

MICROVISION INC  
Form 10-Q  
August 09, 2010

---

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

---

FORM 10-Q

---

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

For the quarterly period ended June 30, 2010

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

Edgar Filing: MICROVISION INC - Form 10-Q

(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	<input checked="" type="checkbox"/>	Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company
<input type="checkbox"/>	<input type="checkbox"/>		(Do not check if a smaller reporting company)		<input type="checkbox"/>

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 August 2, 2010, 88,853,000 shares of the Company's common stock, \$0.001 par value, were outstanding.

---

---

Part I: Financial Information

Item 1. Financial Statements:

Consolidated Balance Sheets as of June 30, 2010 and December 31, 2009 (unaudited)	<u>3</u>
Consolidated Statements of Operations for three and six months ended June 30, 2010 and 2009 (unaudited)	<u>4</u>
Consolidated Statements of Comprehensive Loss for the three and six months ended June 30, 2010 and 2009 (unaudited)	<u>5</u>
Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and 2009 (unaudited)	<u>6</u>
Notes to Consolidated Financial Statements (unaudited)	<u>8</u>

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	<u>14</u>
---	-----------

Item 3. Quantitative and Qualitative Disclosures About Market Risk	<u>19</u>
--	-----------

Item 4. Controls and Procedures	<u>20</u>
---------------------------------	-----------

Part II: Other Information

Item 1A. Risk Factors	<u>20</u>
-----------------------	-----------

Item 6. Exhibits	<u>27</u>
------------------	-----------

Signatures	<u>28</u>
------------	-----------

Exhibit Index	<u>29</u>
---------------	-----------

---

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

	June 30, 2010
<b>Assets</b>	
Current assets	
Cash and cash equivalents	\$ 19,636
Investment securities, available-for-sale	2,613
Accounts receivable, net of allowances of \$113 and \$67	1,505
Costs and estimated earnings in excess of billings on uncompleted contracts	7
Inventory	6,600
Current restricted investments	305
Other current assets	736
	-----
Total current assets	31,402
Property and equipment, net	4,912
Restricted investments	1,189
Other assets	47
	-----
Total assets	\$ 37,550
	=====
<b>Liabilities and Shareholders' Equity</b>	
Current liabilities	
Accounts payable	\$ 7,878
Accrued liabilities	3,813
Billings in excess of costs and estimated earnings on uncompleted contracts	47
Liability associated with common stock warrants	349
Current portion of capital lease obligations	51
Current portion of long-term debt	81
	-----
Total current liabilities	12,219
Capital lease obligations, net of current portion	132
Long-term debt, net of current portion	203
Deferred rent, net of current portion	887
	-----
Total liabilities	13,441
	-----
Commitments and contingencies	
Shareholders' equity	
Preferred stock, par value \$.001; 25,000 shares authorized; 0 and 0 shares issued and outstanding	--
Common stock, par value \$.001; 200,000 shares authorized; 88,836 and 88,686 shares issued and outstanding	89
Additional paid-in capital	375,810
Accumulated other comprehensive loss	(30)
Accumulated deficit	(351,760)
	-----
Total shareholders' equity	24,109

Edgar Filing: MICROVISION INC - Form 10-Q

Total liabilities and shareholders' equity

-----  
\$ 37,550  
=====

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

---

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

	Three Months Ended June 30,	
	2010	2009
Contract revenue	\$ 73	\$ 81
Product revenue	2,015	17
	-----	-----
Total revenue	2,088	98
	-----	-----
Cost of contract revenue	21	52
Cost of product revenue	3,337	54
	-----	-----
Total cost of revenue	3,358	1,07
	-----	-----
Gross margin	(1,270)	(8
	-----	-----
Research and development expense	6,043	5,71
Sales, marketing, general and administrative expense	3,817	3,66
	-----	-----
Total operating expenses	9,860	9,38
	-----	-----
Loss from operations	(11,130)	(9,46
Interest income	50	7
Interest expense	(16)	(2
Gain (loss) on derivative instruments, net	34	(98
Other expense	(11)	(
	-----	-----
Net loss	\$ (11,073)	\$ (10,39
	=====	=====
Net loss per share - basic and diluted	\$ (0.12)	\$ (0.1
	=====	=====
Weighted-average shares outstanding - basic and diluted	88,767	68,88
	=====	=====

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

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

	Three Months Ended June 30,	
	2010	2009
Net loss	\$ (11,073)	\$ (10,39
Other comprehensive gain (loss)		
Unrealized gain (loss) on investment securities, available-for-sale	(5)	
Comprehensive loss	\$ (11,078)	\$ (10,39
	=====	=====

