets forth information regarding commercial loans and real estate serviced for others:

	Loans		Real Estate		
	Amount	Count	Amount	Count	Amount
March 31, 2006:					
Performing	$ 2,054,530	297	$ --	--	$ 2,054,53
Non-performing	143,441	390	52,624	46	196,06
	$ 2,197,971	687	$ 52,624	46	$ 2,250,59
December 31, 2005:					
Performing	$ 1,389,787	300	$ --	--	$ 1,389,78
Non-performing	193,635	274	56,719	69	250,35
	$ 1,583,422	574	$ 56,719	69	$ 1,640,14

At March 31, 2006, our international offices serviced a total of 440 loans with an unpaid principal balance of $1,917,251. This compares to 272 loans with an unpaid principal balance of $1,269,796 serviced at December 31, 2005.

Operating Expenses. The decline in operating expenses in the first quarter of 2006 is primarily due to the sale of our Japan operations in December 2005.

Ocwen Recovery Group

Comparative selected operations data is as follows:

	For the three months ended March 31,	
	2006	2005
Pre-tax income (loss)	$ (350)	$ 503
Revenue:		
Servicing fees:		
Third-party collections	$ 1,933	$ 3,463
Proprietary recoveries	268	349
Total revenue	$ 2,201	$ 3,812
Operating expenses	$ 2,633	$ 3,398

The decline in revenue in the first quarter of 2006 reflects an ongoing shift in revenue from a maturing portfolio of proprietary assets to lower yielding third-party contracts. The decrease in operating expenses in the first quarter of 2006 is largely the result of ongoing process improvements, technology enhancements and a greater concentration of resources in India.

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Residential Origination Services

Comparative selected balance sheet data is as follows:

	March 31, 2006	December 31, 2005
Total assets	$ 431,779	$ 679,432
Trading securities	45,111	27,023
Loans held for resale	364,924	624,671
Receivables	13,525	18,497
Total liabilities	$ 293,094	$ 538,226
Lines of credit and other secured borrowings ...	285,844	530,569

Trading Securities. During the first three months of 2006, trading securities increased by $18,088 primarily due to residual securities with a fair value of $18,732 at March 31, 2006 that were retained in connection with the first quarter loan securitization. In addition to providing various mortgage due diligence and loan origination services, our strategy in this business includes the targeted acquisition of residual securities, either directly or indirectly, through the purchase and subsequent securitization of loans.

Subordinate and residual securities do not have a contractual maturity but are paid down over time as cash distributions are received. The weighted average remaining life of these securities was 2.3 years at March 31, 2006.The anticipated effective yield to maturity as of March 31, 2006 based on the purchase price, actual cash flows received to date and the current estimate of future cash flows under the pricing assumptions at March 31, 2006 was 17.14%. The original anticipated effective yield to maturity based on the purchase price and anticipated future cash flows under pricing assumptions at the time of purchase was 18.09%. Differences in the March 31, 2006 anticipated yield to maturity from that originally anticipated are due to differences between estimated cash flows and actual cash flows. Each quarter, we update the assumptions used to estimate future cash flows based on the actual results to date. The primary assumptions include prepayment speeds, loss rates and the discount rate. The mortgages that underlie our residential trading unrated subprime subordinate and residual securities amounted to $782,577 at March 31, 2006 and are secured by properties located in 50 states, one U.S. territory and the UK. The largest aggregate value of mortgages in any one state, territory or foreign country is $132,748 in Florida.

Loans Held for Resale. Loans held for resale represent single-family residential loans originated or acquired by our Residential Origination Services segment that we intend to sell or securitize. The $259,747 decline in loans held for resale during the first three months of 2006 is due to the securitization of loans with a carrying value of $428,168 at December 31, 2005, offset by the acquisition $158,455 of loans in preparation for a securitization transaction that closed in April 2006 and a $51,705 net increase related to our other loan refinancing, origination and sale programs. Loans held for resale are carried at the lower of cost or market value and were comprised of the following at March 31, 2006:

- Loans with a carrying value of $158,455, net of a market valuation reserve of $554, were acquired during the first quarter of 2006. These loans were securitized in a transaction that closed in April 2006.
- Loans with a carrying value of $11,144, net of a market valuation reserve of $3,206, were acquired as a part of a larger acquisition of loans in September 2005. These loans included non-performing loans at the time of acquisition. We completed a securitization in October 2005 involving the majority of the acquired loans. The remaining carrying value at March 31, 2006 includes $9,464 of non-performing loans.
- Loans with a carrying value of $51,635 were originated in connection with our origination services business.
- A balance of $17,195 represented loans that were originated in response to requests from Residential Servicing customers to refinance their

mortgage. Only loans with sales commitments prior to closing are originated under this program. Of the loans outstanding at March 31, 2006, nearly all were sold in April 2006.

- Loans with a carrying value of $126,495, net of a market valuation reserve of $146, were held by consolidated VIEs. The majority of these loans were sold or securitized in April 2006.

Receivables. The $4,972 decrease in receivables during the first quarter of 2006 is primarily due to the collection of principal and interest on loans held for resale, the balance of which has declined significantly since the end of the year.

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Lines of Credit and Other Secured Borrowings. The loans we acquired in the fourth quarter of 2005 were funded through a transaction involving the sale of loans under an agreement to repurchase, which we account for as a collateralized financing. The loans were securitized in the first quarter of 2006, and the outstanding balance was repaid. Lines of credit and other secured borrowings are as follows:

Borrowing Type	Interest Rate	Maturity	Unused Borrowing Capacity
Repurchase agreement	1-Month LIBOR + 75	March 2006 (1)	$ --
Repurchase agreement - consolidated VIE	Overnight LIBOR + 80 - 110 basis points (2)	July 2006	58,350
Repurchase agreement	1-Month LIBOR + 50 bps	February 2007	520
Master loan and security agreement (3)	1-Month LIBOR + 55 or 355 basis points	October 2006	91,886
Master loan and security agreement - consolidated VIEs (4)	1-Month LIBOR + 55 or 355 basis points	October 2006	223,400
			$ 374,156

(1) This agreement matured on March 31, 2006 and was not extended.
(2) The interest rate on this agreement varies based on the type of loan sold. Overnight LIBOR was 4.90% at March 31, 2006.
(3) We entered into this agreement on October 11, 2005 and borrowings under this agreement will be secured by mortgage loans. We can borrow up to 100% of the principal balance of the mortgage loans or 98% of the market value of the loans whichever is lower. Borrowing up to 90% of the unpaid principal balance of the loans or 88.2% of the market value of the loans bears interest at LIBOR plus 55 basis points. Borrowing above this level bears interest at LIBOR plus 355 basis points.
(4) Two consolidated VIEs entered into this agreement on October 11, 2005. Borrowings under this agreement are secured by mortgage loans. The consolidated VIEs can borrow up to 100% of the principal balance of the mortgage loans or 98% of the market value of the loans whichever is lower. Borrowing up to 90% of the unpaid principal balance of the loans or 88.2%

of the market value of the loans bears interest at LIBOR plus 55 basis points. Borrowing above this level bears interest at LIBOR plus 355 basis points.

