
U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

**QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934.**

For the quarterly period ended June 30, 2002

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)

Washington

(State or Other Jurisdiction of Incorporation
or organization)

91-1600822

(I.R.S. Employer Identification No.)

19910 North Creek Parkway, Bothell, Washington 98011-3008

(Address of Principal Executive Offices)

Issuer's telephone number, including area code: **(425) 415-6847**

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

As of July 31, 2002, 14,467,874 shares of the Company's common stock, no par value, were outstanding.

PART I FINANCIAL INFORMATION

- Item 1 - [Financial Statements \(unaudited\)](#)
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[Consolidated Statement of Operations for the three and six months ended June 30, 2002 and 2001](#)

[Consolidated Statement of Comprehensive Loss for the three and six months ended June 30, 2002 and 2001](#)

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PART II OTHER INFORMATION

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Consolidated Balance Sheet
(In thousands)

	June 30, 2002 (Unaudited)	December 31, 2001
Assets		
Current Assets		
Cash and cash equivalents	\$ 11,120	\$ 15,587
Investment securities, available-for-sale	12,118	18,065
Accounts receivable, net of allowances of \$109 and \$109	940	1,712
Costs and estimated earnings in excess of billings on uncompleted contracts	1,925	1,584
Inventory, net	473	99
Current restricted investments	102	102
Other current assets	1,990	2,302
Total current assets	28,668	39,451
Long-term investment, at cost	—	624
Property and equipment, net	8,256	8,960
Restricted investments	1,356	1,434
Receivables from related parties, net	2,143	2,252
Other assets	829	1,334
Total assets	\$ 41,252	\$ 54,055
Liabilities, Minority Interests and Shareholders' Equity		
Current Liabilities		
Accounts payable	\$ 1,340	\$ 1,613
Accrued liabilities	4,305	4,298
Allowance for estimated contract losses	155	155
Billings in excess of costs and estimated earnings on uncompleted contracts	50	60
Current portion of capital lease obligations	78	170
Current portion of long-term debt	60	57
Total current liabilities	5,988	6,353
Capital lease obligations, net of current portion	34	61
Long-term debt, net of current portion	202	232
Deferred rent, net of current portion	267	259
Total liabilities	6,491	6,905
Commitments and Contingencies	—	—
Minority Interests	11,073	14,824
Shareholders' Equity		
Common stock and paid-in capital, no par value, 31,250 shares authorized; 13,530 and 12,998 shares issued and outstanding	141,341	135,954
Deferred compensation	(1,938)	(2,803)
Subscriptions receivable from related parties	(183)	(321)
Accumulated other comprehensive income	273	427
Accumulated deficit	(115,805)	(100,931)
Total shareholders' equity	23,688	32,326
Total liabilities, minority interests and shareholders' equity	\$ 41,252	\$ 54,055

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

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

	Three months ended June 30,		Six months ended June 30,	
	2002	2001	2002	2001
Revenue	\$ 4,734	\$ 1,772	\$ 8,538	\$ 4,109
Cost of revenue	2,195	1,081	4,006	2,643
Gross margin	2,539	691	4,532	1,466
Research and development expense (exclusive of non-cash compensation expense of \$245 and \$250 for the three months and \$501 and \$352 for the six months ended June 30, 2002 and 2001, respectively)	5,960	8,035	13,329	16,009
Marketing, general and administrative expense (exclusive of non-cash compensation expense of \$153 and \$514 for the three months and \$412 and \$967 for the six months ended June 30, 2002 and 2001, respectively)	4,373	3,303	8,882	7,004
Non-cash compensation expense	398	764	913	1,319

Total operating expenses	10,731	12,102	23,124	24,332
Loss from operations	(8,192)	(11,411)	(18,592)	(22,866)
Interest income	281	723	619	1,429
Interest expense	(11)	(21)	(29)	(45)
Loss due to impairment of long-term investment	(624)	—	(624)	—
Loss before minority interests	(8,546)	(10,709)	(18,626)	(21,482)
Minority interests in loss of consolidated subsidiary	1,898	2,142	3,752	2,696
Net loss	<u>\$ (6,648)</u>	<u>\$ (8,567)</u>	<u>\$ (14,874)</u>	<u>\$ (18,786)</u>
Net loss per share - basic and diluted	<u>\$ (0.49)</u>	<u>\$ (0.72)</u>	<u>\$ (1.12)</u>	<u>\$ (1.57)</u>
Weighted-average shares outstanding - basic and diluted	13,530	11,974	13,287	11,945

