

MICROVISION INC  
Form 10-Q  
October 30, 2009

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-21221

[Microvision, Inc.](#)

(Exact name of Registrant as Specified in its Charter)

**Delaware**

(State or Other Jurisdiction of Incorporation or Organization)

**91-1600822**

(I.R.S. Employer Identification Number)

6222 185th Avenue NE  
Redmond, Washington 98052

(Address of Principal Executive Offices including Zip Code)

(425) 936-6847

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(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 reports), and (2) has been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). YES  NO

As of October 26, 2009, 77,273,000 shares of the Company's common stock, \$0.001 par value, were outstanding.

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Part I: Financial Information

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Microvision, Inc.  
Consolidated Balance Sheet  
(In thousands, except per share data)  
(Unaudited)

	<b>September 30, 2009</b>
	-----
<b>Assets</b>	
Current assets	
Cash and cash equivalents	\$ 17,759
Investment securities, available-for-sale	2,716
Accounts receivable, net of allowances of \$56 and \$57	545
Costs and estimated earnings in excess of billings on uncompleted contracts	242
Inventory	642
Other current assets	568
	-----
Total current assets	22,472
Property and equipment, net	3,895
Restricted investments	1,332
Other assets	53
	-----
Total assets	\$ 27,752
	=====
<b>Liabilities and Shareholders' Equity</b>	
Current liabilities	
Accounts payable	\$ 3,390
Accrued liabilities	3,289
Billings in excess of costs and estimated earnings on uncompleted contracts	47
Liability associated with common stock warrants	3,379
Current portion of capital lease obligations	71
Current portion of long-term debt	76
	-----
Total current liabilities	10,252
Capital lease obligations, net of current portion	165
Long-term debt, net of current portion	264
Deferred rent, net of current portion	1,156
	-----
Total liabilities	11,837
	-----
Commitments and contingencies	
	--
Shareholders' equity	
Common stock, par value \$.001; 125,000 shares authorized; 76,668 and 68,080 shares issued and outstanding	77
Additional paid-in capital	338,690
Accumulated other comprehensive loss	(27)
Accumulated deficit	(322,825)
	-----
Total shareholders' equity	15,915
	-----
Total liabilities and shareholders' equity	\$ 27,752
	=====

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

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Microvision, Inc.  
Consolidated Statement of Operations  
(In thousands, except per share data)  
(Unaudited)

	Three Months Ended September 30,	
	2009	2008
Contract revenue	\$ 817	\$ 48
Product revenue	107	41
Total revenue	924	89
Cost of contract revenue	379	25
Cost of product revenue	720	35
Total cost of revenue	1,099	60
Gross margin (loss)	(175)	28
Research and development expense	5,839	5,80
Sales, marketing, general and administrative expense	3,283	3,45
Total operating expenses	9,122	9,26
Loss from operations	(9,297)	(8,97
Interest income	45	27
Interest expense	(19)	(1
Impairment of investment securities, available-for-sale	--	(30
Gain (loss) on derivative instruments, net	(2,246)	58
Other expense	(8)	(1
Net loss	\$ (11,525)	\$ (8,44
Net loss per share - basic and diluted	\$ (0.15)	\$ (0.1
Weighted-average shares outstanding - basic and diluted	76,265	64,87

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

Microvision, Inc.  
 Consolidated Statement of Comprehensive Loss  
 (In thousands)  
 (Unaudited)

	<b>Three Months Ended</b>	
	<b>September 30,</b>	
	<b>2009</b>	<b>2008</b>
Net loss	\$ (11,525)	\$ (8,44
Other comprehensive gain (loss)		
Unrealized gain (loss) on investment securities, available-for-sale	7	(3
Comprehensive loss	\$ (11,518)	\$ (8,47
	=====	=====

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



Microvision, Inc.  
Consolidated Statement of Cash Flows  
(In thousands)  
(Unaudited)

	<b>Nine Mo</b> <b>Septe</b> <hr style="border-top: 1px dashed black;"/> <b>2009</b> <hr style="border-top: 1px dashed black;"/>
<b>Cash flows from operating activities</b>	
Net loss	\$ (30,784)
Adjustments to reconcile net loss to net cash used in operations:	
Depreciation	819
Non-cash stock-based compensation expense	2,689
Loss (gain) on derivative instruments, net	3,048
Impairment of short-term investment securities	--
Inventory write-downs	978
Allowance for receivables from related parties	--
Net accretion of discount on short-term investments	--
Non-cash deferred rent	(207)
Change in:	
Accounts receivable, net	(8)
Costs and estimated earnings in excess of billings on uncompleted contracts	453
Inventory	(95)
Other current assets	298
Other assets	(6)
Accounts payable	(286)
Accrued liabilities	(300)
Billings in excess of costs and estimated earnings on uncompleted contracts	(15)
Net cash used in operating activities	(23,416)
<b>Cash flows from investing activities</b>	
Sales of investment securities	--
Purchases of investment securities	--
Purchases of restricted investment securities	--
Collections of receivables from related parties	--
Purchases of property and equipment	(729)
Net cash provided by (used in) investing activities	(729)
<b>Cash flows from financing activities</b>	
Principal payments under capital leases	(43)
Principal payments under long-term debt	(53)
Net proceeds from issuance of common stock and warrants	16,467
Net cash provided by financing activities	16,371
Change in cash and cash equivalents	(7,774)
Cash and cash equivalents at beginning of period	25,533
Cash and cash equivalents at end of period	\$ 17,759
<b>Supplemental disclosure of cash flow information</b>	



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Cash paid for interest	\$	50
=====		
<b>Supplemental schedule of non-cash investing and financing activities</b>		
Property and equipment acquired under capital leases	\$	95
=====		
Other non-cash additions to property and equipment	\$	388
=====		

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

MICROVISION, INC.  
Notes to Consolidated Financial Statements  
September 30, 2009  
(Unaudited)

### 1. MANAGEMENT'S STATEMENT AND PRINCIPLES OF CONSOLIDATION

#### Management's Statement

The Consolidated Balance Sheet as of September 30, 2009, the Consolidated Statements of Operations and Comprehensive Loss for the three and nine months ended September 30, 2009 and 2008 and the Consolidated Statements of Cash Flows for the nine months ended September 30, 2009 and 2008 have been prepared by Microvision, Inc. (the "Company" or "Microvision") and have not been audited. In the opinion of management, all adjustments necessary to state fairly the financial position at September 30, 2009 and the results of operations, comprehensive loss and cash flows for all periods presented have been made and consist of normal recurring adjustments. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules of the SEC. You should read these condensed financial statements in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2008. The results of operations for the nine months ended September 30, 2009 are not necessarily indicative of the operating results that may be attained for the entire fiscal year.

At September 30, 2009, Microvision had \$20.5 million in cash, cash equivalents and investment securities, available-for-sale. Microvision's operating plan for 2009 and 2010 includes the launch of its first accessory product, further development of its PicoP display engine for embedded applications and further development of automotive head-up display (HUD) and eyewear applications. In order to fully fund the Company's operating plan for 2010, the Company will require additional capital. The Company plans to obtain additional cash through the issuance of equity or debt securities. There can be no assurance that additional cash will be available or that, if available, it will be available on terms acceptable to the Company on a timely basis. If adequate funds are not available by January 2010, the Company intends to consider reducing the scope of its business to extend its operations as it pursues other financing opportunities and business relationships. This reduction in scope could include delaying development projects resulting in reductions in staff, operating costs, capital expenditures and investment in research and development. With these adjustments to its operating plan the Company believes that it currently has sufficient cash, cash equivalents, and investment securities to fund operations into June 2010.

### 2. NET LOSS PER SHARE

Basic net loss per share is calculated on the basis of the weighted-average number of common shares outstanding during the reporting periods. Diluted net loss per share is calculated on the basis of the weighted-average number of common shares outstanding and taking into account the dilutive effect of all potential common stock equivalents outstanding. Potentially dilutive common stock equivalents primarily consist of warrants, employee stock options and

nonvested equity shares. Diluted net loss per share for the three and nine months ended September 30, 2009 and 2008 is equal to basic net loss per share because the effect of all potential common stock outstanding during the periods, including options, warrants and nonvested equity shares is anti-dilutive. The components of basic and diluted net loss per share were as follows (in thousands, except loss per share data):

	Three Months Ended September 30,	
	2009	2008
	-----	-----
Numerator:		
Net loss available for common shareholders - basic and diluted	\$ (11,525)	\$ (8,4
	=====	=====
Denominator:		
Weighted-average common shares outstanding - basic and diluted	76,265	64,8
	=====	=====
Net loss per share - basic and diluted	\$ (0.15)	\$ (0.
	=====	=====

On September 30, 2009 and 2008, the Company excluded the following convertible securities from diluted net loss per share as the effect of including them would have been anti-dilutive: options and warrants convertible into a total of 19,784,000 and 16,464,000 shares of common stock, respectively, and 410,000 and 125,000 shares of nonvested equity shares, respectively.