Comparative selected operations data is as follows:

	For the three months ended March 31, 2006	For the three months ended March 31, 2005
Pre-tax income (loss)	$ 5,023	$ 2,834
Revenue:		
Process management fees	$ 14,488	$ 12,269
Other	86	(2)
Total revenue	$ 14,574	$ 12,267
Operating expenses:		
Compensation and benefits	$ 7,265	$ 2,674
Servicing and origination	6,954	4,962
Technology and communications	1,734	1,342
Professional services	2,333	142
Occupancy and equipment	606	336
Other	1,656	1,625
Total operating expenses	$ 20,548	$ 11,081
Other income (expense):		
Interest income:		
Subordinate and residual trading securities	$ 2,789	$ 3,455
Loans held for resale	12,794	4
Other	115	1
Total interest income	15,698	3,460
Interest expense	(10,082)	(501)
Gain (loss) on trading securities	135	(1,327)
Gain (loss) on loans held for resale, net	Times New Roman" SIZE="2">55,232	

Comprehensive (loss) income attributable to Kopin Corporation

$
(2,720,207
)

$
6,340,448

$
1,158,027

$
6,514,344

See notes to condensed consolidated financial statements

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KOPIN CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(Unaudited)

See notes to condensed consolidated financial statements.

	Common Stock								
	Shares	Amount	Additional Paid-in Capital	Treasury Stock	Accumulated Other Comprehensive Income(loss)	Accumulated Deficit	Total Kopin Corporation Stockholders Equity	Noncontrolling interest	Total Stockholders Equity
Balance December 27, 2008	**71,873,228**	**$ 718,732**	**$ 310,241,805**	**$ (14,552,865)**	**$ (168,303)**	**$ (157,757,433)**	**$ 138,481,936**	**$ 2,912,519**	**$ 141,394,455**
Exercise of stock options	2,625	26	9,818				9,844		9,844
Vesting of restricted stock	33,000	330	(330)						
Stock based compensation expense			757,249				757,249		757,249
Net unrealized holding gain on marketable securities					1,059,693		1,059,693		1,059,693
Foreign currency translation adjustments					(141,760)		(141,760)	(39,520)	(181,280)
Cumulative effect adjustment as of March 29, 2009 related to non credit-related losses on investments recorded in operations					(1,773,712)	1,773,712			
Change in other-than-temporary impairment loss recorded in other comprehensive income					248,355		248,355		248,355
Restricted stock for tax withholding obligations	(53,550)	(536)	(92,557)				(93,093)		(93,093)
Treasury stock purchase				(5,299,451)			(5,299,451)		(5,299,451)
Net income						5,596,410	5,596,410	(15,713)	5,580,697
Balance June 27, 2009	**71,855,303**	**$ 718,552**	**$ 310,915,985**	**$ (19,852,316)**	**$ (775,727)**	**$ (150,387,311)**	**$ 140,619,183**	**$ 2,857,286**	**$ 143,476,469**
Balance December 26, 2009	**72,267,842**	**$ 722,678**	**$ 311,299,712**	**$ (19,852,316)**	**$ 4,556,813**	**$ (136,540,351)**	**$ 160,186,536**	**$ 4,115,754**	**$ 164,302,290**

Exercise of stock options	8,165	82	30,537				30,619		30,619
Vesting of restricted stock	48,000	480	(480)						
Stock based compensation expense			1,174,094				1,174,094		1,174,094
Net unrealized holding gain on marketable securities					(1,131,353)		(1,131,353)		(1,131,353)
Foreign currency translation adjustments					(608,388)		(608,388)	(174,408)	(782,796)
Change in other-than-temporary impairment loss recorded in other comprehensive income					420,846		420,846		420,846
Restricted stock for tax withholding obligations	(26,467)	(265)	(103,168)				(103,433)		(103,433)
Net income						2,897,768	2,897,768	163,018	3,060,786
Balance June 26, 2010	**72,297,540**	**$ 722,975**	**$ 312,400,695**	**$ (19,852,316)**	**$ 3,237,918**	**$ (133,642,583)**	**$ 162,866,689**	**$ 4,104,364**	**$ 166,971,053**

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KOPIN CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended	
	June 26, 2010	June 27, 2009
Cash flows from operating activities:		
Net income	$ 3,060,786	$ 5,580,697
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,697,463	3,011,561
Amortization of premium (accretion of discount) on marketable debt securities	(84,112)	154,078
Stock-based compensation	1,174,094	757,249
Equity losses in unconsolidated affiliate	182,586	290,658
Impairment on marketable debt securities		926,630
Foreign currency losses (gains)	366,374	(132,583)
Gain on sale of investments	(2,597,505)	
Change in allowance for bad debt		24,519
Change in warranty reserves		350,000
Change in inventory reserves	268,750	553,429
Changes in assets and liabilities:		
Accounts receivable and unbilled receivables	(1,594,190)	3,541,771
Inventory	(1,388,326)	(66,886)
Prepaid expenses and other current assets	(1,352,014)	(1,279,025)
Accounts payable and accrued expenses	(109,215)	(1,403,051)
Billings in excess of revenue earned	(487,030)	(110,893)
Net cash provided by operating activities	1,137,661	12,198,154
Cash flows from investing activities:		
Proceeds from sale and maturity of marketable debt securities	24,168,590	21,523,154
Purchase of marketable debt securities	(36,837,378)	(29,910,068)
Proceeds from sale of investments	4,223,536	
Other assets	28,533	(13,181)
Capital expenditures	(4,316,868)	(542,483)
Net cash used in investing activities	(12,733,587)	(8,942,578)
Cash flows from financing activities:		
Treasury stock purchases		(5,299,451)
Proceeds from exercise of stock options	30,619	9,844
Settlements of restricted stock for tax withholding obligations	(103,433)	(93,093)
Net cash used in financing activities	(72,814)	(5,382,700)
Effect of exchange rate changes on cash	7,210	25,890
Net decrease in cash and equivalents	(11,661,530)	(2,101,234)
Cash and equivalents:		
Beginning of period	54,832,744	57,949,449

End of period	$	43,171,214	$	55,848,215
Supplemental disclosure of cash flow information:				
Income taxes paid	$	200,000	$	412,000
Supplemental schedule of noncash investing activities:				
Construction in progress included in accrued expenses	$	464,000	$	

See notes to condensed consolidated financial statements

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KOPIN CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The condensed consolidated financial statements include the accounts of Kopin Corporation, its wholly owned subsidiaries, Kowon Technology Co., Ltd. (Kowon), a majority owned (78%) subsidiary located in Korea, and Kopin Taiwan Corporation (KTC), a majority owned (87%) subsidiary located in Taiwan (collectively the Company). Amounts of Kowon and KTC not attributable to the Company are referred to as noncontrolling interests. All intercompany transactions and balances have been eliminated. The condensed consolidated financial statements for the three and six months ended June 26, 2010 and June 27, 2009 are unaudited and include all adjustments which, in the opinion of management, are necessary to present fairly the results of operations for the periods then ended. These condensed consolidated financial statements should be read in conjunction with the Company s annual consolidated financial statements and notes thereto.