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

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

	Three months ended June 30,		Six months ended June 30,	
	2002	2001	2002	2001
Net loss	\$ (6,648)	\$ (8,567)	\$ (14,874)	\$ (18,786)
Other comprehensive income (loss) - Unrealized gain (loss) on investment securities, available-for-sale:	28	(99)	(154)	234
Comprehensive loss	<u>\$ (6,620)</u>	<u>\$ (8,666)</u>	<u>\$ (15,028)</u>	<u>\$ (18,552)</u>

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

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

	Six months ended June 30,	
	2002	2001
Cash flows from operating activities		
Net loss	\$ (14,874)	\$ (18,786)
Adjustments to reconcile net loss to net cash used in operations:		
Depreciation	1,354	1,077
Non-cash expenses related to issuance of stock, warrants, options and amortization of deferred compensation	913	1,321
Non-cash expenses related to issuance of stock for an exclusive license agreement	—	970
Impairment of long-term investment	624	—
Allowance for receivables from related parties	500	—
Minority interests in loss of consolidated subsidiary	(3,752)	(2,696)
Non-cash deferred rent	8	8
Allowance for estimated contract losses	—	(140)
Change in:		
Accounts receivable	772	419
Costs and estimated earnings in excess of billings on uncompleted contracts	(341)	1,134
Inventory	(374)	—
Other current assets	312	(1,534)
Other assets	3	(58)
Accounts payable	(273)	(532)
Accrued liabilities	7	978
Billings in excess of costs and estimated earnings on uncompleted contracts	(10)	(373)
Net cash used in operating activities	<u>(15,131)</u>	<u>(18,212)</u>
Cash flows from investing activities		

Sales of investment securities	5,919	5,000
Purchases of investment securities	(126)	(5,392)
Sales of restricted investment securities	1,434	1,173
Purchases of restricted investment securities	(1,356)	—
Advances to related parties	(391)	(620)
Purchases of property and equipment	(650)	(2,603)
Net cash provided by (used in) investing activities	4,830	(2,442)
Cash flows from financing activities		
Principal payments under capital leases	(119)	(182)
Principal payments under long-term debt	(27)	(25)
Payments received on subscriptions receivable	138	80
Net proceeds from issuance of common stock	5,842	1,043
Net proceeds from sale of subsidiary's equity to minority interests	—	21,242
Net cash provided by financing activities	5,834	22,158
Net increase (decrease) in cash and cash equivalents	(4,467)	1,504
Cash and cash equivalents at beginning of period	15,587	7,307
Cash and cash equivalents at end of period	\$ 11,120	\$ 8,811

Supplemental disclosure of cash flow information

Cash paid for interest	\$ 29	\$ 45
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Supplemental schedule of non-cash investing and financing activities

Effect of change in interest in subsidiary from issuance of subsidiary common stock	\$ —	\$ 3,001
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The accompanying notes are an integral part of these financial statements.

MICROVISION, INC.
Notes to Consolidated Financial Statements
June 30, 2002

Management's Statement

The Consolidated Balance Sheet as of June 30, 2002, the Consolidated Statements of Operations and Comprehensive Loss for the three and six months ended June 30, 2002 and June 30, 2001, and the Consolidated Statements of Cash Flows for the six months ended June 30, 2002 and June 30, 2001 have been prepared by Microvision, Inc. (the "Company") and have not been audited. In the opinion of management, all adjustments necessary to present fairly the financial position at June 30, 2002 and the results of operations 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. 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, 2001. The results of operations for the three and six months ended June 30, 2002 are not necessarily indicative of the operating results that may be attained for the entire fiscal year.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and Lumera Corporation ("Lumera"). As of June 30, 2002 and December 31, 2001, Microvision owned 76% of the outstanding common stock and 11% of the mandatorily redeemable convertible preferred stock of Lumera. The balance of Lumera's outstanding capital stock is owned by its directors, Microvision employees, the University of Washington ("UW") and other investors unaffiliated with Microvision. Lumera's losses were first allocated to its common shareholders until such losses exceeded its common equity and then to its preferred shareholders pro rata in accordance with their respective ownership interests. All material intercompany accounts and transactions have been eliminated in consolidation.