### 3. CASH EQUIVALENTS, INVESTMENT SECURITIES AVAILABLE-FOR-SALE AND FAIR VALUE MEASUREMENTS

The Company accounts for cash equivalents and investment securities in accordance with the provisions of Statement of Financial Accounting Standards (FAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities* (FAS 115) (FASB Accounting Standards Codification - "ASC" 320) and FAS Board Staff Position (FSP) No. FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (ASC 320). FAS 115 (ASC 320) addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and debt securities. FSP FAS 115-2 and FAS 124-2 (ASC 320) provides guidance on accounting and presentation of investments with other-than-temporary impairments. The Company adopted FSP FAS 115-2 and FAS 124-2 (ASC 320) effective April 1, 2009. The Company applies guidance in FAS No. 157, *Fair Value Measurements* (FAS 157) (ASC 820) and FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (ASC 820) when estimating fair values of its cash equivalents, investment securities and liability associated with common stock warrants. FAS 157 (ASC 820) and FSP FAS 157-4 (ASC 820) address estimating fair values and related disclosures. The Company adopted FAS 157 (ASC 820) on January 1, 2008 for financial assets and liabilities and for nonfinancial assets and liabilities measured at fair value on a recurring basis. It elected to defer the adoption of FAS 157 (ASC 820) for nonfinancial assets and liabilities accounted for on a nonrecurring basis until January 1, 2009 as permitted by FSP No. FAS 157-2, *Effective Date of FAS 157* (ASC 820). Neither of the two stages of adopting FAS 157 (ASC 820) resulted in a material impact on the Company's consolidated financial position, results of operations or cash flows.

As of September 30, 2009, the Company held \$3.0 million par value student loan auction rate securities (SLARS), fair valued at \$2.7 million. The SLARS owned by the Company are investment grade long-term bonds with variable interest rate resets, purchases and sales to be determined via a Dutch Auction process every 28 days. They were issued to fund U.S. government guaranteed student loans. Beginning in February 2008 as global credit markets significantly deteriorated, insufficient clearing bids have been submitted for the SLARS. In accordance with the bond terms, the

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interest rates have been reset to "maximum rates" instead of "auction rates." Since that time, the SLARS have been illiquid through the auction process and secondary markets.

The valuation inputs hierarchy classification for assets and liabilities measured at fair value on a recurring basis are summarized below as of September 30, 2009:

	Level 1	Level 2	Level 3	Total
	-----	-----	-----	-----
Assets				
Corporate debt and equity securities	\$ --	\$ 16,000	\$ --	\$ 16,000
Auction-rate securities	--	--	2,700,000	2,700,000
	-----	-----	-----	-----
	\$ --	\$ 16,000	\$ 2,700,000	\$ 2,716,000
	=====	=====	=====	=====
Liabilities				
Liability associated with common stock warrants		\$ 3,379,000		\$ 3,379,000
		-----		-----
		\$ 3,379,000		\$ 3,379,000
		=====		=====

The corporate debt securities and liability associated with common stock warrants are classified within Level 2 of the fair value hierarchy because they are valued using valuation inputs and common methods with sufficient levels of transparency and observability. The SLARS are classified in Level 3 of the fair value hierarchy because of the significance of sufficiently unobservable assumptions and inputs developed by the Company and used in the valuations.

The following table summarizes the activity for those financial assets where fair value measurements are estimated utilizing Level 3 inputs:

Balance, December 31, 2008	\$2,700,000
Transfer to (from) Level 3, September 30, 2009	--
Recognized loss included in earnings	--
	-----
Balance, September 30, 2009	\$2,700,000
	=====

The Company's investments and liability associated with common stock warrants are summarized below as of September 30, 2009 and December 31, 2008:

	Cost/ Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	C Equi
	-----	-----	-----	-----	-----
As of September 30, 2009:					
Assets					
Corporate debt and equity securities	\$ 43,000	\$ --	\$ (27,000)	\$ 16,000	\$
Auction rate securities	2,700,000	--	--	2,700,000	
	-----	-----	-----	-----	-----
	\$ 2,743,000	\$ --	\$ (27,000)	\$ 2,716,000	\$
	=====	=====	=====	=====	=====

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Liabilities					
Liability associated with common stock warrants				\$ 3,379,000	
				=====	
					-----
As of December 31, 2008:					
Assets					
Corporate debt and equity securities	\$ 5,022,000	\$ --	\$ (38,000)	\$ 4,984,000	\$4,97
Auction rate securities	2,700,000	--	--	2,700,000	
	\$ 7,722,000	\$ --	\$ (38,000)	\$ 7,684,000	\$4,97
	=====	=====	=====	=====	=====
Liabilities					
Liability associated with common stock warrants				\$ 331,000	
				=====	

As of September 30, 2009, the unrealized losses on the Company's investments in equity securities were due primarily to declines in the stock prices of the equity securities. The realized gains and losses resulting from the liability associated with common stock warrants were primarily due to changes in the Microvision stock price and decreasing terms to expiration. The maturities of the debt investment securities available-for-sale as of September 30, 2009 are greater than 5 years.

The guidance in FAS 115-2 (ASC 320) requires that impairments determined to be other than temporary be classified into one of two categories, "credit" or "other factors". Upon adoption, one is to apply this guidance on an as-if basis to investments currently held. As of September 30, 2008, based on continuing low market liquidity and auction failures with significant uncertainty as to when such conditions would improve, the Company determined that the estimated fair value of the SLARS no longer approximated par value, and the impairments were other-than-temporary. An "impairment of investment securities, available-for-sale" of \$300,000 was recorded on the consolidated statement of operations. The Company used a discounted cash flow model, with rates adjusted for liquidity, to determine that the present value of estimated cash collections was less than the adjusted cost. Upon adopting FAS 115-2 (ASC 320) effective April 1, 2009, the other-than-temporary-impairment that was recorded during the period ended September 30, 2008 was categorized as credit type and no transition adjustments were recorded.

The Company's significant nonfinancial assets and liabilities that are subject to consideration for recognition and disclosure at fair value in the financial statements on a nonrecurring basis primarily include property and equipment, capital lease obligations, a tenant improvement loan agreement and deferred rent. If the Company concludes there has been an event indicating the potential impairment of a nonfinancial asset or liability, or periodically if no such indicating event is deemed to have occurred, it utilizes guidance contained in FAS 157 (ASC 820) to determine the fair value, test for the existence of an impairment, and record significant impairments in the period of determination.

#### 4. INVENTORY

Inventory at September 30, 2009 and December 31, 2008 consisted of the following:

	September 30, 2009	December 2008
Raw materials	\$ 242,000	\$ 45,
Finished goods	400,000	1,480,
	\$ 642,000	\$ 1,525,

The inventory at September 30, 2009 consisted of raw materials and finished goods for SHOWWX, the Company's accessory projector and ROV, the Company's hand-held barcode scanner. The inventory at December 31, 2008 consisted of raw materials and finished goods for ROV, the Company's hand-held bar code scanner. Inventory is stated at the lower of cost or market, with cost determined on a weighted-average basis. Management periodically assesses the need to provide for obsolescence of inventory and adjusts the carrying value of inventory to its net realizable value when required. In addition, Microvision reduces the value of its inventory to its estimated scrap value when management determines that it is not probable that the inventory will be consumed through normal production during the next twelve months. As a result of lower than planned ROV revenue the Company recorded an additional write down of ROV inventory of \$638,000 during the quarter ended September 30, 2009 and reduced its investment in ROV sales and marketing.

#### 5. SHARE-BASED COMPENSATION

The Company accounts for stock-based employee compensation arrangements in accordance with the provisions of Statement of FAS No. 123, as revised December 2004 (FAS 123(R)) (ASC 718). The Company accounts for equity instruments issued to non-employees in accordance with the provisions of Emerging Issues Task Force Issue No. 96-18 (ASC 505) and FAS No. 123 (ASC 718). The following table shows the amount of stock-based employee compensation expense included in the Consolidated Statements of Operations:

	Three Months Ended September 30,	
	2009	2008
Cost of contract revenue	\$ 18,000	\$ 7,0
Cost of product revenue	2,000	4,0
Research and development expense	239,000	167,0
Sales, marketing, general and administrative expense	434,000	355,0
Share-based employee compensation cost charged against income	\$ 693,000	\$ 533,0

#### Options Activity and Positions

The following table summarizes shares, weighted average exercise price, weighted average remaining contractual term and aggregate intrinsic value of options outstanding and options exercisable as of September 30, 2009:

Options	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
---------	--------	--	--	---------------------------------

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Outstanding as of September 30, 2009	8,706,000	\$	3.55	7.2	\$21,910,000
Exercisable as of September 30, 2009	5,074,000	\$	4.22	6.3	\$11,363,000

As of September 30, 2009, the Company's unamortized share-based compensation was \$4,385,000. The Company plans to amortize this share-based compensation cost over the next 2.5 years.