The results of the Company s operations for any interim period are not necessarily indicative of the results of the Company s operations for any other interim period or for a full fiscal year.

2. CASH AND EQUIVALENTS AND MARKETABLE SECURITIES

The Company considers all highly liquid, short-term debt instruments with original maturities of three months or less to be cash equivalents.

Marketable debt securities consist primarily of commercial paper, medium-term corporate notes, and United States government and agency backed securities. The Company classifies these marketable debt securities as available for sale in Marketable Securities . The investment in Advanced Wireless Semiconductor Company (AWSC) is included in Other Assets as available-for-sale and recorded at fair value. The Company records the amortization of premium and accretion of discounts on marketable debt securities in the results of operations.

The Company uses the specific identification method as a basis for determining cost and calculating realized gains and losses for marketable securities. The gross gains and losses realized related to sales and maturities of marketable debt securities were not material during the six months ended June 26, 2010 and the year ended December 26, 2009.

Investments in available-for-sale marketable debt securities are as follows at June 26, 2010 and December 26, 2009:

	Amortized Cost		Unrealized Gains		Unrealized Losses		Fair Value	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**
U.S. government and agency backed securities	$ 32,761,457	$ 29,601,836	$ 435,720	$ 188,068	$	$	$ 33,197,177	$ 29,789,904
Corporate debt	38,487,244	29,433,451	480,546	490,402			38,967,790	29,923,853
Total	$ 71,248,701	$ 59,035,287	$ 916,266	$ 678,470	$	$	$ 72,164,967	$ 59,713,757

The contractual maturity of the Company s marketable debt securities is as follows at June 26, 2010:

	Less than One year	One to Five years	Greater than Five years	Total
U.S. government and agency backed securities	$ 2,649,140	$ 26,177,833	$ 4,370,204	$ 33,197,177
Corporate debt	16,025,684	17,099,856	5,842,250	38,967,790
Total	$ 18,674,824	$ 43,277,689	$ 10,212,454	$ 72,164,967

The Company conducts a review of its marketable debt securities on a quarterly basis for the presence of other-than-temporary impairment (OTTI). Included in Other Income and Expense is an impairment charge on investments in corporate debt instruments of $0.9 million for the six months ended June 26, 2009.

The Company assesses whether OTTI is present when the fair value of a debt security is less than its amortized cost basis at the balance sheet date. Under these circumstances OTTI is considered to have occurred (1) if the Company intends to sell the security before recovery of its amortized cost basis; (2) if it is more likely than not the Company will be required to sell the security before recovery of its amortized cost basis; or (3) the present value of expected cash flows is not sufficient to recover the entire amortized cost basis.

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KOPIN CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company further estimates the amount of OTTI resulting from a decline in the credit worthiness of the issuer (credit-related OTTI) and the amount of non credit-related OTTI. Noncredit-related OTTI can be caused by such factors as market illiquidity. Credit-related OTTI is recognized in earnings while noncredit-related OTTI on securities not expected to be sold is recognized in other comprehensive income (OCI). The Company reclassified $1.8 million of non credit-related OTTI recognized in its earnings prior to March 29, 2009 from retained earnings to accumulated OCI as a cumulative effect adjustment when it adopted a new accounting standard in the second quarter of 2009.

3. FAIR VALUE MEASUREMENTS

Financial instruments are categorized as Level 1, Level 2 or Level 3 based upon the method by which their fair value is computed. An investment is categorized as Level 1 when its fair value is based on unadjusted quoted prices in active markets for identical assets that the Company has the ability to access at the measurement date. An investment is categorized as Level 2 if its fair market value is based on quoted market prices for similar assets in active markets, quoted prices for identical or similar assets in markets that are not active, based on observable inputs such as interest rates, yield curves, or derived from or corroborated by observable market data by correlation or other means. An investment is categorized as Level 3 if its fair value is based on assumptions developed by the Company about what a market participant would use in pricing the assets.

		Fair Value Measurement at June 26, 2010 Using:		
		Level 1	**Level 2**	**Level 3**
Money Markets and Cash Equivalents	$ 43,171,214	$ 43,171,214	$	$
U.S. Government Securities	33,197,177	33,197,177		
Corporate Debt	38,967,790	14,988,973	23,978,817	
Investment in AWSC	3,767,629	3,767,629		
	$ 119,103,810	$ 95,124,993	$ 23,978,817	$

		Fair Value Measurement at December 26, 2009 Using:		
		Level 1	**Level 2**	**Level 3**
Money Markets and Cash Equivalents	$ 54,832,744	$ 54,832,744	$	$
U.S. Government Securities	29,789,904	29,789,904		
Corporate Debt	29,923,853	2,434,824	27,489,029	
Investment in Micrel, Inc.	1,640,678	1,640,678		
Investment in AWSC	5,122,133	5,122,133		
	$ 121,309,312	$ 93,820,283	$ 27,489,029	$

4. INVENTORY

Inventory is stated at the lower of cost (determined on the first-in, first-out or specific identification method) or market and consists of the following at June 26, 2010 and December 26, 2009:

	June 26, 2010	December 26,

		2009
Raw materials	$ 8,309,227	$ 8,336,915
Work-in-process	3,840,657	3,416,727
Finished goods	5,381,190	4,700,227
	$ 17,531,074	$ 16,453,869

Inventory on consignment at customer locations was $4.4 million and $3.2 million at June 26, 2010 and December 26, 2009, respectively. Included in prepaid expenses and other current assets is a deposit of $1.3 million for raw materials in advance of delivery.

5. NET INCOME PER SHARE

Basic net income per share is computed using the weighted average number of shares of common stock outstanding during the period less any unvested restricted shares. Diluted earnings per common share is calculated using weighted-average shares outstanding and contingently issuable shares, less weighted-average shares reacquired during the period. The net outstanding shares are adjusted for the dilutive effect of shares issuable upon the assumed conversion of the Company s common stock equivalents, which consist of outstanding stock options and unvested restricted stock units.