Long-Term Investment

In December 1999, the Company invested \$624,000 in Gemfire Corporation ("Gemfire"), a privately held corporation. Gemfire is a developer of diode laser components for display and telecommunication applications. The Company accounts for the investment using the cost method. In June 2002, Gemfire announced a recapitalization plan that would reduce the value of the Company's investment. In June 2002, the Company recorded an expense for a loss of the entire value of its investment in Gemfire.

Receivables from Related Parties

In 2000, the Board of Directors authorized the Company to provide an unsecured line of credit to four of the Company's senior officers. The limit of the line of credit is three times the respective executive's base salary less any amounts outstanding under the Company's Executive Option Exercise Loan Plan. In October 2001 and July 2002, the Board of Directors authorized an additional \$500,000 and \$200,000, respectively, to the limit for one of the senior officers.

The Company establishes an allowance for doubtful accounts when it determines that a borrower may have insufficient net worth and short-term earnings potential to repay the outstanding balance under the Company-sponsored lines of credit. The Company recorded an allowance for doubtful accounts for the receivables from related parties of \$500,000 at June 30, 2002. The Company has no plans to forgive any portion of the principal of the outstanding receivable balance.

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. Diluted net loss per share for the periods ended June 30, 2002 and 2001 is equal to basic net loss per share because the effect of potential common stock equivalents outstanding during the periods, including convertible preferred stock, options and warrants, is anti-dilutive.

The components of basic and diluted earnings per share were as follows (in thousands except earnings per share data):

	Three months ended June 30,		Six months ended June 30,	
	2002	2001	2002	2001
Numerator:				
Net loss available	\$ (6,648)	\$ (8,567)	\$ (14,874)	\$ (18,786)
Denominator:				
Basic and diluted weighted-average common shares outstanding	13,530	11,974	13,287	11,945
Basic and diluted net loss per share	\$ (.49)	\$ (.72)	\$ (1.12)	\$ (1.57)

As of June 30, 2002 and 2001, the Company had outstanding options and warrants to purchase 6,200,000 and 3,868,000 shares of common stock, respectively.

Equity

In March 2002, the Company raised \$6,028,000, before issuance costs, from the sale of 524,000 shares of its common stock at a price of \$11.50 per share to six investors.

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Segment Information

The Company is organized into two major segments - Microvision, which is engaged in the development and commercialization of retinal scanning displays and related technologies, and Lumera, which is engaged in the development and commercialization of optical systems components technology. The segments were determined based on how management views and evaluates the Company's operations.

A portion of the segments' expenses arise from shared services that Microvision has provided to both segments in order to realize economies of scale and to efficiently use resources. These shared services include centralized management, legal, accounting, human resources, real estate, management information systems, treasury and other corporate services. These expenses are allocated to the segments on a basis that the Company considers to be a reasonable reflection of the utilization of services provided to or benefits received by the segments.

The following table reflects the results of the Company's reportable segments under the Company's financial management system. The performance of each segment is measured based on several metrics. These results are used, in part, by management in evaluating the performance of, and in allocation of resources to, each of the segments.

	Three months ended June 30, 2002 (in thousands)			
	Microvision	Lumera	Eliminations	Total
Revenues	\$ 4,461	\$ 273	\$ —	\$ 4,734
Interest income	226	55	—	281
Interest expense	11	—	—	11
Depreciation	437	254	—	691
Segment loss	6,413	2,133	(1,898)	6,648
Segment assets	35,242	12,507	(6,497)	41,252
Expenditures for capital assets	191	145	—	336

	Three months ended June 30, 2001 (in thousands)			
	Microvision	Lumera	Eliminations	Total
Revenues	\$ 1,749	\$ 23	\$ —	\$ 1,772
Interest income	619	143	(39)	723
Interest expense	21	39	(39)	21
Depreciation	360	210	—	570
Segment loss	8,302	2,407	(2,142)	8,567
Segment assets	48,375	20,139	(6,478)	62,036
Expenditures for capital assets	658	1,487	—	2,145