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

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

	Six Months Ended June 30, 2010
	----- 2010 -----
<b>Cash flows from operating activities</b>	
Net loss	\$ (20,190)
Adjustments to reconcile net loss to net cash used in operations:	
Depreciation	741
Non-cash stock-based compensation expense	2,099
Loss (gain) on derivative instruments, net	(429)
Inventory write-downs	1,872
Non-cash deferred rent	(138)
Change in:	
Accounts receivable, net	(592)
Costs and estimated earnings in excess of billings on uncompleted contracts	63
Inventory	(7,546)
Other current assets	(49)
Other assets	1
Accounts payable	2,328
Accrued liabilities	(420)
Billings in excess of costs and estimated earnings on uncompleted contracts	(8)
	-----
Net cash used in operating activities	(22,268)
	-----
<b>Cash flows from investing activities</b>	
Sales of investment securities	100
Purchases of restricted investment securities	(305)
Purchases of property and equipment	(1,148)
	-----
Net cash used in investing activities	(1,353)
	-----
<b>Cash flows from financing activities</b>	
Principal payments under capital leases	(36)
Principal payments under long-term debt	(38)
Net proceeds from issuance of common stock and warrants	306
	-----
Net cash provided by financing activities	232
	-----
Net decrease in cash and cash equivalents	(23,389)
Cash and cash equivalents at beginning of period	43,025
	-----
Cash and cash equivalents at end of period	\$ 19,636
	=====
<b>Supplemental disclosure of cash flow information</b>	
Cash paid for interest	\$ 33
	=====
<b>Supplemental schedule of non-cash investing and financing activities</b>	
Property and equipment acquired under capital leases	\$ --
	=====



Edgar Filing: MICROVISION INC - Form 10-Q

Other non-cash additions to property and equipment

\$ 686

=====

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

---

MICROVISION, INC.  
Notes to Consolidated Financial Statements  
June 30, 2010  
(Unaudited)

1. MANAGEMENT'S STATEMENT AND PRINCIPLES OF CONSOLIDATION

Management's Statement

The Consolidated Balance Sheet as of June 30, 2010, the Consolidated Statements of Operations and Comprehensive Loss for the three and six months ended June 30, 2010 and 2009, and Consolidated Statements of Cash Flows for the six months ended June 30, 2010 and 2009 have been prepared by Microvision, Inc. ("we" or "us") and have not been audited. In the opinion of management, all adjustments necessary to state fairly the financial position at June 30, 2010 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 Securities and Exchange Commission (the "SEC"). You should read these condensed financial statements in conjunction with the financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2009. The results of operations for the six months ended June 30, 2010 are not necessarily indicative of the operating results that may be attained for the entire fiscal year.

We have incurred significant losses since inception. We have funded operations to date primarily through the sale of common stock, convertible preferred stock, warrants, the issuance of convertible debt and, to a lesser extent, from development contract revenues and product sales. At June 30, 2010, Microvision had \$22.2 million in cash, cash equivalents and investment securities available-for-sale, which included \$2.6 million in auction rate securities (ARS). There is currently no established primary orderly market for these ARS. If we were required to sell them in a short period of time, we might receive less than their current estimated fair values. However, based on our current operating plan and ability to access our \$19.6 million held in cash and cash equivalents as of June 30, 2010, we do not expect to be required to sell these securities materially below their current estimated fair value.

Based on our current operating plan, we anticipate that we have sufficient cash and cash equivalents to fund our operations through January 2011. We will require additional cash to fund our operating plan past that time. We are introducing new products into an emerging market which creates significant uncertainty about our ability to accurately project revenue, costs and cash flows. If the level of sales anticipated by our financial plan is not achieved or our working capital requirements are higher than planned, we will need to raise additional cash sooner or take actions to reduce operating expenses. 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 on a timely basis, we intend to consider limiting our operations substantially to extend our funds as we pursue other financing opportunities and business relationships. This limitation of operations could include reducing our planned investment in working capital to fund revenue growth and delaying development projects resulting in reductions in staff, operating costs, capital expenditures and investment in research and development.

As a result of the late filing of a current report on Form 8-K reporting the results of our 2010 annual meeting of shareholders, we are not eligible to use Form S-3 for registering new securities for sale by us. We can use our currently filed registration statements on Form S-3 until we file our next annual report on Form 10-K. We would again be eligible to use Form S-3 on July 1, 2011 if we remain current in our filings as provided in Form S-3 until that time.