As of September 30, 2009, the Company's unamortized nonvested equity share-based compensation was \$463,000. The Company plans to amortize this nonvested equity share-based compensation cost over the next 2.2 years.

### 6. LIABILITY ASSOCIATED WITH COMMON STOCK WARRANTS

In March and December 2005, the Company issued warrants to purchase 2,302,000 shares of common stock. The warrants met the definition of derivative instruments that must be accounted for as liabilities under the provisions of Emerging Issues Task Force Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* (ASC 815), because the Company cannot engage in certain corporate transactions affecting the common stock unless it makes a cash payment to the holders of the warrants. The Company records changes in the fair values of the warrants in the statements of operations each period. In July 2008, warrants to purchase 750,000 shares of common stock expired unexercised. The Company valued the remaining warrants to purchase 1,552,000 shares of common stock at September 30, 2009 using the Black-Scholes option-pricing model with the following assumptions: expected volatilities of 78%; expected dividend yields of 0%; risk free interest rates of from 0.4% to 0.5%; and contractual lives ranging from .5 year to 1.2 years. The change in value of the warrants of \$2,246,000 for the three and \$3,048,000 for the nine months ended September 30, 2009 was recorded as a non-operating loss and is included in "Gain (loss) on derivative instruments, net" in the consolidated statements of operations. The Company valued the warrants at September 30, 2008 using the Black-Scholes option-pricing model with the following assumptions: expected volatilities of 69%; expected dividend yields of 0%; risk free interest rates ranging from 1.9% to 2.1%; and contractual lives ranging from 1.5 years to 2.2 years. The changes in value of the warrants of \$599,000 for the three months and \$2,134,000 for the nine months ended September 30, 2008 were recorded as non-operating gains and are included in "Gain (loss) on derivative instruments, net" in the consolidated statements of operations.

### 7. LONG-TERM NOTES

#### Tenant Improvement Loan Agreement

During 2006, the Company entered into a loan agreement with the lessor of the Company's corporate headquarters in Redmond to finance \$536,000 in tenant improvements. The loan carries a fixed interest rate of 9% per annum, is repayable over the initial term of the lease, which expires in 2013, and is secured by a letter of credit. The balance of the loan was \$340,000 at September 30, 2009.

### 8. COMMON STOCK

In June 2009, the Company raised approximately \$15,000,000, before issuance costs of approximately \$217,000, from the sale of 8,076,239 shares of common stock and warrants to purchase 2,019,060 shares of its common stock to Max Display Enterprises Limited, a subsidiary of Walsin Lihwa. Walsin Lihwa is the parent company of Touch Micro-system Technology Corp. (TMT). Microvision has worked for a number of years with both Walsin Lihwa and then TMT, as manufacturers of Microvision's Micro-Electrical Mechanical systems (MEMS) chips. The warrants have an exercise price of \$2.1850 per share, a three year term, and are exercisable on the date of issuance. The Company can call the warrants after six months and once the shares are registered if the average closing bid price of its stock is over \$8.74 for any 20 consecutive trading days. The warrants were accounted for as permanent equity under the

provisions of Emerging Issues Task Force Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* (ASC 815). As of September 30, 2009, Max Display Enterprises Limited beneficially owned 12.8% of Microvision's common stock, as determined in accordance with the rules of the Securities Exchange Commission.

## 9. WARRANTS

In September 2009, the Company raised \$1,475,000 from the exercise of warrants to purchase 451,795 shares of common stock.

## 10. RECEIVABLES FROM RELATED PARTIES

In 2000, 2001 and 2002, the Board of Directors authorized the Company to provide unsecured lines of credit to each of the Company's three officers. The lines of credit carry interest rates of 5.4% to 6.2% and were due within one year of the officer's termination.

In January 2006, one officer left the Company and his outstanding loans became due in January 2007. In May 2007, the Company foreclosed on 50,000 shares of Lumera common stock pledged as collateral for the loans. In October 2009, the Company entered into a settlement agreement with the former officer. The Company has received total proceeds of \$237,000 to date, and the officer has committed to make additional payments of \$30,000 over the next two years. Pursuant to the settlement agreement, all claims and counterclaims filed in the collection lawsuit, including the previously disclosed claim by the former officer against the Company for \$15 million have been dismissed.

Another officer with outstanding loans left the Company in August 2007 and his loans became due in August 2008. The Company is pursuing collection of the remaining outstanding balance from the former officer.

As of September 30, 2009 and December 31, 2008, the total amount outstanding under the lines of credit was \$410,000 and \$1,851,000, respectfully, and the balances were fully reserved.

## 11. COMMITMENTS AND CONTINGENCIES

### Litigation

The Company is subject to various claims and pending or threatened lawsuits in the normal course of business. The Company is not currently party to any such legal proceedings that management believes would have a material adverse effect on the Company's financial position, results of operations or cash flows.

## 12. NEW ACCOUNTING PRONOUNCEMENTS

In May 2009, the Financial Accounting Standards Board (FASB) issued SFAS No. 165, *Subsequent Events* (FAS 165) (ASC 855). This standard sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. FAS 165 is effective for fiscal years and interim periods ended after June 15, 2009. The Company adopted this standard during the quarter ended June 30, 2009 and has evaluated any subsequent events through October 30, 2009, the date of this filing.

In October 2009, the FASB issued Accounting Standards Update No. 2009-13 Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements (ASU 2009-13) (ASC 605). ASU 2009-13 provides amendments to establish a selling price hierarchy for determining the selling price of a deliverable and expands the disclosures

required for multiple-deliverable revenue arrangements. ASU 2009-13 becomes effective for revenue arrangements that are entered into or are materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. The Company is currently evaluating the impact that ASU 2009-13 will have on its financial statements.

In October 2009, the FASB issued Accounting Standards Update No. 2009-14 Software (Topic 985): Certain Revenue Arrangements That Include Software Elements (ASU 2009-14) (ASC 985). ASU 2009-14 excludes software from the scope of the software revenue recognition guidance if the software is included with tangible products and is essential to the tangible product's functionality. ASU 2009-13 becomes effective for revenue arrangements that are entered into or are materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. The Company is currently evaluating the impact that ASU 2009-14 will have on its financial statements.

### 13. SUBSEQUENT EVENTS

In October 2009, the Company raised \$2,110,000 from the exercise of warrants to purchase 587,332 shares of common stock.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Forward-Looking Statements

The information set forth in this report in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and Item 3, "Quantitative and Qualitative Disclosure about Market Risk," includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and is subject to the safe harbor created by that section. Such statements may include, but are not limited to, projections of revenues, income or loss, capital expenditures, plans for product development and cooperative arrangements, future operations, financing needs or plans of Microvision, as well as assumptions relating to the foregoing. The words "anticipate," "believe," "estimate," "expect," "goal," "may," "plan," "project," "will," and similar expressions identify forward-looking statements, which speak only as of the date the statement was made. Factors that could cause actual results to differ materially from those projected in our forward-looking statements include the following: our ability to obtain financing; market acceptance of our technologies and products; our financial and technical resources relative to those of our competitors; our ability to keep up with rapid technological change; government regulation of our technologies; our ability to enforce our intellectual property rights and protect our proprietary technologies; the ability to obtain additional contract awards and to develop partnership opportunities; the timing of commercial product launches; the ability to achieve key technical milestones in key products; and other risk factors identified in this report under the caption "Item 1A - Risk Factors."

### Overview

We are developing high-resolution miniature display and imaging engines based upon our technology platform. Our technology platform utilizes our expertise in two dimensional Micro-Electrical Mechanical systems (MEMS), lasers, optics and electronics to create a high quality video or still image from a small form factor device with lower power needs than conventional display technologies.

Our strategy is to develop and supply a proprietary display engine called PicoP to potential OEM customers who will embed them into a variety of consumer and automotive products. The primary objective for consumer applications is to provide users of mobile devices with a large screen viewing experience produced by a small embedded projector. Mobile devices may include cell phones, PDA's, gaming consoles and other consumer electronics products. These potential products would allow users to watch movies, play videos, display images, and other data onto a variety of flat or curved surfaces.