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	Six months ended June 30, 2002 (in thousands)			
	Microvision	Lumera	Eliminations	Total
Revenues	\$ 8,002	\$ 536	\$ —	\$ 8,538
Interest income	499	120	—	619

Interest expense	29	—	—	29
Depreciation	848	506	—	1,354
Segment loss	14,410	4,216	(3,752)	14,874
Segment assets	35,242	12,507	(6,497)	41,252
Expenditures for capital assets	466	184	—	650

	Six months ended June 30, 2001			
	(in thousands)			
	Microvision	Lumera	Eliminations	Total
Revenues	\$ 4,070	\$ 39	\$ —	\$ 4,109
Interest income	1,636	186	(393)	1,429
Interest expense	45	393	(393)	45
Depreciation	720	357	—	1,077
Segment loss	16,223	5,259	(2,696)	18,786
Segment assets	48,375	20,139	(6,478)	62,036
Expenditures for capital assets	960	1,643	—	2,603

New Accounting Pronouncements

In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." The Company adopted this statement during the first quarter of 2002. As the Company has no recorded goodwill or intangible assets, there was no initial effect from the adoption of this standard.

In July 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." Adoption of this statement is required no later than January 1, 2003. The Company is currently assessing the impact of this statement on its results of operations, financial position and cash flows.

In October 2001, the FASB issued SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." FAS 144 retains the fundamental provisions of SFAS No. 121 for recognition and measurement of the impairment of long-lived assets to be held and used and for measurement of long-lived assets to be disposed of by sale. This statement applies to all long-lived assets, including discounted operations, and replaces the provisions of APB Opinion No. 30, "Reporting Results of Operations-Reporting the Effects of Disposal of a Segment of a

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Business," for the disposal of segments of a business. This statement requires that those long-lived assets be measured at the lower of carrying amount or fair value. Microvision adopted this statement during the first quarter of 2002 and there was no material impact on the Company's results of operations, financial position or cash flows.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The Company will be required to adopt this statement for exit or disposal activities that are initiated after December 31, 2002. The adoption of SFAS 146 will not have a significant impact on its financial position, results of operations and cash flows.

Subsequent Event

In July 2002 the Company reduced its workforce by approximately 7%. The Company will pay approximately \$200,000 in involuntary termination benefits during the third quarter of 2002. The liability for the involuntary termination benefits did not meet the criteria for accrual established in Emerging Issues Task Force 94-3, and therefore the related expense will be recognized in the third quarter of 2002.

In July 2002, the Company raised \$3,000,000 before issuance costs from the sale of 937,500 shares of Microvision common stock at \$3.20 per share and fully vested five-year warrants to purchase 234,375 shares of common stock at a price of \$4.80 per share to two investors.

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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 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 the Company, as well as assumptions relating to the foregoing. The words "believe," "expect," "anticipate," "estimate," "project," and similar expressions identify forward-looking statements, which speak only as of the date the statement was made. Certain factors that realistically could cause results to differ materially from those projected in the forward-looking statements are set forth below under the caption "Risk Factors Relating to the Company's Business."

Overview

Microvision, Inc. ("Microvision" or the "Company") develops information display and capture devices and related technologies. The Company is developing and seeks to commercialize technologies and products in three business platforms relating to the delivery of images and information:

- Retinal Scanning Displays - Uses the retinal scanning display technology to display information on the retina of the viewers eye.
- Image Capture Devices - Uses proprietary scanning technology to capture images and information in applications such as bar code readers or cameras.

- Electro-Optical Materials Technology - Uses a new class of organic non-linear materials technology that interact with, and can be used to change the properties of, light waves to transmit information.

Retinal Scanning Displays

The Company has developed prototype retinal scanning display technology devices, including head-worn, portable color versions as well as head-worn monochrome and color see-through versions, and is currently refining and developing its retinal scanning display technology for defense, medical, industrial and consumer applications. The Company is commercializing its technology through the development of products and also plans to supply personal display technology to original equipment manufacturers. The Company believes the retinal scanning display technology will be useful in a variety of applications, such as portable communications and visual simulation applications that will require images to be superimposed onto the user's field of vision. The Company expects that its retinal scanning display technology will allow for

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the production of highly miniaturized, lightweight, battery-operated displays that can be held or worn comfortably.