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KOPIN CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Weighted average common shares outstanding used to calculate earnings per share are as follows:

	Three Months Ended		Six Months Ended	
	June 26, 2010	June 27, 2009	June 26, 2010	June 27, 2009
Weighted average common shares outstanding-basic	66,625,637	66,704,092	66,606,789	67,428,519
Stock options and nonvested restricted common stock	731,660	845,581	727,178	608,584
Weighted average common shares outstanding -diluted	67,357,297	67,549,673	67,333,967	68,037,103

The following were not included in weighted average common shares outstanding-diluted because they are anti-dilutive or performance conditions have not been met at the end of the period.

	June 26, 2010	June 27, 2009
Nonvested restricted common stock	948,189	246,524
Stock options	3,368,473	5,409,645
Total	4,316,662	5,656,169

6. STOCK BASED COMPENSATION

The fair value of stock option awards is estimated on the date of grant using the Black-Scholes-Merton option-pricing model. There were no stock options granted in fiscal years 2010 and 2009. The fair value of nonvested restricted common stock awards is generally the market value of the Company s equity shares on the date of grant. The nonvested common stock awards require the employee to fulfill certain obligations, including remaining employed by the Company for one, two or four years (the vesting period) and in certain cases meeting performance criteria. The performance criteria primarily consist of the achievement of the Company s annual incentive plan goals. For nonvested restricted common stock awards which solely require the recipient to remain employed with the Company, the stock compensation expense is amortized over the anticipated service period. For nonvested restricted common stock awards which require the achievement of performance criteria, the Company reviews the probability of achieving the performance goals on a periodic basis. If the Company determines that it is probable that the performance criteria will be achieved, the amount of compensation cost derived for the performance goal is amortized over the service period. If the performance criteria are not met, no compensation cost is recognized and any recognized compensation cost is reversed. The Company recognizes compensation costs on a straight-line basis over the requisite service period for time vested awards. For awards that vest based on performance conditions, the Company uses the accelerated model for graded vesting awards.

A summary of award activity under the stock option plans as of June 26, 2010 and changes during the six month period is as follows. All options were vested as of June 26, 2010.

	Six months ended June 26, 2010	
	Shares	Weighted

		Average Exercise Price
Balance, December 26, 2009	4,337,902	$ 10.90
Options granted		
Options forfeited/cancelled	(605,414)	28.18
Options exercised	(8,165)	3.75
Balance, June 26, 2010	3,724,323	$ 8.11
Exercisable, June 26, 2010	3,724,323	

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KOPIN CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes information about stock options outstanding and exercisable at June 26, 2010:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	**Number Outstanding**	**Weighted Average Remaining Contractual Life (Years)**	**Weighted Average Exercise Price**	**Number Exercisable**	**Weighted Average Exercise Price**
$ 0.01 $ 3.55	132,500	5.98	$3.42	132,500	$ 3.42
$ 3.75 $ 4.97	1,128,980	3.61	4.45	1,128,980	4.45
$ 5.00 $ 9.95	1,105,587	3.18	6.01	1,105,587	6.01
$10.00 $13.00	1,097,912	1.77	11.57	1,097,912	11.57
$14.31 $44.88	259,344	1.39	20.70	259,344	20.70
	3,724,323	2.87	$8.11	3,724,323	$ 8.11
Aggregate intrinsic value on June 26, 2010	$ 21,075			$ 21,075	

NonVested Restricted Common Stock

A summary of the activity for nonvested restricted common stock awards as of June 26, 2010 and changes during the six months then ended is presented below:

	Shares	**Weighted Average Grant Fair Value**
Balance December 26, 2009	2,111,166	$ 3.27
Granted	541,601	4.49
Forfeited		
Vested	(48,000)	2.87
Balance June 26, 2010	2,604,767	$ 3.53

Stock-Based Compensation

The following table summarizes stock-based compensation expense within each of the categories below as it relates to employee stock options and nonvested restricted common stock awards for the six months ended June 26, 2010 and June 27, 2009 (no net tax benefits were recognized):

Six Months Ended

	June 26, 2010	June 27, 2009
Cost of product revenues	$ 274,000	$ 203,000
Research and development	170,000	103,000
Selling, general and administrative	730,000	451,000
Total	$ 1,174,000	$ 757,000

The total unrecognized compensation cost related to nonvested restricted common stock awards is expected to be recognized over a weighted average period of 3 years. The total unrecognized compensation cost at June 26, 2010 is $5.9 million.

7. OTHER ASSETS AND AMOUNTS DUE TO / FROM AFFILIATES

Marketable Equity Securities

At June 26, 2010 the Company had an investment in Advance Wireless Semiconductor Company (AWSC), with a fair market value of $3.8 million and an adjusted cost basis of $0.8 million, as compared to a fair market value of $5.1 million and an adjusted cost basis of $0.9 million at December 26, 2009.

One of the Company s Directors is a director of AWSC and several directors and officers own amounts ranging from 0.1% to 0.5% of the outstanding stock of AWSC.

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KOPIN CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the second quarter of 2010 the Company sold shares of AWSC with an adjusted cost basis of $0.2 million and recorded a gain of $1.6 million. Also during the first quarter the Company received approximately $0.3 million representing an amount escrowed from the sale of the Company s Kenet investment in 2008.

During the first quarter of 2010 the Company sold its investment in Micrel, Inc. and recorded a gain of $0.7 million.

Non-Marketable Securities Equity Method Investments

The Company has an approximate 19% interest in KoBrite and at June 26, 2010 the carrying value of the investment was $3.1 million. The Company accounts for its interest in KoBrite using the equity method and for the six months ended June 26, 2010 and June 27, 2009 recorded equity losses in unconsolidated affiliates of $0.2 million and $0.3 million, respectively. One of the Company s Directors is also a member of the Board of Directors of Bright LED, one of the principal investors of KoBrite.

Summarized financial information for KoBrite for the three and six month periods ended March 27, 2010 and March 28, 2009 and for KTC for the three and six month periods ended June 27, 2009 is as follows (KoBrite s results are recorded one quarter in arrears). As described below in Note 8, KTC became a consolidated subsidiary as of July 31, 2009.