We recently launched a small accessory projector that is the first commercial product based on the PicoP display engine. The accessory projector can display images from a variety of video sources including cell phones, portable media players, PDAs, gaming consoles, laptop computers, digital cameras, and other consumer electronics products. We are currently shipping the accessory projector in limited quantity through our Asian based distributor. We plan to add distribution channels as the production capacity for our manufacturing partner, green laser suppliers and other component suppliers increases.

The PicoP with some modification could be embedded into a vehicle or integrated into a portable standalone aftermarket device to create a high-resolution head-up display (HUD) that could project point-by-point navigation, critical operational, safety and other information important to the driver or pilot. The PicoP could be further modified to be embedded into a pair of glasses to provide the mobile user with a see-through or occluded personal display to view movies, play games or access other content.

### Results of Operations

Contract revenue.

(in thousands)	2009	% of contract revenue	2008	% of contract revenue	\$ change	% chan
	-----	-----	-----	-----	-----	-----
<b>Three months ended September 30</b>						
Government revenue	\$ 370	45.3	\$ 376	78.3	\$ (6)	(1)
Commercial revenue	447	54.7	104	21.7	343	329
	-----		-----		-----	
Total contract revenue	\$ 817		\$ 480		\$ 337	70
	=====		=====		=====	
 Nine months ended September 30						
Government revenue	\$ 1,412	60.3	\$ 1,945	51.6	\$ (533)	(27)
Commercial revenue	930	39.7	1,822	48.4	(892)	(49)
	-----		-----		-----	
Total contract revenue	\$ 2,342		\$ 3,767		\$ (1,425)	(37)
	=====		=====		=====	

We earn contract revenue from performance on development contracts with the U.S. government and commercial customers and from the sale of prototype units and evaluation kits based on our PicoP display engine.

Our contract revenue from development contracts in a particular period is dependent upon when we enter into a contract, the value of the contracts we have entered into, and the availability of technical resources to perform work on the contracts.

We recognize contract revenue as work progresses on long-term, cost plus fixed fee and fixed price contracts using the percentage-of-completion method, which relies on estimates of total expected contract revenue and costs. Our revenue contracts generally include a statement of the work we are to complete and the total fee we will earn from the contract. When we begin work on the contract and at the end of each accounting period, we work with the members of our technical team to estimate the labor and material and other cost required to complete the statement of work compared to cost incurred to date. We use information provided by project managers, vendors, outside consultants and others as we deem necessary to develop our cost estimates. Since our contracts generally require some level of technology development to complete, the actual cost required to complete a statement of work can vary from our estimated cost to complete. We have developed processes that allow us to make reasonable estimates of the cost to complete a contract. Historically, we have made only immaterial revisions in the estimates to complete the contract at each reporting period. Recognized revenues are subject to revisions as the contract progresses to completion and actual revenue and

cost becomes certain. Revisions in revenue estimates are reflected in the period in which the facts that give rise to the revision become known. In the future, revisions in these estimates could significantly impact recognized revenue in any one reporting period. If the U.S. government cancels a contract, we would receive payment for work performed and costs committed to prior to the cancellation.

We recognize contract revenue on the sales of prototype units and evaluation kits upon acceptance of the deliverables by the customer or expiration of the contractual acceptance period. While we anticipate future sales of these units, revenue may vary substantially due to the timing of orders from customers and potential constraints on resources. Contract revenue was higher during the three months ended September 30, 2009 than the same period in 2008 due to an increase in revenue from contracts for prototype units offsetting a decrease in development contract revenue. Contract revenue was lower during the nine months ended September 30, 2009 than the same period in 2008, due to reduced contract activity and lower beginning backlog in 2009 compared to the prior year. We expect that we will have fewer opportunities to enter into new development contracts as we commercialize products based on our PicoP display engine.

As long as most of our revenue is earned from performance on development contracts, we believe there may be a high degree of variability in revenue from quarter to quarter.

In July 2009, Microvision entered into a 9 month \$1.0 million subcontract with Lockheed Martin Corporation to supply two full-color, daylight readable, see-through display systems as part of the U.S. government's Urban Leader Tactical Response, Awareness & Visualization program. Lockheed Martin holds a prime contract with the U.S. government for development of the soldier worn display.

Our backlog of development contracts, including orders for prototype units, at September 30, 2009 was \$103,000 compared to \$336,000 at September 30, 2008, all of which is scheduled for completion during the next twelve months.

#### Product revenue

(in thousands)	2009	% of product revenue	2008	% of product revenue	\$ change	% chan
	-----	-----	-----	-----	-----	-----
<b>Bar code revenue</b>						
Three months ended September 30	\$ 107	100.0	\$ 414	100.0	\$ (307)	(74)
Nine months ended September 30	520	100.0	1,319	100.0	\$ (799)	(60)

Our bar code sales generally include acceptance provisions. We recognize revenue for bar code shipments upon acceptance of the product by the customer or expiration of the contractual acceptance period. Our quarterly bar code revenue may vary substantially due to the timing of product orders from customers.

Bar code revenue was lower during the three and six months ended September 30, 2009 than the same period in 2008, due to decreased purchasing volume of small and mid-sized businesses as a result of the global economic conditions. As a result of this downturn we have reduced our sales and marketing efforts on the bar code product. We do not expect to increase our investment in the bar code product in the future and we are currently evaluating opportunities to sell our existing bar code inventory, sell or license our bar code production capability and technology.

The backlog of product orders at September 30, 2009 was approximately \$1,874,000, compared to \$311,000 at September 30, 2008, all of which is scheduled for delivery during the next twelve months. The backlog at September 30, 2009 included \$1,710,000 of orders for our recently introduced PicoP based accessory product.

## Cost of contract revenue

(in thousands)	2009	% of contract revenue	2008	% of contract revenue	\$ change	% chan
	-----	-----	-----	-----	-----	-----
Three months ended September 30	\$ 379	46.4	\$ 253	52.7	\$ 126	49
Nine months ended September 30	1,289	55.0	1,389	36.9	(100)	(7

Cost of contract revenue includes both the direct and allocated indirect costs of performing on development contracts. Direct costs include labor, materials and other costs incurred directly in performing on a contract. Indirect costs include labor and other costs associated with operating our research and development department and building our technical capabilities and capacity. Cost of contract revenue is determined both by the level of direct costs incurred on development contracts and by the level of indirect costs incurred in operating and building our technical capabilities and capacity. Both the direct and indirect costs can fluctuate substantially from period to period.

Cost of contract revenue, as a percentage of contract revenue, was lower during the three months ended September 30, 2009 than the same period in 2008 as a result of the cost mix of the contracts during those periods and the sale of prototype units that have been previously expensed to internally funded programs. Cost of contract revenue was lower during the nine months ended September 30, 2009 than September 30, 2008 as a result of the decreased activity on development contracts. The increase in cost of contract revenue as a percentage of contract revenue during the nine month periods ended September 30, 2009 compared to the same periods in 2008 was also the result of differences in the cost mix of the contracts during those periods.

The cost of revenue as a percentage of revenue can fluctuate significantly from period to period, depending on the contract cost mix and the levels of direct and indirect costs incurred. However, over longer periods of time we expect modest fluctuations in the cost of contract revenue, as a percentage of contract revenue.

## Cost of product revenue

(in thousands)	2009	% of product revenue	2008	% of product revenue	\$ change	% chan
	-----	-----	-----	-----	-----	-----
Three months ended September 30	\$ 720	672.9	\$ 356	86.0	\$ 364	102
Nine months ended September 30	1,504	289.2	1,224	92.8	280	22

Cost of product revenue includes both the direct and allocated indirect costs of manufacturing products sold to customers. Direct costs include labor, materials and other costs incurred directly in the manufacture of these products. Indirect costs include labor and other costs associated with operating our manufacturing capabilities and capacity.

Our overhead, which includes the costs of procuring, inspecting and storing material, facility and depreciation costs, is allocated to inventory, cost of product revenue, cost of contract revenue, and research and development expense based on the proportion of direct material purchased for the respective activity. During the three months ending September 30, 2009 and 2008, we expensed approximately \$33,000 and \$40,000, respectively, of manufacturing overhead associated with production capacity in excess of production requirements. For the nine months ending September 30, 2009 and 2008, we expensed approximately \$168,000 and \$112,000, respectively, of manufacturing overhead associated with production capacity in excess of production requirements.