We can also register sales of shares by us or investors on Form S-1.

## 2. NET LOSS PER SHARE

Basic net loss per share is calculated using the weighted-average number of common shares outstanding during the reporting periods. Diluted net loss per share is calculated using the weighted-average number of common shares outstanding and taking into account the dilutive effect of all potentially dilutive securities, including common stock equivalents and convertible securities 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 six months ended June 30, 2010 and 2009 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 June 30,	
	2010	2009
Numerator:		
Net loss available for common shareholders - basic and diluted	\$ (11,073)	\$ (10,3
	=====	=====
Denominator:		
Weighted-average common shares outstanding - basic and diluted	88,767	68,8
	=====	=====
Net loss per share - basic and diluted	\$ (0.12)	\$ (0.
	=====	=====

On June 30, 2010 and 2009, we excluded the following convertible securities from diluted net loss per share, as the effect of including them would have been anti-dilutive: publicly traded warrants convertible into 6,025,000 and 6,703,000 shares of common stock, respectively, options and private warrants convertible into a total of 13,415,000 and 13,538,000 shares of common stock, respectively, and 485,000 and 409,000 shares of nonvested equity shares, respectively.

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

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between informed market participants. The authoritative guidance establishes a three level fair value inputs hierarchy, and requires us to use observable valuation inputs where possible. When estimating fair values, we use market data, assumptions and risks we believe market participants would use, and we consider the risks inherent in the assumptions and the valuation techniques.

Our investment securities are principally comprised of auction rate debt securities issued by student loan financial aid organizations to fund guaranteed student loans. These securities are fully collateralized by the associated funded student loans which, in turn, are guaranteed by the U.S. Government.

The auction rate securities are investment grade variable interest rate long-term bonds with rate resets, purchases and sales determined via a Dutch auction process every 28 days. Beginning in February 2008, deteriorating global banking and economic conditions led to insufficient investor bids to clear the auctions and fund the secondary market. In compliance with the securities' terms, the issuers began, and continue, to pay interest at "maximum rates", instead of

Edgar Filing: MICROVISION INC - Form 10-Q

"auction rates". In March 2010, one of the issuers redeemed \$100,000 of our auction rate securities at par value through its voluntary lottery redemption program.

In May 2010, we purchased foreign currency contracts granting us options to purchase an aggregate of 1.6 million Euro at \$1.26 on expiration dates in August, October and November, 2010. The expiration dates are related to estimated product component purchase dates.

As of June 30, 2010, our assets and liabilities measured at fair value on a recurring basis are classified within the inputs hierarchy as follows:

	Level 1	Level 2	Level 3	Total
	-----	-----	-----	-----
Assets				
Corporate equity securities	\$ --	\$ 13,000	\$ --	\$ 13,000
Auction rate debt securities	--	--	2,600,000	2,600,000
Other current assets	--	34,000	--	34,000
	-----	-----	-----	-----
	\$ --	\$ 47,000	\$ 2,600,000	\$ 2,647,000
	=====	=====	=====	=====
Liabilities				
Liability associated with common stock warrants		\$ 349,000		\$ 349,000
		=====		=====

We valued the auction rate securities using significant unobservable assumptions and inputs and classified these securities at Level 3 in the inputs hierarchy. The corporate equity securities, other current assets and liability associated with common stock warrants are valued using inputs and common methods with sufficient levels of transparency and observability to be classified at Level 2.

We applied various valuation techniques to value the auction rate securities including discounted cash flow, with liquidity adjustments, market estimates, and other inputs. The primary inputs used for adjusted discounted cash flow analysis are as follows: benchmarked debt security yields from similarly rated U.S. Treasuries and Agencies, financial industry corporate bonds rated AA and A; maturity horizons varying from 9 months to 10 years; liquidity premiums on benchmark yields varying from 15% to 25%; and, coupon payments estimated assuming that the current 1.25% - 1.50% premiums to U.S. Treasury yields would continue for all time horizons. Due to liquidity issues in this market, the limited number of market price indications were significantly down-weighted in the analysis.

The foreign currency contracts were valued using generally applied model-based methodologies with empirical and market-based inputs and some bank-specific estimations.