	Three Months Ended		**Six Months Ended**	
	June 26, 2010	**June 27, 2009**	**June 26, 2010**	**June 27, 2009**
Revenue	$ 3,582,000	$ 3,352,000	$ 6,814,000	$ 5,152,000
Gross margin	(161,000)	(310,000)	(147,000)	(537,000)
Loss from operations	(577,000)	(1,015,000)	(1,075,000)	(2,126,000)
Net loss	$ (463,000)	$ (915,000)	$ (940,000)	$ (2,119,000)

Amounts Due from and Due to Affiliates

Related party receivables at June 26, 2010 and December 26, 2009 approximate the following amounts:

	June 26, 2010	**December 26, 2009**
Advanced Wireless Semiconductor Company trade receivables	$ 4,813,000	$ 2,885,000
KoBrite trade receivables	67,000	105,000
KoBrite non-trade receivables		453,000
Accounts receivable from unconsolidated affiliates	$ 4,880,000	$ 3,443,000

In fiscal year 2008 the Company entered into an agreement wherein it agreed to sell certain of its patents that it was no longer using to a party who would attempt to sub-license the patents. Under the terms of the agreement the amount the Company would receive for the sale of the patents was a percentage of any fees, after expenses, from the sublicense. In the three and six months ended June 26, 2010, the Company recorded $0 and $0.2 million, respectively, of fees from the sale of these patents as compared to $1.5 million and $4.1 million for the three and six months ended June 27, 2009.

8. ACQUISITION OF EQUITY INTERESTS IN KTC

On July 30, 2009, and August 11, 2009 the Company purchased an additional 19,572,468 and 128,226, respectively, shares of KTC common stock for approximately $6.3 million. As a result of these two transactions and the Company s previous investments in KTC, the Company owns approximately 87% of the now outstanding common stock of KTC.

The following supplemental pro forma disclosures are provided for the three and six months ended June 27, 2009, assuming the acquisition of the controlling interest in KTC had occurred as of December 26, 2008 (the first day of the Company s 2009 fiscal year). All intercompany transactions have been eliminated.

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KOPIN CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Three Months Ended June 27, 2009	Six Months Ended June 27, 2009
Revenues	$ 28,229,000	$ 50,100,000
Net income	$ 3,522,000	$ 5,047,000

9. ACCRUED WARRANTY

The Company warrants its products against defect for 12 months. A provision for estimated future costs and estimated returns for credit relating to warranty is recorded in the period when product is shipped and revenue recognized, and is updated as additional information becomes available. The Company s estimate of future costs to satisfy warranty obligations is based primarily on historical warranty expense experienced and a provision for potential future product failures. Changes in the accrued warranty for the six month periods ended June 26, 2010 and June 27, 2009 are as follows:

	Six Months Ended	
	June 26, 2010	June 27, 2009
Beginning Balance	$ 1,600,000	$ 1,250,000
Additions	327,000	1,266,000
Claim and reversals	(327,000)	(916,000)
Ending Balance	$ 1,600,000	$ 1,600,000

10. INCOME TAXES

The Company s tax provision of $93,000 for the six months ended June 26, 2010 represents alternative minimum tax, state income tax and foreign tax expenses which are partially offset by the Company s net operating loss carryforwards (NOL) and tax credits.

As of June 26, 2010, the Company has available for tax purposes federal NOLs of $21.6 million expiring through 2030. The Company has recognized a full valuation allowance on its net deferred tax assets due to the uncertainty of realization of such assets. The Company has not historically recorded, nor does it intend to record the excess tax benefits from stock awards until realized. Unrecorded benefits from stock awards approximate $12.1 million.

The Company s income tax returns have not been examined by the Internal Revenue Service and are subject to examination for all years since 1994. State income tax returns are generally subject to examination for a period of 3 to 5 years after filing of the respective return. The state impact of any federal changes remains subject to examination by various states for a period of up to one year after formal notification to the states.

11. SEGMENTS AND GEOGRAPHICAL INFORMATION

The Company s chief operating decision maker is its Chief Executive Officer. The Company s chief operating decision maker evaluates the operating results of the Company s reportable segments based on revenues and net income.

The Company has three operating and reportable segments: (i) Kopin U.S., which includes the operations in the United States and the Company s equity method investments, (ii) Kowon and (iii) KTC (commencing in the third quarter of 2009). The following table presents the Company s reportable segment results for the three and six month periods ended June 26, 2010 and June 27, 2009:

	Kopin U.S.	Kowon	KTC	Adjustments	Total
Three Months Ended					
June 26, 2010					
Revenues	$ 29,337,000	$ 2,856,000	$ 2,367,000	$ (4,371,000)	$ 30,189,000
Net income (loss) attributable to the controlling interest	914,000	881,000	293,000	(227,000)	1,861,000
June 27, 2009					
Revenues	$ 28,229,000	$ 1,803,000	$	$ (1,803,000)	$ 28,229,000
Net income (loss) attributable to the controlling interest	4,374,000	(893,000)	$	200,000	3,681,000

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KOPIN CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Kopin U.S.	Kowon	KTC	Adjustments	Total
Six Months Ended					
June 26, 2010					
Revenues	$ 54,303,000	$ 5,239,000	$ 3,926,000	$ (7,825,000)	$ 55,643,000
Net income (loss) attributable to the controlling interest	2,112,000	590,000	359,000	(163,000)	2,898,000
June 27, 2009					
Revenues	$ 49,528,000	$ 3,887,000	$	$ (3,710,000)	$ 49,705,000
Net income (loss) attributable to the controlling interest	5,606,000	(25,000)	$	15,000	5,596,000

The adjustments to reconcile to the consolidated financial statement total revenue and net income include the elimination of intercompany sales and noncontrolling interest in income of subsidiary.

During the three and six month periods ended June 26, 2010 and June 27, 2009, the Company derived its sales from the following geographies (as a percentage of net sales):

	Three Months Ended		Six Months Ended	
	June 26, 2010	June 27, 2009	June 26, 2010	June 27, 2009
Asia-Pacific	22%	13%	24%	14%
Americas	78%	87%	76%	86%
Total Revenues	100%	100%	100%	100%

During the three month periods ended June 26, 2010 and June 27, 2009, revenues by product group consisted of approximately the following:

	Three Months Ended		Six Months Ended	
	June 26, 2010	June 27, 2009	June 26, 2010	June 27, 2009
Display	$ 14,257,000	$ 17,859,000	$ 25,197,000	$ 32,471,000
III-V	15,932,000	10,370,000	30,446,000	17,234,000
Total Revenues	$ 30,189,000	$ 28,229,000	$ 55,643,000	$ 49,705,000

12. LITIGATION

The Company is engaged in legal proceedings arising in the ordinary course of business. On August 14, 2009, a complaint was filed against us and certain of our officers and directors in Massachusetts Superior Court in Bristol County, asserting that the defendants breached fiduciary duties in connection with the issuance of proxy statements, which allegedly contained false and misleading statements concerning certain of our past stock option grants. We served the plaintiff a motion to dismiss in October 2009, and oral arguments were heard in June 2010 on this matter. Claims, suits, investigations and proceedings are inherently uncertain and it is not possible to predict the ultimate outcome of the matters previously discussed. While the Company will continue to defend itself vigorously in all such matters, it is possible that the Company s business, financial condition, results of operations or cash flows could be affected in any particular period by the resolution of one or more of these matters.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements

This Quarterly Report on Form 10-Q 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 belief that we will continually evaluate our estimates used in the preparation of our financial statements; our belief that we are a leading developer and manufacturer of advanced semiconductor products and miniature displays; our expectation that we will use our proprietary semiconductor material technology to design, manufacture and market our III-V and display products; our belief that the increase in industry sales of 3G and smart phones will continue in 2010; our belief that the U.S. government is reducing research and development funding; our belief that the U.S. military programs that we support with our display products will continue to be an important weapon for U.S. soldiers; our belief that that 2009 III-V revenues were below normal expectations as our customers

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decreased orders as a result of the weak global environment at that time; our expectation that the prices of certain of our products will decline in fiscal year 2010; our expectation that the average selling price of certain of our products for consumer application will decline approximately 5% to 10%; our expectation that the average sales price of our display products for military applications will remain relatively flat for 2010; our expectation that the overall increase or decrease in the average sales price of our display products will be dependent on the sales mix of commercial and military display sales; our expectation that if our display products for consumer electronic applications do not increase or new markets are not identified, we may have to record impairment charges on Kowon s long lived assets; our expectation that revenue will be between $120 million and $130 million for fiscal year 2010; our belief that if sales of smart phones do not average growth rate of approximately 35% to 40% over the next five years we may not reach our revenue goals; our belief that if we do not renew certain customer agreements or increase HBT transistor wafer sales to other customers our sales may decline and we may not meet our revenue projections; our expectation that 2010 revenues will primarily be from customers located in the U.S.; our belief that in 2010 sale prices of display products for military applications will remain stable and sales prices of our III-V products for wireless handset applications will decline; our belief that one of the benefits of our display technology is the ability to produce high resolution displays in small form factors; our belief that 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 our belief that we may be subject to alternative minimum taxes, foreign taxes and state income taxes; our expectation that we will not receive any additional material amounts from the sales of certaion patents; our expectation that we will expend between $10.0 million and $20.0 million on capital expenditures over the next twelve months; our belief that our available cash resources will support our operations and capital needs for at least the next twelve months; our expectation that our third quarter will be our strongest sales quarter for sales of our displays to customers who use them in consumer electronic applications and sales of our III-V products, followed by our second quarter then our fourth quarter and our first quarter would be our lowest sales quarter; our expectation that we will sell more display products for military applications which we do not expect to have the historical sales trends of our consumer oriented products; our belief that our principle sales of HBT transistors has not demonstrated the seasonal pattern over the last two years that we would expect; 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 to our cash flows or income; our 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. 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 set forth in our other periodic filings filed with the Securities and Exchange Commission, including our Form 10-K for the fiscal year ended December 26, 2009.

Critical Accounting Policies

Management s discussion and analysis of our financial condition and results of operations are based upon our unaudited 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. We continually evaluate our estimates used in the preparation of our financial statements, including those related to revenue recognition under the percentage of completion method, bad debts, inventories, warranty reserves, investment valuations, valuation of stock compensation awards and recoverability of deferred tax assets. 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 will most likely differ from these estimates. Further detail regarding our critical accounting policies can be found in Item 7. Management Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 26, 2009.

Business Matters

We are a leading developer and manufacturer of advanced semiconductor products and miniature displays. We use our proprietary semiconductor material technology to design, manufacture and market our III-V and display products for use in highly demanding commercial, industrial and military mobile wireless communication and high-resolution electronic applications.

We have two principal sources of revenues: product revenues and research and development revenues. Product revenues consist of sales of our CyberDisplay products and our III-V products, principally gallium arsenide (GaAs) HBT transistor wafers. Research and development revenues consist primarily of development contracts with agencies of the U.S. government. For the three and six months ended June 26, 2010, research and development revenues were $1.1 million and $2.6 million respectively. This contrasted with $2.1 million and $3.0 million for the corresponding period in 2009.

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Results of Operations

The three and six month periods ended June 26, 2010 and June 27, 2009 are referred to as 2010 and 2009, respectively. The year ended periods December 26, 2009 and December 27, 2008 are referred to as fiscal year 2009 and fiscal year 2008, respectively.

Revenues. For the three and six month periods ended June 26, 2010 and June 27, 2009, our revenues, which include product sales and amounts earned from research and development contracts, were as follows (in millions):

Revenues (in millions):	Three Months Ended June 26, 2010	Three Months Ended June 27, 2009	Six Months Ended June 26, 2010	Six Months Ended June 27, 2009
Cyber Display	$ 14.3	$ 17.9	$ 25.2	$ 32.5
III-V	15.9	10.3	30.4	17.2
Total revenues	$ 30.2	$ 28.2	$ 55.6	$ 49.7

The increase in our III-V revenues resulted primarily from an increase in demand from customers who purchase our HBT transistor wafers for use in cellular handsets. We believe there was an increase in demand of 3G or smart phones in 2010 over 2009. 3G and smart phones offer more functions, for example web browsing, than a standard wireless handset. 3G and smart phones require more HBT transistors than a standard wireless handset to support the increased functionality. We believe the increase in industry sales of 3G and smart phones will continue in 2010. In addition we believe that first quarter of 2009 III-V revenues were below normal expectations as our customers decreased orders as a result of the weak global environment at that time and therefore the six month comparison for 2010 and 2009 may not be representative of typical results.

The decrease in display revenues in 2010 compared to 2009 resulted from a decrease in sales of our CyberDisplay products to customers that use them for military (military customers) and consumer electronic applications, partially offset by increases in sales of our products for eyewear applications. If and when we receive purchase orders and ship our displays for military applications is dependent on the government procurement cycle. Display revenues for consumer and military applications for 2010 and 2009 were as follows:

Display Revenues by Category (in millions)	Three Months Ended June 26, 2010	Three Months Ended June 27, 2009	Six Months Ended June 26, 2010	Six Months Ended June 27, 2009
Consumer Electronic Applications	$ 2.8	$ 2.1	$ 5.0	$ 4.3
Military Application	10.1	13.7	16.4	25.0
Eyewear Application	0.5	0.3	1.5	0.7
Research & Development	0.9	1.8	2.3	2.5
Total	$ 14.3	$ 17.9	$ 25.2	$ 32.5

We expect revenue of between $120 million and $130 million for fiscal year 2010, however our ability to forecast revenues and results of operations is very limited. Our forecasts are based on our discussions with customers, expectations about U.S. military spending and our expectations about the future global economy and are not based on firm non-cancellable orders. During the first six months of 2010 we believe orders from military customers were delayed as the U.S. Department of Defense (DoD) reviewed its budgets. We believe that this review was prompted by the U.S. federal budget deficit. We also believe that the U.S. government is reducing research and development funding. We believe the U.S. military programs that we support with our display products will continue to be an important weapon for U.S. soldiers; however, our receipt of orders from our military customers may be affected by DoD budgets which are expected to decline. An important element in our projections is the continued increase in sales of smart phones. Industry estimates indicate that sales of smart phones will have a constant average growth rate of approximately 35% to 40% over the next five years. If these forecasts are incorrect we may not reach our revenue goals.