The Company has periodically entered into noncancelable purchase contracts in order to ensure the availability of materials to support bar code scanner production. Management periodically assesses the need to provide for the impairment on these purchase contracts and records a loss on purchase commitments when required. As a result of lower than planned ROV revenue, cost of product revenue for the three and nine month periods ending September 30, 2009 includes approximately \$638,000 and \$978,000 of inventory write-downs, respectively. In addition, cost of product revenue for the nine months ended September 30, 2009 included \$19,000 for noncancelable purchase contracts that were in excess of estimated future proceeds from the sale of the ROV scanners.

The cost of product revenue as a percentage of product revenue can fluctuate significantly from period to period, depending on the product mix, the level of overhead expense and the volume of direct materials purchased.

Research and development expense.

<b>(in thousands)</b>	<b>2009</b>	<b>2008</b>	<b>\$ change</b>	<b>% change</b>
	-----	-----	-----	-----
Three months ended September 30	\$ 5,839	\$ 5,804	\$ 35	0.6
Nine months ended September 30	17,165	16,111	1,054	6.5

Research and development expense consists of:

- Compensation related costs of employees and contractors engaged in internal research and product development activities,
- Laboratory operations, outsourced development and processing work, and
- Other operating expenses.

We have increased spending in research and development as part of our strategy to accelerate the time to market for products based on the PicoP. The increase in cost during the nine months ended September 30, 2009 as compared to the nine months ended September 30, 2008 is primarily attributable to increases in payroll costs and direct materials.

We believe that a substantial level of continuing research and development expense will be required to develop additional commercial products using the scanned beam display technology. Accordingly, we anticipate our level of research and development spending will continue to be substantial.

Sales, marketing, general and administrative expense.

<b>(in thousands)</b>	<b>2009</b>	<b>2008</b>	<b>\$ change</b>	<b>% change</b>
	-----	-----	-----	-----
Three months ended September 30	\$ 3,283	\$ 3,456	\$ (173)	(5.0)
Nine months ended September 30	10,764	11,694	(930)	(8.0)

Sales, marketing, general and administrative expense includes compensation and support costs for marketing, sales, management and administrative staff, and for other general and administrative costs, including legal and accounting services, consultants and other operating expenses.

The decrease in sales, marketing, general and administrative expense for the three and nine months ended September 30, 2009 compared to the same periods in 2008 was primarily the result of decreased payroll costs due to reductions in staffing levels.

We continue to aggressively manage these costs as part of our strategy to accelerate the development of PicoP-based products while controlling our cash used in operations.

Interest income.

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<b>(in thousands)</b>	<b>2009</b>	<b>2008</b>	<b>\$ change</b>	<b>% change</b>
	-----	-----	-----	-----
Three months ended September 30	\$ 45	\$ 271	\$ (226)	(83.4)
Nine months ended September 30	188	962	(774)	(80.5)

The decrease in interest income for the three and nine months ended September 30, 2009 compared to the same period in 2008 resulted primarily from lower average cash, investment securities balances, and interest rates.

Interest expense.

<b>(in thousands)</b>	<b>2009</b>	<b>2008</b>	<b>\$ change</b>	<b>% change</b>
	-----	-----	-----	-----
Three months ended September 30	\$ 19	\$ 11	\$ 8	72.7
Nine months ended September 30	50	36	14	38.9

Gain (loss) on derivative instruments, net.

<b>(in thousands)</b>	<b>2009</b>	<b>2008</b>	<b>\$ change</b>	<b>% change</b>
	-----	-----	-----	-----
Three months ended September 30	\$ (2,246)	\$ 585	\$ (2,831)	(483.9)
Nine months ended September 30	(3,048)	2,004	(5,052)	(252.1)

In March and December 2005, we issued warrants to purchase 2,302,000 shares of common stock. The warrants met the definition of derivative instruments that must be accounted for as liabilities under the provisions of Emerging Issues Task Force Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*, (ASC 815) because we cannot engage in certain corporate transactions affecting the common stock unless we make a cash payment to the holders of the warrants. We record changes in the fair values of the warrants in the statements of operations each period. In July 2008, warrants to purchase 750,000 shares of common stock expired unexercised. We valued the remaining warrants to purchase 1,552,000 shares of common stock at September 30, 2009 using the Black-Scholes option-pricing model with the following assumptions: expected volatilities of 78%; expected dividend yields of 0%; risk free interest rates of from 0.4% to 0.5%; and contractual lives ranging from 0.5 year to 1.2 years. The change in value of the warrants of \$2,246,000 for the three months and \$3,048,000 for the nine months ended September 30, 2009 was recorded as a non-operating loss and is included in "Gain (loss) on derivative instruments, net" in the consolidated statements of operations. The realized losses were primarily due to changes in the Microvision stock price and decreasing terms to expiration. We valued the warrants at September 30, 2008 using the Black-Scholes option-pricing model with the following assumptions: expected volatilities of 69%; expected dividend yields of 0%; risk free interest rates ranging from 1.9% to 2.1%; and contractual lives ranging from 1.5 years to 2.2 years. The change in value of the warrants of \$599,000 for the three months and \$2,134,000 for the nine months ended September 30, 2008 were recorded as a non-operating gain and are included in "Gain (loss) on derivative instruments, net" in the consolidated statements of operations.

Prior to December 9, 2008, we held warrants to purchase 170,500 shares of Lumera common stock. On December 9, 2008, Lumera merged with GigOptix, LLC and the combined company now conducts business as GigOptix, Inc. Our Lumera warrants were exchanged for warrants to purchase shares of the new company's common stock, after applying a 0.125 exchange ratio and exercise price escalation. As of December 31, 2008, the fair value of the warrants was determined to be zero. As of September 30, 2008, the warrants were valued using the Black-Scholes option-pricing model with the following assumptions: expected volatility of 127%; expected dividend yields of 0%; risk free interest rates of 2.13%; and contractual lives of 2.5 years. The change in value of \$14,000 for the three months and \$130,000 for the six months ended September 30, 2008 was recorded as a non-operating loss and is included in "Gain (loss) on derivative instruments, net" in the consolidated statements of operations.

## Liquidity and Capital Resources

We have funded our operations to date primarily through the sale of equity and debt securities and, to a lesser extent, from development contract revenues and product sales. At September 30, 2009, we had \$20.5 million in cash, cash equivalents and investment securities, available-for-sale. In October 2009, we raised \$2,110,000 from the exercise of warrants to purchase 587,332 shares of common stock. Our operating plan for 2009 and 2010 includes the launch of the first accessory product, further development of our PicoP display engine for embedded applications and further development of automotive HUD and eyewear applications. In order to fully fund our operating plan for 2010, we will require additional capital. We plan to obtain additional cash through the issuance of equity or debt securities. There can be no assurance that additional cash will be available or that, if available, it will be available on terms acceptable to us on a timely basis. If adequate funds are not available by January 2010, we intend to consider reducing the scope of our business to extend our operations as we pursue other financing opportunities and business relationships. This reduction in scope could include delaying development projects resulting in reductions in staff, operating costs, capital expenditures and investment in research and development. With these adjustments to our operating plan, we believe that we currently have sufficient cash, cash equivalents, and investment securities to fund operations into June 2010.

Cash used in operating activities totaled \$23.5 million during the nine months ended September 30, 2009, compared to \$22.3 million during the same period in 2008. During the nine months ended September 30, 2009, the increase in cash used in operating activities was primarily driven by lower contract activity and higher research and development costs as we commercialize PicoP based products.

We had the following material gains and charges, and changes in assets and liabilities during the nine months ended September 30, 2009:

- *"Gain on derivative instruments, net"*  
In March and December 2005 we issued warrants to purchase 2,302,000 shares of common stock, of which 1,552,000 remain outstanding as of September 30, 2009. Due to changes in our stock price, we recognized a \$3,048,000 non-operating loss during the nine months ended September 30, 2009.
- *"Inventory write-downs"*  
During the nine months ended September 30, 2009, we recorded \$978,000 of inventory write-downs due to lower than planned ROV revenue.
- *"Accounts payable"*

During the nine months ended September 30, 2009, accounts payable decreased by \$286,000 due to payments made for inventory, research and development expenses, and general operating expenses that were billed to us in 2008.

Cash used in investing activities totaled \$729,000 for the nine months ended September 30, 2009 compared to cash provided by investing activities of \$15.5 million during the nine months ended September 30, 2008. During the nine months ended September 30, 2009, we used cash of \$729,000 for capital expenditures, compared to \$320,000 during the same period in 2008. During the nine months ended September 30, 2008,

we had net sales of investment securities totaling \$15.9 million.