The Company's retinal scanning display technology includes proprietary technology developed by the Company, technology licensed from other companies and technology licensed from the University of Washington.

Image Capture Devices

The Company is also developing products that capture images using the Company's proprietary scanning technologies. The Company believes that the basic scanning components of the retinal scanning display system can be used to develop products, such as bar code readers and miniature high-resolution cameras, that have higher performance and lower cost than those currently available. The Company has developed proprietary scanner technology, which it plans to use in a low cost hand held bar code scanner targeted at industrial applications. The laser-based hand held bar code device would allow the user to record information in a way that is both easy and fast. The Company plans to continue to refine the design of the hand held scanner and introduce the product in September 2002.

Electro-Optical Materials and Devices

During 2000, the Company formed a subsidiary company, Lumera Corporation ("Lumera"), to develop and commercialize a new class of non-linear organic electro-optical chromophores ("Optical Materials") and devices that use the optical properties of these proprietary materials. Non-linear organic electro-optical materials interact with and can be used to change the properties of light waves to transmit information. The formation of Lumera was an outgrowth of the Company's prior work in photonics. In October 2000, Lumera entered into an exclusive license agreement with the University of Washington for certain Optical Materials technology. Lumera expects that these materials and devices made from the Optical Materials will improve the performance and reduce the cost of electro-optic components used for fiber-optic telecommunications and data communications systems, phased-array antennas, optical computing and other photonics applications.

Plan of Operation

The Company introduced Nomad™, a production version of a retinal scanning display, in December 2001. The Company plans to sell Nomad to customers in general aviation, industrial, medical and defense sectors. The Company plans to distribute Nomad directly to end-users and through value added resellers who will develop applications using Nomad. As of June 30, 2002 the Company had entered into agreements with 21 value added resellers to distribute Nomad.

The Company plans to introduce "Flic™", a hand held bar code scanner, in September 2002. Flic will be produced by a contract manufacturer. The Company plans to distribute Flic through the

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same channels as existing bar code products including value added resellers and original equipment manufacturers.

The Company also intends to continue entering into strategic relationships with systems integrators and original equipment manufacturers to pursue the development of commercial products incorporating the retinal scanning display technology.

In addition, the Company plans to continue to pursue, obtain and perform on development contracts. The Company expects that such contracts will further the development of the retinal scanning display and Optical Materials technologies and lead to additional commercial applications of its technologies. The Company also plans to invest funds for ongoing innovation and improvements to the retinal scanning display and Optical Materials technologies. These innovations and improvements include developing component technology, building additional prototypes, and designing components and products for manufacturability. The Company intends to continue hiring qualified sales, technical and other personnel and to continue investing in laboratory facilities and equipment to achieve development and production objectives.

Lumera plans to develop optical components that offer increased speed, reduced size and cost, greater reliability, and more efficient operation than existing electro-optic component technologies. Moreover, Lumera believes that its Optical Materials technology is well suited to the manufacture of highly complex, highly integrated optical systems. The first product planned for introduction is a high-speed electro-optical ("EO") modulator that will provide a direct replacement for currently available lithium niobate modulators. The function of an EO modulator is to encode data onto laser beams that carry and deliver data throughout optical fiber networks. Lumera's Optical Materials and devices can be designed to optimize performance for a specific application. In addition, the Optical Materials technology has potential applications in a broad range of optical networking components.

Lumera's Optical Materials technology may ultimately be sold in a variety of forms, including coated wafers, non-packaged discrete devices, non-packaged integrated devices, packaged discrete components, packaged integrated components, and intellectual property in the form of licenses, integrated cells and other forms. Lumera's target customers include strategic technology partners, sub-system manufacturers, private label component vendors, component distributors and systems manufacturers in the telecommunications industry.