We anticipate, based on current discussions with our customers, historical trends and certain contractual obligations, that the prices of certain of our products used for consumer applications will decline in the range of 5% to 10% per year. We expect the average sales price of our display products for military applications to remain relatively flat. We define a price decrease as the sales price of the identical product being lower in the current period as compared to the preceding period or periods. We do not consider new versions of products in determining whether a price decline has occurred. The overall increase or decrease in the average sales price of our products will be dependent on the sales mix of commercial and military display sales.

The back-end packaging manufacturing process of our displays which are sold for consumer applications is performed at Kowon. Kowon had a net loss of approximately $0.1 million from operations for the six months ended June 26, 2010. If sales of our display products for consumer electronic applications do not increase or new markets are not identified, we may have to record impairment charges on Kowon s long lived assets, which are recorded in our financial statements at $2.8 million at June 26, 2010.

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International sales represented 24% and 14% of product revenues for the six months ended June 26, 2010 and June 27, 2009, respectively. The increase in international sales is primarily attributable to an increase in sales of our CyberDisplay products for eyewear applications and III-V products to customers who are primarily Asian-based and a decline in sales of our display products for military electronic applications. We expect our 2010 revenues will primarily be from customers located in the U.S. International sales are primarily sales of CyberDisplay products to consumer electronic manufacturers located in Japan, Korea and China and our III-V products to customers in Taiwan. 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.

	Three Months Ended		Six Months Ended	
Cost of product revenues :	**June 26, 2010**	**June 27, 2009**	**June 26, 2010**	**June 27, 2009**
Cost of product revenues (in millions):	$ 21.9	$ 19.4	$ 39.4	$ 34.0
Cost of product revenues as a % of net product revenues	75.0%	74.3%	74.3%	72.8%

Cost of product revenues, which is comprised of materials, labor and manufacturing overhead related to our products, increased approximately $5.4 million or 16% for the six month period ended June 26, 2010 as compared to the same period in 2009. Our gross margin is affected by increases or decrease in the sales prices 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 for our HBT wafers and displays sold for commercial applications historically decline on an annual basis. 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 very dependent on the sales prices of our products, yields and volume of sales. Gross margins as a percentage of revenues decreased because sales of our display products for military applications, which have higher gross margins than our other products, decreased as a percentage of our total revenues for 2010 as compared to 2009 and lower sales prices of our III-V products. For 2010 we anticipate sale prices of display products for military applications to remain stable and sales prices of our III-V products for wireless handset applications to decline. As a result, in order for us to increase gross margins we need to increase manufacturing efficiencies and or increase the unit volume of sales.

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 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.

Research and Development. Research and development (R&D) expenses are incurred in support of internal display and III-V product development programs or programs funded by agencies or prime contractors of the U.S. government and commercial partners. R&D revenues associated with funded programs are presented separately in revenue in the statement of operations. Research and development costs include staffing, purchases of materials and laboratory supplies, circuit design costs, fabrication and packaging of display products, and overhead. For 2010 and 2009, R&D expense was as follows (in millions):

	Three Months Ended		Six Months Ended	
Research and development expense (in millions):	**June 26, 2010**	**June 27, 2009**	**June 26, 2010**	**June 27, 2009**
Funded	$ 0.8	$ 1.1	$ 1.4	$ 1.6
Internal	4.1	2.7	7.8	5.3
Total research and development expense	$ 4.9	$ 3.8	$ 9.2	$ 6.9

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Funded R&D expense decreased in 2010 as compared to the prior year primarily because of a decrease in funded programs from agencies and prime contractors of the U.S. government.

The increase in internal research and development expenses was primarily attributed to higher costs for the development of certain industrial display and display eyewear products and III-V products for 3G and smartphone applications. For the three and six months ended June 26, 2010 R&D included approximately $0.1 million and $0.2 million, respectively, of expenses for Kopin Taiwan Corporation

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.

	Three Months Ended		Six Months Ended	
	June 26, 2010	June 27, 2009	June 26, 2010	June 27, 2009
Selling, general and administration expense (in millions):	$ 4.2	$ 2.6	$ 7.9	$ 7.0
Selling, general and administration expense as a % of revenues	14.0%	9.0%	14.1%	14.1%

The increase in S,G&A expenses in 2010 as compared to 2009 is attributable to increases of approximately $0.4 million in labor costs, $0.2 million of professional fees, $0.3 million of incentive plans and $0.2 million of investor relations costs partially offset by a decrease in warranty costs of $0.4 million. For the three and six months ended June 26, 2010 S,G&A also included approximately $0.2 million and $0.3 million, respectively, of expenses for Kopin Taiwan Corporation.

Other Income and Expense.

	Three Months Ended		Six Months Ended	
	June 26, 2010	June 27, 2009	June 26, 2010	June 27, 2009
Other income and expense (in millions):	$ 3.1	$ 1.5	$ 4.1	$ 4.8

Other income and expense, net, is composed of interest income, foreign currency transaction and remeasurement gains and losses incurred by our Korean and Taiwanese subsidiaries, other-than temporary impairment on marketable debt securities, gains resulting from the sale of investments and license fees. In the six months ended June 26, 2010 and June 27, 2009, we recorded $0.4 million and $0.1 million, respectively, of foreign currency gains. During the six months ended June 26, 2010 we sold available for sale equity investments and recorded gains of $2.2 million. In addition, we received a $0.4 million payment which represented amounts held in escrow from the sale of our investment in Kenet on October 3, 2008. Other income and expense, net for the six months ended June 27, 2009 includes an expense of $0.9 million from an impairment write-down of certain marketable debt securities which were deemed other-than-temporarily impaired.

In fiscal year 2008 we entered into an agreement wherein we agreed to sell certain patents we were no longer using, to a party which would attempt to sub-license the patents. Under the terms of the agreement the amount we would receive for the sale of the patents was a percentage of any license fees, after expenses, from the sublicense. For the six months ended June 26, 2010 and June 27, 2009, we recorded $0.2 and $4.1 million, respectively, of license fees from the sale of these patents. We do not expect to receive any additional material amounts from the sales of these patents.

Equity Losses in Unconsolidated Affiliate. For the three and six months ended June 26, 2010, the equity loss in unconsolidated affiliate consists of our approximate 19% share of the losses of KoBrite. For the three and six months ended June 27, 2009, the equity loss is a result of our approximate 19% interest in the operating results of KoBrite.