We used a Black-Scholes model with the following assumptions to value the liability associated with warrants issued from a 2005 financing transaction at \$0.32 per warrant share: expected volatility of 80%, expected dividend yield of zero, risk free interest rate of 0.21%, and contractual lives of 0.4 years. The warrant shares are convertible into common stock at 1:1 and expire in December 2010. The following table summarizes the activity of Level 3 assets for the six months ended June 30, 2010:

Balance, December 31, 2009	\$ 2,700,000
Par value of redeemed securities	(100,000)
Recognized gain included in earnings	--
	-----
Balance, June 30, 2010	\$ 2,600,000
	=====

## 4. INVENTORY

Inventory consists of the following:

	June 30, 2010	December 2009
Raw materials	\$ 3,888,000	\$ 626,000
Finished goods	2,712,000	300,000
	<u>\$ 6,600,000</u>	<u>\$ 926,000</u>

The inventory at June 30, 2010 and December 31, 2009 consisted of raw materials for our pico projector products, and finished goods for our accessory pico projector and for ROV, our hand-held barcode scanner. Because our cost is currently higher than our selling price for our accessory pico projector product, inventory at June 30, 2010 also included write downs of \$1.5 million for lower of cost or market adjustments.

Inventory is stated at the lower of cost or market, with cost determined on a standard cost 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, we reduce the value of our inventory to our 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.

## 5. SHARE-BASED COMPENSATION

We use the straight-line attribution method to allocate the fair value of share-based compensation awards over the requisite service period for each award. The following table shows the amount of stock-based employee compensation expense included in the consolidated statements of operations:

	Three Months Ended June 30,	
	2010	2009
Cost of contract revenue	\$ 2,000	\$ 58,000
Cost of product revenue	19,000	7,000
Research and development expense	575,000	522,000
Sales, marketing, general and administrative expense	844,000	779,000
Share-based employee compensation cost charged against income	<u>\$ 1,440,000</u>	<u>\$ 1,366,000</u>

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 June 30, 2010:

	Weighted Average	Weighted Average Remaining Contractual	Aggregate
--	---------------------	---	-----------

Options	Shares	Exercise Price	Term (years)	Intrinsic Value
Outstanding as of June 30, 2010	9,508,000	\$ 3.37	7.0	\$3,613,000
Exercisable as of June 30, 2010	6,249,000	\$ 3.71	6.1	\$1,967,000

As of June 30, 2010, our unamortized share-based compensation was \$4.6 million which we plan to amortize over the next 2.7 years.

As of June 30, 2010, our unamortized nonvested equity share-based compensation was \$517,000 which we plan to amortize over the next 1.7 years.

## 6. LONG-TERM NOTES

### Tenant Improvement Loan Agreement

During 2006, we entered into a loan agreement with the lessor of our corporate headquarters in Redmond, Washington 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 \$284,000 at June 30, 2010.

## 7. RECEIVABLES FROM RELATED PARTIES

In January 2006, one officer left the company and his outstanding loans from the company became due in January 2007. In October 2009, we entered into a settlement agreement with the former officer. In addition to payments already received by us, the officer has committed to make additional payments of \$30,000 over the next two years.

Another officer with outstanding loans left the company in August 2007 and his loans from the company became due in August 2008. We are pursuing collection of the remaining outstanding balance from the former officer.

As of June 30, 2010 and December 31, 2009, the total amount outstanding under the loans was \$400,000 and the balances were fully reserved.

## 8. WARRANTS

In 2005 we issued warrants to purchase 2,302,000 shares of common stock in connection with certain notes, of which 1,089,000 remained outstanding as of June 30, 2010. The warrants meet the definition of derivative instruments that must be accounted for as liabilities 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 statement of operations each period. We valued the remaining warrants at June 30, 2010 using the Black-Scholes option pricing model with the following assumptions: expected volatility of 80%; expected dividend yield of 0%; risk free interest rate of 0.21%; and contractual lives of 0.4 years. The changes in value of the warrants of \$98,000 for the three months and \$491,000 for the six months ended June 30, 2010 were recorded as non-operating gains and are included in "Gain (loss) on derivative instruments, net" in the consolidated statement of operations.

## 9. COMMITMENTS AND CONTINGENCIES

### Litigation

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

## 10. NEW ACCOUNTING PRONOUNCEMENTS

In October 2009, the FASB issued guidance which 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. The guidance is 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. We are currently evaluating the impact that implementation of this guidance will have on our financial statements.

In October 2009, the FASB issued guidance which allows exclusion of 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. The guidance 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. We are currently evaluating the impact that implementation of this guidance will have on our financial statements.

## 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 proprietary PicoP® display engine 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, PDAs, 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 the sale of 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 have been selling the accessory projector in limited quantity through our Asian and European based distributors. In March 2010, we began selling the accessory projector through our online store to customers in the United States. We plan to add distribution channels as the production capacity for our manufacturing partner, green laser suppliers and other component suppliers increases.