Cash provided by financing activities totaled \$16.4 million for the nine months ended September 30, 2009 compared to \$24.4 million during the same period in 2008. In June 2009, we raised approximately \$15.0 million, before issuance costs of approximately \$217,000, from the sale of 8,076,239 shares of common stock and warrants to purchase 2,019,060 shares of our common stock. The warrants have an exercise price of \$2.1850 per share, a three year term, and are exercisable on the date of issuance. We can call the warrants after six months and once the shares are registered if the average closing bid price of its stock is over \$8.74 for any 20 consecutive trading days. In addition, in September 2009, we raised \$1,475,000 from the exercise of warrants to purchase 451,795 shares of common stock.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate and Market Liquidity Risks

As of September 30, 2009, 87% of our total cash, cash equivalents and investment securities, available-for-sale have variable interest rates or are very short-term discount notes traded in active markets. Therefore, we believe our exposure to the market and interest rate risk is not material. The remaining 13% is composed of \$3.0 million par student loan auction-rate securities (SLARS). The SLARS owned by the Company are investment grade long-term bonds, structured with variable interest rate resets, purchases and sales to be determined via a Dutch Auction process every 28 days. They were issued to fund U.S. government guaranteed student loans. Beginning in February 2008 as global credit markets significantly deteriorated, insufficient clearing bids have been submitted for the SLARS. The auctions have thus failed and the interest rates have been reset to "maximum rates" instead of "auction rates". The SLARS have been illiquid through the auction process and through inactive secondary ARS markets.

Given the adverse credit market conditions, the fair value of the principal of these bonds has become affected by changes in interest rates, the spread between short and long rates, and credit market liquidity. As a result, at December 31, 2008, we estimated the fair value of our SLARS to be approximately \$2.7 million. If market conditions worsen, we may have to further adjust the estimated fair value of the SLARS, including additional charges to earnings, if we believe the adjustment is other than temporary. In the event we need access to the funds invested in the SLARS, we could be required to sell these securities at an amount below our carrying value. Any of these events could affect our consolidated financial condition, results of operations and cash flows. However, based on our current operating plan and ability to access our \$17.8 million held in cash and cash equivalents and other investment securities available for sale held as of September 30, 2009, we do not expect to be required to sell these securities materially below their current estimated values.

Our investment policy generally directs that the investment managers should select investments to achieve the following goals: principal preservation, adequate liquidity and return. As of September 30, 2009, our cash and cash equivalents and investments available-for-sale securities portfolio are comprised of short-term highly rated money market funds, corporate bonds and the SLARS.

	<u>Amount</u>	<u>Percent</u>
Cash and cash equivalents	\$ 5,578	27.24%
Less than one year	12,197	59.57%
One to two years	--	--
Greater than five years	2,700	13.19%
	-----	-----
	\$ 20,475	100.00%
	=====	=====

Foreign Exchange Rate Risk

All of our development contract payments are made in U.S. dollars. However, in the future we may enter into additional development contracts in foreign currencies that may subject us to foreign exchange rate risk. We intend to enter into foreign currency hedges to offset material exposure to currency fluctuations when we can adequately determine the timing and amounts of the foreign currency exposure.

## ITEM 4. CONTROLS AND PROCEDURES

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this report and, based on this evaluation, our principal executive officer and principal financial officer have concluded that these disclosure controls and procedures

are effective. There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f)) that occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II

### OTHER INFORMATION

#### ITEM 1A — RISK FACTORS

##### Risk Factors Relating to the Microvision Business

We have a history of operating losses and expect to incur significant losses in the future.

We have had substantial losses since our inception. We cannot assure you that we will ever become or remain profitable.

- As of September 30, 2009, we had an accumulated deficit of \$322.8 million.
- We incurred consolidated net losses of \$239.6 million from inception through 2006, \$19.8 million in 2007, \$32.6 million in 2008, and consolidated net loss of \$30.8 million in the nine months ended September 30, 2009.

The likelihood of our success must be considered in light of the expenses, difficulties and delays frequently encountered by companies formed to develop and market new technologies. In particular, our operations to date have focused primarily on research and development of the scanned beam technology and development of demonstration units. We are unable to accurately estimate future revenues and operating expenses based upon historical performance.

We cannot be certain that we will succeed in obtaining additional development contracts or that we will be able to obtain substantial customer orders for our products. In light of these factors, we expect to continue to incur losses and negative cash flow at least through 2010 and likely thereafter. We cannot be certain that we will achieve positive cash flow at any time in the future.

We will require additional capital to fund our operations and to implement our business plan. If we do not obtain additional capital, we may be required to curtail our operations substantially. Raising additional capital may dilute the value of current shareholders' shares.

Our operating plan for 2009 and 2010 includes the launch of our first accessory product, further development of the PicoP display engine for embedded applications and further development of automotive HUD and eyewear applications. In order to fully fund our operating plan for 2010, we will require additional capital. We plan to obtain additional cash through the issuance of equity or debt securities. We will require additional capital in the future to fund our operations, including to:

- Further develop the technology platform and PicoP display engine,
- Develop and protect our intellectual property rights, and
- Fund long-term marketing and business development opportunities.

Our capital requirements will depend on many factors, including, but not limited to, the rate at which we can, directly or through arrangements with original equipment manufacturers, introduce products incorporating the PicoP display engine and image capture technologies, the market acceptance and competitive position of such products, and the revenues, volumes and margins of such products. If the level of revenues or margin are less than anticipated amounts or if expenses exceed the amounts budgeted, the Company may require additional capital earlier than expected to further the development of our technologies, for expenses associated with product development, and to respond to competitive pressures or to meet unanticipated development difficulties. In addition, our operating plan provides for



the development of strategic relationships with systems and equipment manufacturers that may require additional investments by us.

There can be no assurance that additional capital will be available to us, or if available, on terms acceptable to us or on a timely basis. Raising additional capital may involve issuing securities with rights and preferences that are senior to our common stock and may dilute the value of current shareholders' shares. If adequate funds are not available by January 2010, we intend to consider reducing the scope of our business to extend our operations as we pursue other financing opportunities and business relationships. This reduction in scope could include reductions in staff and operating costs as well as reductions in capital expenditures and investment in research and development. With these adjustments to our operating plan we believe that we currently have sufficient cash, cash equivalents, and investment securities to fund operations into June 2010.

If we cannot manufacture products at competitive prices, our financial results will be adversely affected.

We are currently negotiating component pricing with suppliers for our future products. The cost per unit for PicoP based accessory projectors currently exceeds the level at which we could expect to profitably sell these products. If we cannot lower our cost of production, we may face increased demands on our financial resources, possibly requiring additional equity and/or debt financing to sustain our business operations.

We cannot be certain that our technology platform or products incorporating our PicoP display engine will achieve market acceptance. If products incorporating the PicoP display engine do not achieve market acceptance, our revenues may not grow.

Our success will depend in part on customer acceptance of the PicoP display engine. The PicoP display engine may not be accepted by manufacturers who use display technologies in their products, by systems integrators who incorporate our products into their products or by end users of these products. To be accepted, the PicoP display engine must meet the expectations of our potential customers in the consumer, defense and industrial markets. If our technology fails to achieve market acceptance, we may not be able to continue to develop our technology platform.

Our planned future products are dependent on advances in technology by other companies.

We rely on and will continue to rely on technologies, such as light sources, MEMS and optical components that are developed and produced by other companies. The commercial success of certain of our planned future products will depend in part on advances in these and other technologies by other companies. We may, from time to time, contract with and support companies developing key technologies in order to accelerate the development of them for our specific uses. There are no guarantees that such activities will result in useful technologies or components for us.

It may become more difficult to sell our stock in the public market.

Our common stock is listed for quotation on The NASDAQ Global Market. To keep our listing on this market, we must meet NASDAQ's listing maintenance standards. If we are unable to continue to meet NASDAQ's listing maintenance standards, our common stock could be delisted from The NASDAQ Global Market. If our common stock were delisted, we likely would seek to list the common stock on the NASDAQ Capital Market, the American Stock Exchange or on a regional stock exchange. Listing on such other market or exchange could reduce the liquidity for our common stock. If our common stock were not listed on the Capital Market or an exchange, trading of our common stock would be conducted in the over-the-counter market on an electronic bulletin board established for unlisted securities or directly through market makers in our common stock. If our common stock were to trade in the over-the-counter market, an investor would find it more difficult to dispose of, or to obtain accurate quotations for the price of, the common stock. A delisting from The NASDAQ Global Market and failure to obtain listing on such other market or exchange would subject our securities to so-called penny stock rules that impose additional sales practice and market-making requirements on broker-dealers who sell or make a market in such securities. Consequently,

removal from The NASDAQ Global Market and failure to obtain listing on another market or exchange could affect the ability or willingness of broker-dealers to sell or make a market in our common stock and the ability of purchasers of our common stock to sell their securities in the secondary market. In addition, when the market price of our common stock is less than \$5.00 per share, we become subject to penny stock rules even if our common stock is still listed on The NASDAQ Global Market. While the penny stock rules should not affect the quotation of our common stock on The NASDAQ Global Market, these rules may further limit the market liquidity of our common stock and the ability of investors to sell our common stock in the secondary market. The market price of our stock has mostly traded below \$5.00 per share during 2009 and 2008. On October 26, 2009, the closing price of our stock was \$3.98.