Tax(provision). For the three and six months ended June 26, 2010 we recorded a provision for income taxes of $180,000 and $93,000, respectively, compared to provisions of $367,000 and $636,000 for the three and six month periods ended June 27, 2009. Our provision for income taxes is comprised of our estimated alternative minimum tax and state income tax liabilities on our domestic taxable earnings and estimated foreign taxes due on our Korean and Taiwanese subsidiaries taxable earnings.

Net (loss) income attributable to noncontrolling interest. We own approximately 78% of the equity of Kowon Technology Co. Ltd. (Kowon) and approximately 87% of the equity of Kopin Taiwan Corp. Net (loss) income attributable to noncontrolling interest on our consolidated statement of operations represents the portion of the results of operations of our majority owned subsidiaries which is allocated to the shareholders of the equity interests not owned by us. The change in net (loss) income attributable to noncontrolling interest is the result of the change in the results of operations of Kowon and the addition of the income attributable to the noncontrolling interests in KTC.

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Liquidity and Capital Resources

As of June 26, 2010, we had cash and equivalents and marketable securities of $115.3 million and working capital of $139.5 million compared to $114.5 million and $134.2 million, respectively, as of December 26, 2009. The change in cash and equivalents and marketable securities was primarily due to cash generated from operating activities of $1.1 million and proceeds from investment sales of $4.2 million, partially offset by investments in capital equipment and other assets of approximately $4.3 million.

We have a purchase and supply agreement with a significant HBT customer that expires in July 2012, excluding a last time buy option contained in the agreement. Under the terms of this agreement we 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 the majority 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 $40.0 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 2020 and the other in 2012. The Taunton lease which expires in 2020 may be extended for an additional 10 year term. The Westborough and Scotts Valley leases expire in 2012. We believe these facilities are suitable for our operating needs for the foreseeable future.

We expect to expend between $10.0 million and $20.0 million on capital expenditures over the next twelve months, primarily for the acquisition of equipment relating to the production of our III-V and CyberDisplay products.

As of June 26, 2010, we had 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.

Historically 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. We believe our available cash resources will support our operations and capital needs for at least the next twelve months.

Seasonality

The consumer markets we sell into are traditionally seasonal and we would expect that our third quarter would be our strongest sales quarter for sales of our displays to customers who use them in consumer electronic applications and sales of our III-V products, followed by our second quarter then our fourth quarter and our first quarter would be our lowest sales quarter. We anticipate selling more display products for military applications which we would not expect to have the historical sales trends of our consumer oriented products. Depending upon the relative success of our consumer oriented products verses our military products, our total display revenues may or may not have a seasonal trend. Our principle III-V product is our HBT transistors and revenues from the sales of HBT transistors has not demonstrated the seasonal pattern over the last two years that we would expect.

Contractual Obligations

The following is a summary of our contractual payment obligations for operating leases as of June 26, 2010:

Contractual Obligations	Total	Less than 1 year	1-3 Years	3-5 years	More than 5 years
Operating Lease Obligations	$ 7,094,781	$ 1,521,783	$ 2,344,247	$ 1,616,938	$ 1,611,813

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We invest our excess cash in high-quality U.S. government, government-backed (Fannie Mae, FDIC guaranteed bonds and certificates of deposit) 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 Advanced Wireless Semiconductor Company (AWSC) of approximately $3.8 million, which is subject to changes in value because of either specific operating issues 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

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subsidiary. We are also exposed to the affects of exchange rates in the purchase of certain raw materials whose price is in U.S. dollars but the price on future purchases is subject to change based on the relationship of the Japanese Yen to the U.S. dollar. 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 but do not enter into forward or futures hedging contracts.

Item 4. Controls and Procedures

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective as of June 26, 2010 and designed to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

During our last fiscal quarter, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

The Company is engaged in legal proceedings arising in the ordinary course of business. On August 14, 2009, a complaint was filed against us and certain of our officers and directors in Massachusetts Superior Court in Bristol County, asserting that the defendants breached fiduciary duties in connection with the issuance of proxy statements, which allegedly contained false and misleading statements concerning certain of our past stock option grants. We served the plaintiff a motion to dismiss in October 2009, and oral arguments were heard in June 2010 on this matter. Claims, suits, investigations and proceedings are inherently uncertain and it is not possible to predict the ultimate outcome of the matters previously discussed. While the Company will continue to defend itself vigorously in all such matters, it is possible that the Company s business, financial condition, results of operations or cash flows could be affected in any particular period by the resolution of one or more of these matters.

Item 1A. Risk Factors

In addition to the other information set forth in this report and the risk factor set forth below, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for our fiscal year ended December 26, 2009. The risks discussed in our Annual Report on Form 10-K could materially affect our business, financial condition and future results. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Sale of Unregistered Securities

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

Use of Proceeds

The information required by this item regarding use of proceeds by the Company is reported in herein in Part 1, Item 2 under Liquidity and Capital Resources .

Purchase of Equity Securities

On December 8, 2008, we announced that our Board of Directors authorized a stock repurchase program of up to $15 million of our common stock. Pursuant to the stock repurchase program, we may purchase in one or more open market or private transactions up to $15 million of shares of our common stock. The stock repurchase program shall terminate on December 2, 2011, unless earlier terminated by our Board of Directors. We did not repurchase any securities during the first or second quarters of 2010. At June 26, 2010 we had repurchased 2.0 million shares for $5.3 million under the program.

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Item 3. Defaults Upon Senior Securities

None

Item 4. Reserved

Item 5. Other Information

None

Item 6. Exhibits

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation (1)
3.2	Amendment to Certificate of Incorporation (2)
3.3	Amendment to Certificate of Incorporation (2)
3.4	Fourth Amended and Restated By-laws (3)
31.1	Certificate of John C.C. Fan, Chief Executive Officer of the Registrant, filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
31.2	Certificate of Richard A. Sneider, Chief Financial Officer of the Registrant, filed pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
32.1	Certificate of John C.C. Fan, Chief Executive Officer of the Registrant, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
32.2	Certificate of Richard A. Sneider, Chief Financial Officer of the Registrant, furnished pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

(1) Filed as an exhibit to Registration Statement on Form S-1, File No. 33-57450, and incorporated herein by reference
(2) Filed as an exhibit to Quarterly Report on Form 10-Q for the quarterly period July 1, 2000 and incorporated by reference herein
(3) Filed as an exhibit to Annual Report on Form 8-K filed on December 12, 2008 and incorporated herein by reference.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	KOPIN CORPORATION	
	(Registrant)	
Date: August 3, 2010	By:	/s/ JOHN C.C. FAN **John C.C. Fan** **President, Chief Executive Officer and** **Chairman of the Board of Directors** **(Principal Executive Officer)**
Date: August 3, 2010	By:	/s/ RICHARD A. SNEIDER **Richard A. Sneider** **Treasurer and Chief Financial Officer** **(Principal Financial and Accounting Officer)**

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