With some modification, the PicoP 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.

	2010	% of contract revenue	2009	% of contract revenue	\$ change	% chan
<b>(in thousands)</b>	-----	-----	-----	-----	-----	-----
<b>Three months ended June 30</b>						
Government revenue	\$ --	--	\$ 622	76.5	\$ (622)	(100)
Commercial revenue	73	100.0	191	23.5	(118)	(61)
	-----		-----		-----	
Total contract revenue	\$ 73		\$ 813		\$ (740)	(91)
	=====		=====		=====	
<b>Six months ended June 30</b>						
Government revenue	\$ 71	19.1	\$ 1,042	68.3	\$ (971)	(93)
Commercial revenue	300	80.9	483	31.7	(183)	(37)
	-----		-----		-----	
Total contract revenue	\$ 371		\$ 1,525		\$ (1,154)	(75)
	=====		=====		=====	

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. Our contract revenue from sales of prototype units and evaluation kits may vary substantially due to the timing of orders from customers and potential constraints on resources.

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. We have developed processes that allow us to make reasonable estimates of the cost to complete a contract. When we begin work on the contract and at the end of each accounting period, we estimate the labor, material and other costs required to complete the statement of work using information provided by our technical team, project managers, vendors, outside consultants and others, and compare these estimates to cost incurred to date. Since our contracts generally require some level of technology development to complete, the actual cost required to complete a contract can vary from our estimates. Recognized revenues are subject to revisions as actual 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 sale of prototype units and evaluation kits, upon acceptance of the deliverables by the customer or expiration of the contractual acceptance period, after which there are no rights of return. 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 substantially lower during the three and six months ended June 30, 2010 than the same periods in 2009, due to reduced contract activity and lower beginning backlog in 2010 compared to the prior year. We expect that we will enter into fewer new development contracts for engineering services as we continue to focus our resources on commercialization of our PicoP-based products.

Our backlog of development contracts, including orders for prototype units and evaluation kits, at June 30, 2010 was \$122,000 compared to \$719,000 at June 30, 2009, all of which is scheduled for completion during the next twelve months.

#### Product revenue

	2010	% of product revenue	2009	% of product revenue	\$ change	% change
<b>(in thousands)</b>	-----	-----	-----	-----	-----	-----
<b>Three months ended June 30</b>						
Bar code revenue	\$ 114	5.7	\$ 174	100.0	\$ (60)	(34)
Pico projector revenue	1,901	94.3	--	--	1,901	
	-----		-----		-----	
Total product revenue	\$ 2,015		\$ 174		\$ 1,841	1,058
	=====		=====		=====	
<b>Six months ended June 30</b>						
Bar code revenue	\$ 220	9.2	\$ 413	100.0	\$ (193)	(46)
Pico projector revenue	2,165	90.8	--	--	2,165	
	-----		-----		-----	
Total product revenue	\$ 2,385		\$ 413		\$ 1,972	477
	=====		=====		=====	

Our product sales generally include acceptance provisions. We recognize product revenue upon acceptance of the product by the customer or expiration of the contractual acceptance period, after which there are no rights of return.

Our quarterly revenue may vary substantially due to the timing of product orders from customers, production constraints and availability of components and raw materials.

Bar code revenue was lower during the three and six months ended June 30, 2010 than the same period in 2009, due to our decreased investment in our bar code product during 2009. 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 and sell or license our bar code production capability and technology.

Pico projector revenue includes the sales of our accessory pico projector product which was launched in September 2009.

In March 2010, we received an \$8.5 million purchase order from an OEM customer for our PicoP based embedded engine. The customer plans to incorporate our PicoP engine into a high end media player scheduled for release in 2010. We expect to begin supplying this customer with embedded engines later this year.

The backlog of product orders at June 30, 2010 was approximately \$20.0 million, which is composed almost exclusively of PicoP based products, compared to \$135,000 at June 30, 2009, which is scheduled for delivery over the next fifteen months.

#### Cost of contract revenue

	2010	% of contract revenue	2009	% of contract revenue	\$ change	% change
(in thousands)						
Three months ended June 30	\$ 21	28.8	\$ 527	64.8	\$ (506)	(96)
Six months ended June 30	149	40.2	910	59.7	(761)	(83)

Cost of contract revenue includes both the direct and allocated indirect costs of performing on development contracts and producing prototype units and evaluation kits. Direct costs include labor, materials and other costs incurred directly in performing on a contract or producing prototype units and evaluation kits. 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 by the level of direct and indirect costs incurred, which can fluctuate substantially from period to period.