Our lack of the financial and technical resources relative to our competitors may limit our revenues, potential profits, overall market share or value.

Our current products and potential future products will compete with established manufacturers of existing products and companies developing new technologies. Many of our competitors have substantially greater financial, technical and other resources than we have. Because of their greater resources, our competitors may develop products or technologies that are superior to our own. The introduction of superior competing products or technologies could result in reduced revenues, lower margins or loss of market share, any of which could reduce the value of our business.

We may not be able to keep up with rapid technological change and our financial results may suffer.

The information display industry has been characterized by rapidly changing technology, accelerated product obsolescence and continuously evolving industry standards. Our success will depend upon our ability to further develop our technology platform and to cost effectively introduce new products and features in a timely manner to meet evolving customer requirements and compete with competitors' product advances.

We may not succeed in these efforts because of:

- delays in product development,
- lack of market acceptance for our products, or
- lack of funds to invest in product development and marketing.

The occurrence of any of the above factors could result in decreased revenues, market share and value.

We could face lawsuits related to our use of the PicoP display engine or other technologies. Defending these suits would be costly and time consuming. An adverse outcome in any such matter could limit our ability to commercialize our technology and products, reduce our revenues and increase our operating expenses.

We are aware of several patents held by third parties that relate to certain aspects of light scanning displays and image capture products. These patents could be used as a basis to challenge the validity, limit the scope or limit our ability to obtain additional or broader patent rights of our patents or patents we have licensed. A successful challenge to the validity of our patents or patents we have licensed could limit our ability to commercialize our technology and the PicoP display engine and, consequently, materially reduce our revenues. Moreover, we cannot be certain that patent holders or other third parties will not claim infringement by us with respect to current and future technology. Because U.S. patent applications are held and examined in secrecy, it is also possible that presently pending U.S. applications will eventually be issued with claims that will be infringed by our products or our technology. The defense and prosecution of a patent suit would be costly and time consuming, even if the outcome were ultimately favorable to us. An adverse outcome in the defense of a patent suit could subject us to significant cost, to require others and us to cease selling products that incorporate the PicoP display engine, to cease licensing our technology or to require disputed rights to be licensed from third parties. Such licenses, if available, would increase our operating expenses. Moreover, if claims of infringement are asserted against our future co-development partners or customers, those

partners or customers may seek indemnification from us for damages or expenses they incur.

Our products may be subject to future health and safety regulations that could increase our development and production costs.

Products incorporating the PicoP display engine could become subject to new health and safety regulations that would reduce our ability to commercialize the PicoP display engine. Compliance with any such new regulations would likely increase our cost to develop and produce products using the PicoP display engine and adversely affect our financial results.

Our dependence on sales to distributors increases the risks of managing our supply chain and may result in excess inventory or inventory shortages.

We expect that the majority of our distributor relationships for the SHOWWX and its accessories will involve the distributor taking inventory positions and reselling to multiple customers. With these distributor relationships, we would not recognize revenue until the distributors sell the product through to their end user customers. Our distributor relationships would reduce our ability to forecast sales and increases risks to our business. Since our distributors would act as intermediaries between us and the end user customers, we would be required to rely on our distributors to accurately report inventory levels and production forecasts. This would require us to manage a more complex supply chain and monitor the financial condition and credit worthiness of our distributors and the end user customers. Our failure to manage one or more of these risks could result in excess inventory or shortages that could adversely impact our operating results and financial condition.

Our future growth will suffer if we do not achieve sufficient market acceptance of our products to compete effectively.

Our success depends, in part, on our ability to gain acceptance of our current and future products by a large number of customers. Achieving market based acceptance for our products will require marketing efforts and the expenditure of financial and other resources to create product awareness and demand by potential customers. We may be unable to offer products consistently or at all that compete effectively with products of others on the basis of price or performance. Failure to achieve broad acceptance of our products by potential customers and to effectively compete would have a material adverse effect on our operating results.

Our operating results may be adversely impacted by worldwide political and economic uncertainties and specific conditions in the markets we address.

In the recent past, general worldwide economic conditions have experienced a downturn due to slower economic activity, concerns about inflation, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, and adverse business conditions. Any continuation or worsening of the current global economic and financial conditions could materially adversely affect our ability to raise, or the cost of, needed capital and could materially adversely affect our ability to commercialize products. We cannot predict the timing, strength, or duration of any economic slowdown or subsequent economic recovery, worldwide, or in the display industry.

Because we plan to continue using foreign contract manufacturers, our operating results could be harmed by economic, political, regulatory and other factors in foreign countries.

We currently use a contract manufacturer in Asia to manufacture our SHOWWX product, and we plan to use foreign manufacturers to manufacture future products, where appropriate. These international operations are subject to inherent risks, which may adversely affect us, including:

- political and economic instability;
- high levels of inflation, historically the case in a number of countries in Asia;

- burdens and costs of compliance with a variety of foreign laws;
- foreign taxes;
- changes in tariff rates or other trade and monetary policies; and
- changes or volatility in currency exchange rates.

If we have to qualify a new contract manufacturer or foundry for our products, we may experience delays that result in lost revenues and damaged customer relationships.

We rely on single suppliers to manufacture our PicoP display engine, our SHOWWX product and our MEMS chips in wafer form. The lead time required to establish a relationship with a new contract manufacturer or foundry is long, and it takes time to adapt a product's design to a particular manufacturer's processes. Accordingly, there is no readily available alternative source of supply for these products and components in high volumes. This could cause significant delays in shipping products if we have to change our source of supply and manufacture quickly, which may result in lost revenues and damaged customer relationships.

If we experience delays or failures in developing commercially viable products, we may have lower revenues.

We have begun sales of units incorporating the PicoP display engine. However, we must undertake additional research, development and testing before we are able to develop additional products for commercial sale. Product development delays by us or our potential product development partners, or the inability to enter into relationships with these partners, may delay or prevent us from introducing products for commercial sale. We intend to rely on third party developments or to contract with other companies to continue development of green laser devices we will need for our products.

Our success will depend, in part, on our ability to secure significant third party manufacturing resources.

We are developing our capability to manufacture products in commercial quantities. Our success depends, in part, on our ability to provide our components and future products in commercial quantities at competitive prices. Accordingly, we will be required to obtain access, through business partners or contract manufacturers, to manufacturing capacity and processes for the commercial production of our expected future products. We cannot be certain that we will successfully obtain access to sufficient manufacturing resources. Future manufacturing limitations of our suppliers could result in a limitation on the number of products incorporating our technology that we are able to produce.

If our licensors and we are unable to obtain effective intellectual property protection for our products and technology, we may be unable to compete with other companies.

Intellectual property protection for our products is important and uncertain. If we do not obtain effective intellectual property protection for our products, processes and technology, we may be subject to increased competition. Our commercial success will depend in part on our ability and the ability of the University of Washington and our other licensors to maintain the proprietary nature of the PicoP display and other key technologies by securing valid and enforceable patents and effectively maintaining unpatented technology as trade secrets. We try to protect our proprietary technology by seeking to obtain United States and foreign patents in our name, or licenses to third-party patents, related to proprietary technology, inventions, and improvements that may be important to the development of our business. However, our patent position and the patent position of the University of Washington and other licensors involve complex legal and factual questions. The standards that the United States Patent and Trademark Office and its foreign counterparts use to grant patents are not always applied predictably or uniformly and can change. Additionally, the scope of patents are subject to interpretation by courts and their validity can be subject to challenges and defenses, including challenges and defenses based on the existence of prior art. Consequently, we cannot be certain as to the extent to which we will be able to obtain patents for our new products and technology or the extent to which the patents that we already own or license from others protect our products and technology. Reduction in scope

of protection or invalidation of our licensed or owned patents, or our inability to obtain new patents, may enable other companies to develop products that compete with ours on the basis of the same or similar technology.