Cost of contract revenue was lower during the three and six months ended June 30, 2010 than the same periods in 2009 as a result of the decreased activity on development contracts. The cost of contract revenue as a percentage of contract revenue was lower in the three and six months ended June 30, 2010 than in the comparable periods in 2009 as a result of differences in the cost mix of the contracts, prototype units and evaluation kits produced 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

	2010	% of product revenue	2009	% of product revenue	\$ change	% change
(in thousands)						
Three months ended June 30	\$ 3,337	165.6	\$ 543	312.1	\$ 2,794	514
Six months ended June 30	4,496	188.5	784	189.8	3,712	473

Our costs to produce accessory pico projector units during the three and six months ended June 30, 2010 were substantially higher than product revenue. Cost of product revenue includes the direct and allocated indirect cost 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.

## Edgar Filing: MICROVISION INC - Form 10-Q

During the three and six months ended June 30, 2010, cost of product revenue included a lower of cost or market adjustment of \$701,000 and \$1,457,000, respectively, for inventory in stock at the end of the quarter.

Our overhead, which includes the costs of procuring, inspecting and storing material, and facility and depreciation costs, is allocated to inventory, cost of product revenue, cost of contract revenue, and research and development expense based on the level of effort supporting production or research and development activities.

The cost of product revenue as a percentage of product revenue can fluctuate significantly from period to period, depending on the product mix and volume and the level of overhead expense. The decrease in the cost of product revenue as a percentage of product revenue in 2010, compared to the same periods in 2009, was primarily attributed to lower of cost or market adjustments comprising a smaller proportion of total cost of product revenue.

Research and development expense.

(in thousands)	2010	2009	\$ change	% change
	-----	-----	-----	-----
Three months ended June 30	\$ 6,043	\$ 5,716	\$ 327	5.7
Six months ended June 30	11,041	11,326	(285)	(2.5)

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.

In addition, we allocate our research and development resources based on the business opportunity of the available projects, the skill mix of the resources available and the contractual commitments we have made to customers. The increase in cost during the three months ended June 30, 2010, compared to the same period in 2009, is primarily attributable to lower contract revenue resulting in decreases in both overhead and direct material allocated to cost of contract revenue.

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

Sales, marketing, general and administrative expense.

(in thousands)	2010	2009	\$ change	% change
	-----	-----	-----	-----
Three months ended June 30	\$ 3,817	\$ 3,667	\$ 150	4.1
Six months ended June 30	7,705	7,481	224	3.0

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. We continue to 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.

(in thousands)	2010	2009	\$ change	% change
	-----	-----	-----	-----

## Edgar Filing: MICROVISION INC - Form 10-Q

Three months ended June 30	\$	50	\$	79	\$	(29)	(36.7)
Six months ended June 30		79		143		(64)	(44.8)

The decrease in interest income for the three and six months ended June 30, 2010 compared to the same periods in 2009 resulted primarily from lower average cash, investment securities balances, and interest rates.

Interest expense.

(in thousands)	2010	2009	\$ change	% change
Three months ended June 30	\$ 16	\$ 20	\$ (4)	(20.0)
Six months ended June 30	33	31	2	6.5

Gain (loss) on derivative instruments, net.

(in thousands)	2010	2009	\$ change	% change
Three months ended June 30	\$ 34	\$ (982)	\$ 1,016	(103.5)
Six months ended June 30	429	(802)	1,231	(153.5)

In 2005 we issued warrants to purchase 2,302,000 shares of common stock in connection with certain notes, of which 1,089,000 remain outstanding as of June 30, 2010. The warrants meet the definition of derivative instruments that must be accounted for as liabilities 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 statement of operations each period. We valued the remaining warrants at June 30, 2010 using the Black-Scholes option pricing model with the following assumptions: expected volatility of 80%; expected dividend yield of 0%; risk free interest rate of 0.21%; and contractual life of 0.4 years. The changes in value of the warrants of \$98,000 for the three months and \$491,000 for the six months ended June 30, 2010 were recorded as non-operating gains and are included in "Gain (loss) on derivative instruments, net" in the consolidated statement of operations. The changes in value of the warrants for the three and six months ended June 30, 2010 was the result of changes in the value of our stock price and the decreasing contractual lives of the outstanding warrants.

### Liquidity and Capital Resources

We have incurred significant losses since inception. 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 June 30, 2010, we had \$22.2 million in cash, cash equivalents and investment securities, available-for-sale, which included \$2.6 million in auction rate securities (ARS). There is currently no established primary orderly market for these ARS. If we were required to sell them in a short period of time we might receive less than their current estimated fair values. However, based on our current operating plan and ability to access our \$19.6 million held in cash and cash equivalents as of June 30, 2010, we do not expect to be required to sell these securities materially below their current estimated fair value.

As a result of increases in our cash requirements during the quarter ended June 30, 2010, and increases in our forecasted cash requirements during the second half of 2010, we have revised our estimate of how long our cash will fund operations as reported in our Form 10-Q for the quarter ended March 31, 2010. Based on our current operating plan, we anticipate that we have sufficient cash and cash equivalents to fund our operations through January 2011. We will require additional cash to fund our operating plan past that time. We are introducing new products into an emerging market which creates significant uncertainty about our ability to accurately project revenue, costs and cash flows. If the level of sales anticipated by our financial plan is not achieved or our working capital requirements are higher than planned, we will need to raise additional cash sooner or take actions to reduce operating expenses. 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 on a timely basis, we intend to consider limiting our operations substantially to extend our funds as we pursue other financing opportunities and business relationships. This limitation of operations could include reducing our planned investment in working capital to fund revenue growth and delaying development projects resulting in reductions in staff, operating costs, capital expenditures and investment in research and development.

As a result of the late filing of a current report on Form 8-K reporting the results of our 2010 annual meeting of shareholders, we are not eligible to use Form S-3 for registering new securities for sale by us. We can use our currently filed registration statements on Form S-3 until we file our next annual report on Form 10-K. We would again be eligible to use Form S-3 on July 1, 2011 if we remain current in our filings as provided in Form S-3 until that time. We can also register sales of shares by us or investors on Form S-1.

Cash used in operating activities totaled \$22.3 million during the six months ended June 30, 2010, compared to \$16.3 million during the same period in 2009. During the six months ended June 30, 2010, the increase in cash used in operating activities was primarily driven by lower contract activity and higher inventory purchases as we began commercial sales of PicoP-based products.

We had the following material gains and charges, and changes in assets and liabilities during the six months ended June 30, 2010:

- *"Inventory"* During the six months ended June 30, 2010, ending inventory increased by \$5,674,000, primarily attributable to our accessory pico projector product.
- *"Accounts Payable"* During the six months ended June 30, 2010, accounts payable increased approximately \$2,929,000, primarily due to increased inventory purchases for the pico projector product line.

Cash used in investing activities totaled \$1,353,000 for the six months ended June 30, 2010 compared to \$544,000 during the six months ended June 30, 2009. During the six months ended June 30, 2010, we used cash of \$1,148,000 for capital expenditures, compared to \$544,000 during the same period in 2009. During the six months ended June 30, 2010, the increase in cash used in investing activities was primarily a result of the costs associated with a new enterprise resource planning system and production equipment purchases.

Cash provided by financing activities totaled \$232,000 for the six months ended June 30, 2010 compared to \$14.9 million during the same period in 2009.

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

#### Interest Rate and Market Liquidity Risks

As of June 30, 2010, approximately 88% 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 remainder is composed of \$2.6 million par student loan auction-rate securities (SLARS). Our SLARS are investment grade variable interest rate long-term bonds with rate resets, with purchases and sales determined via a Dutch Auction process every 28 days. They were issued to fund U.S. government guaranteed student loans. Beginning in February 2008, deteriorating global banking conditions led to insufficient investor bids to clear the auctions and fund the secondary market. In compliance with the securities' terms, the issuers then began, and continue, to pay interest at "maximum rates", instead of "auction rates".

Given the adverse credit market conditions and SLARS short-term illiquidity, the fair value of the principal became more sensitive to changes in interest rates and the spread between short and long rates than it was in the pre-2008 ARS credit marketplace. As a result, we estimated the fair value of the SLARS to be approximately \$2.7 million at

December 31, 2008. There were no adjustments to the fair value of the SLARS during 2009 or through June 30, 2010. In March 2010, one of the issuers redeemed \$100,000 of our auction rate securities at par value through its voluntary lottery redemption program. If market conditions worsen, we may have to further adjust the estimated fair value and record additional charges to earnings if we believe the adjustment is other-than-temporary. In the event we need immediate access to the funds invested in the SLARS, we could be required to sell them at an amount below our current carrying value. Any of these events could affect our consolidated financial condition, results of operations and cash flows. However, based on recent market stabilization and strengthening, we do not expect to be required to sell these securities materially below their current estimated fair 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 June 30, 2010, our cash and cash equivalents and investments available-for-sale securities portfolio are comprised of short-term highly rated money market funds and the SLARS.