We also rely on the law of trade secrets to protect unpatented know-how and technology to maintain our competitive position. We try to protect this know-how and technology by limiting access to the trade secrets to those of our employees, contractors and partners with a need to know such information and by entering into confidentiality agreements with parties that have access to it, such as our employees, consultants and business partners. Any of these parties could breach the agreements and disclose our trade secrets or confidential information, or our competitors might learn of the information in some other way. If any trade secret not protected by a patent were to be disclosed to or independently developed by a competitor, our competitive position could be materially harmed.

We could be exposed to significant product liability claims that could be time-consuming and costly, divert management attention and adversely affect our ability to obtain and maintain insurance coverage.

We may be subject to product liability claims if any of our product applications are alleged to be defective or cause harmful effects. For example, because some of our PicoP displays are designed to scan a low power beam of colored light into the user's eye, the testing, manufacture, marketing and sale of these products involve an inherent risk that product liability claims will be asserted against us. Product liability claims or other claims related to our products, regardless of their outcome, could require us to spend significant time and money in litigation, divert management time and attention, require us to pay significant damages, harm our reputation or hinder acceptance of our products. Any successful product liability claim may prevent us from obtaining adequate product liability insurance in the future on commercially desirable or reasonable terms. An inability to obtain sufficient insurance coverage at an acceptable cost or otherwise to protect against potential product liability claims could prevent or inhibit the commercialization of our products.

We rely heavily on a limited number of development contracts with the U.S. government, which are subject to immediate termination by the government for convenience at any time, and the termination of one or more of these contracts could have a material adverse impact on our operations.

During the first nine months of 2009 and the full year of 2008, 49% and 34%, respectively, of our revenue was derived from performance on a limited number of development contracts with the U.S. government. Therefore, any significant disruption or deterioration of our relationship with the U.S. government would significantly reduce our revenues. Our government programs must compete with programs managed by other contractors for limited amounts and uncertain levels of funding. The total amount and levels of funding are susceptible to significant fluctuations on a year-to-year basis. Our competitors continuously engage in efforts to expand their business relationships with the government and are likely to continue these efforts in the future. Our contracts with the government are subject to immediate termination by the government for convenience at any time. The government may choose to use contractors with competing display technologies or it may decide to discontinue any of our programs altogether. In addition, those development contracts that we do obtain require ongoing compliance with applicable government regulations. Termination of our development contracts, a shift in government spending to other programs in which we are not involved, a reduction in government spending generally, or our failure to meet applicable government regulations could have severe consequences for our results of operations.

Our development agreements have long sales cycles, which make it difficult to plan our expenses and forecast our revenues.

Our development agreements have lengthy sales cycles that involve numerous steps including determination of a product application, exploring the technical feasibility of a proposed product, evaluating the costs of manufacturing a product and manufacturing or contracting out the manufacturing of the product. Our long sales cycle, which can last several years, makes it difficult to predict the quarter in which contract signing and revenue recognition will occur. Delays in entering into development agreements could cause significant variability in our revenues and operating

results for any particular quarterly period.

Our development contracts may not lead to products that will be profitable.

Our development contracts, including without limitation those discussed in this document are exploratory in nature and are intended to develop new types of products for new applications. These efforts may prove unsuccessful and these relationships may not result in the development of products that will be profitable.

Our revenues are highly sensitive to developments in the defense industry.

Our revenues to date have been derived principally from product development research relating to defense applications of our technology. We believe that development programs and sales of potential products in this market will represent a significant portion of our future revenues. Developments that adversely affect the defense sector, including delays in government funding and a general economic downturn, could cause our revenues to decline substantially.

If we lose our rights under our third party technology licenses, our operations will be adversely affected.

Our business depends in part on technology rights licensed from third parties. We could lose our exclusivity or other rights to use the technology under our licenses if we fail to comply with the terms and performance requirements of the licenses. In addition, certain licensors may terminate a license upon our breach and have the right to consent to sublicense arrangements. If we were to lose our rights under any of these licenses, or if we were unable to obtain required consents to future sublicenses, we would lose a competitive advantage in the market, and may even lose the ability to commercialize our products completely. Either of these results could substantially decrease our revenues.

We are dependent on third parties in order to develop, manufacture, sell and market our products.

Our strategy for commercializing our technology and products incorporating the PicoP display engine includes entering into cooperative development, manufacturing, sales and marketing arrangements with corporate partners, original equipment manufacturers and other third parties. We cannot be certain that we will be able to negotiate arrangements on acceptable terms, if at all, or that these arrangements will be successful in yielding commercially viable products. If we cannot establish these arrangements, we would require additional capital to undertake such activities on our own and would require extensive manufacturing, sales and marketing expertise that we do not currently possess and that may be difficult to obtain. In addition, we could encounter significant delays in introducing the PicoP display engine or find that the development, manufacture or sale of products incorporating the PicoP display engine would not be feasible. To the extent that we enter into cooperative development, sales and marketing or other joint venture arrangements, our revenues will depend upon the performance of third parties. We cannot be certain that any such arrangements will be successful.

Loss of any of our key personnel could have a negative effect on the operation of our business.

Our success depends on our executive officers and other key personnel and on the ability to attract and retain qualified new personnel. Achievement of our business objectives will require substantial additional expertise in the areas of sales and marketing, research and product development and manufacturing. Competition for qualified personnel in these fields is intense, and the inability to attract and retain additional highly skilled personnel, or the loss of key personnel, could reduce our revenues and adversely affect our business.

We are dependent on a small number of customers for our revenue. Our quarterly performance may vary substantially and this variance, as well as general market conditions, may cause our stock price to fluctuate greatly and potentially expose us to litigation.

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Our revenues to date have been generated primarily from a limited number of development contracts with U.S. government entities and commercial partners. Our quarterly operating results may vary significantly based on:

- reductions or delays in funding of development programs involving new information display technologies by the U.S. government or our current or prospective commercial partners;
- changes in evaluations and recommendations by any securities analysts following our stock or our industry generally;
- announcements by other companies in our industry;
- changes in business or regulatory conditions;
- announcements or implementation by our competitors of technological innovations or new products;
- the status of particular development programs and the timing of performance under specific development agreements;
- economic and stock market conditions; or
- other factors unrelated to our company or industry.

In one or more future quarters, our results of operations may fall below the expectations of securities analysts and investors and the trading price of our common stock may decline as a consequence. In addition, following periods of volatility in the market price of a company's securities, shareholders often have instituted securities class action litigation against that company. If we become involved in a class action suit, it could divert the attention of management, and, if adversely determined, could require us to pay substantial damages.

If we fail to manage expansion effectively, our revenue and expenses could be adversely affected.

Our ability to successfully offer products and implement our business plan in a rapidly evolving market requires an effective planning and management process. The growth in business and relationships with customers and other third parties has placed, and will continue to place, a significant strain on our management systems and resources. We will need to continue to improve our financial and managerial controls, reporting systems and procedures and will need to continue to train and manage our work force.

### ITEM 4.

#### **SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The Company's Annual Shareholder's Meeting was held on September 15, 2009. The following proposals were introduced and voted on:

Proposal No. 1 - Election of Directors

Name

Votes For

Votes Withheld

Alexander Tokman

63,711,265

814,277

Richard A. Cowell

63,616,510

909,032

Slade Gorton

62,925,058

1,600,484

Jeanette Horan

62,592,795

1,932,747

Brian Turner

63,637,049

888,493

Proposal No. 2 - Ratification of the Selection of Independent Registered Public Accounting Firm

<u>For</u>	<u>Against</u>	<u>Abstain</u>
54,928,815	590,646	910,426

Proposal No. 3 - Amendment to the Company's Certificate of Incorporation to increase the number of authorized shares

<u>For</u>	<u>Against</u>	<u>Abstain</u>
47,035,739	8,275,724	1,118,424

ITEM 6. Exhibits

- 3.1 Amended and Restated Certificate of Incorporation
- 31.1 Chief Executive Officer Certification Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Chief Financial Officer Certification Pursuant to Rule 13a-14 of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Chief Executive Officer Certification pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Chief Financial Officer Certification pursuant to Section 1350, Chapter 63 of Title 18, United States Code, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

SIGNATURES



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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.

MICROVISION, INC.

October 30, 2009

BY: /s/ Alexander Y. Tokman  
Alexander Y. Tokman  
Chief Executive Officer  
(Principal Executive Officer)

October 30, 2009

BY: /s/ Jeff Wilson  
Jeff Wilson  
Chief Financial Officer  
(Principal Financial Officer)

EXHIBIT INDEX

The following documents are filed.

Exhibit  
Number  
Description

3.1

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