The values of cash equivalents and investment securities, available-for-sale by maturity date as of June 30, 2010, are as follows:

	Amount	Percent
	-----	-----
Cash and cash equivalents	\$ 19,636	88.25%
Less than one year	13	0.06%
One to two years	--	--
Greater than five years	2,600	11.69%
	-----	-----
	\$ 22,249	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.

In May 2010, we purchased foreign currency contracts granting us options to purchase an aggregate of 1.6 million Euro at \$1.26 on expiration dates in August, October and November, 2010. The expiration dates are related to estimated product component purchase dates.

#### 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 June 30, 2010, we had an accumulated deficit of \$351.8 million.
- We incurred consolidated net losses of \$259.5 million from inception through 2007, \$32.6 million in 2008, and \$39.5 in 2009, and a net loss of \$20.2 million in the six months ended June 30, 2010.

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 our technology platform 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 substantial 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.

Based on our current operating plan, we anticipate that we have sufficient cash and cash equivalents to fund our operations through January 2011. We will require additional cash to fund our operating plan past that time. We are introducing new products into an emerging markets which creates significant uncertainty about our ability to accurately project revenue, costs and cash flows. If the level of sales anticipated by our financial plan is not achieved or our working capital requirements are higher than planned, we will need to raise additional cash sooner or take actions to reduce operating expenses. We plan to obtain additional cash through the issuance of equity or debt securities.

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 and the market acceptance and competitive position of such products. If revenues are less than we anticipate, if the mix of revenues varies from anticipated amounts or if expenses exceed the amounts budgeted, we may require additional capital earlier than expected to fund our operations. In addition, our operating plan provides for the development of strategic relationships with systems and equipment manufacturers that may require additional investments by us.

Additional capital may not 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 on a timely basis we intend to consider limiting our operations substantially to extend out funds as we pursue other financing opportunities and business relationships. This limitation of operations could include reducing our planned investment in working capital

to fund revenue growth and delaying development projects resulting in reductions in staff and operating costs as well as reductions in capital expenditures and investment in research and development.

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 current and 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, industrial, and medical 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.

We or our customers may fail to perform under open purchase orders, which could adversely affect our operating results and cash flows.

Our backlog of open purchase orders reported from time to time may be significant and totaled \$20.1 million as of June 30, 2010. We may be unable to meet the performance requirements, including performance specifications or delivery dates, required by such purchase orders. Further, our customers may be unable or unwilling to perform their obligations thereunder if, among other reasons, our products and technologies do not achieve market acceptance, our customers' products and technologies do not achieve market acceptance or our customers otherwise fail to achieve their operating goals. To the extent we are unable to perform under such purchase orders or to the extent customers are unable or unwilling to perform, our operating results and cash flows could be adversely affected.

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 of our common stock. If our common stock were not listed on the NASDAQ 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, 2008, and 2007. On August 2, 2010, the closing price of our stock was \$2.83.

Our lack of 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 costs, 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 the majority of our distributor relationships for our accessory pico projector and its accessories to 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 may 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 may 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 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 (i) our ability to raise, or the cost of, needed capital, (ii) demand for our current and future products and (iii) 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 accessory pico projector 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 accessory pico projector 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 our 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 our 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 half of 2010 and the full year of 2009, 3% and 43%, 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.

If we lose our rights under our third-party technology licenses, our operations could 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 could lose a competitive advantage in the market, and may even lose the ability to commercialize certain 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.

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:

## Edgar Filing: MICROVISION INC - Form 10-Q

- 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 6. Exhibits

<u>Exhibit</u> <u>Number</u>	<u>Description</u>
---------------------------------	--------------------

10.1	
------	--

	Microvision, Inc. 2006 Incentive Plan, as amended
--	---

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

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.

Date: August 9, 2010

BY: /s/ Alexander Y. Tokman

Alexander Y. Tokman

Chief Executive Officer

(Principal Executive Officer)

Date: August 9, 2010

BY: /s/ Jeff Wilson

Jeff Wilson

Chief Financial Officer

(Principal Financial Officer)

---



EXHIBIT INDEX

The following documents are filed herewith.

<u>Exhibit</u>	<u>Number</u>	<u>Description</u>
----------------	---------------	--------------------

10.1		Microvision, Inc. 2006 Incentive Plan, as amended
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

---