Results of Operations

THREE MONTHS ENDED JUNE 30, 2002 COMPARED TO
THREE MONTHS ENDED JUNE 30, 2001

Revenue. The Company earns revenue from performance on development contracts, sales of demonstration products, and sales of Nomad. Revenue in the three months ended June 30, 2002 increased by \$2.9 million, or 167%, to \$4.7 million from \$1.8 million in the same period in 2001. For the three months ended June 30, 2002, 78% of revenue

was derived from performance on development contracts with the United States government, 18% from performance on development contracts with commercial customers, and

the remainder from the sales of Nomad units.

In May 2002, the Company entered a \$3.3 million contract modification with the U.S. Army's Aviation Applied Technology Directorate to continue work on an advanced helmet mounted display and imaging system to be used in the virtual cockpit optimization program.

In June 2002, the Company entered a \$1.9 million development contract with NASA Langley Research Center to deliver a prototype cockpit helmet display system.

The backlog of development contracts and product sales at June 30, 2002 was \$5.7 million of development contract work and product orders, all of which are scheduled for completion during the next twelve months. The backlog is comprised of development contracts, including amendments thereto, and purchase orders that were entered into through June 30, 2002.

Cost of Revenue. Cost of revenue includes both the direct and allocated indirect costs of performing on development contracts and producing Nomad. Indirect costs include staff and related support costs associated with building the Company's technical capabilities and capacity to perform on development contracts the Company expects to enter into in the future.

Cost of revenue for the three months ended June 30, 2002 increased by \$1.1 million, or 103%, to \$2.2 million from \$1.1 million in the same period in 2001. Total direct costs for the three months ended June 30, 2002 increased by approximately 90% over the same period in 2001. The direct labor costs portion of direct cost for the three months ended June 30, 2002 increased by 200% over the same period in 2001. The increase in direct cost was principally a result of the higher volume of contract work that the Company performed during the three months ended June 30, 2002 compared to the same period in 2001. Research and development overhead is allocated to both cost of revenue and research and development expense based on the proportion of direct labor cost incurred in cost of revenue and research and development, respectively. As a result of the higher direct labor cost in cost of revenue for the three months ended June 30, 2002 approximately 60% more overhead was allocated to cost of revenue than in the same period in 2001.

The Company is in the early phase of Nomad production and has not achieved production volumes to support commercial production as described in SFAS No. 2 "Accounting for Research and Development Cost." The Company's costs to produce Nomad units during the three months ended June 30, 2002 were substantially higher than product revenue. The Company has classified production cost in excess of product revenue as research and development expense. When the Company reaches normal Nomad production levels all manufacturing costs will be included in cost of revenue.

The Company expects that cost of revenue on an absolute dollar basis will increase in the future. This increase will likely result from anticipated sales of commercial products, additional development contract work that the Company expects to perform and commensurate growth in the Company's personnel and technical capacity required for performance on such contracts and product sales. The cost of revenue as a

percentage of revenue can fluctuate significantly from period to period, depending on the contract mix, the cost of future products and the level of direct and indirect cost incurred.

Research and Development Expense. 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,
- Fees and expenses related to patent applications, prosecution and protection, and
- Related operating expenses.

Included in research and development expenses are costs incurred in acquiring and maintaining licenses of technology from other companies. The Company has charged all research and development costs to cost of revenue or research and development expense.

Research and development expense in the three months ended June 30, 2002 decreased by \$2.0 million, or 26%, to \$6.0 million from \$8.0 million in the same period in 2001. During the three month period ended June 30, 2001 the Company recorded \$1.4 million in direct expense relating to light source research performed for the Company by CREE, Inc. The Company's development agreement with CREE ended in April 2002, resulting in a \$1.4 million cost reduction in the three-month period ended June 30, 2002.

Due to the higher volume of work performed on revenue contracts during the three months ended June 30, 2002, more indirect research and development costs were allocated to cost of revenue than in the same period in 2001.

The Company believes that a substantial level of continuing research and development expense will be required to develop additional commercial products using the retinal scanning display technology and the Optical Materials technology. Accordingly, the Company anticipates that a high level of research and development spending will continue. These expenses will be incurred as a result of:

- Expanding and equipping in-house laboratories,
- Acquiring rights to additional technologies,
- Subcontracting work to development partners
- Incurring related operating expenses, and
- Hiring additional technical and support personnel.

The Company expects that the amount of spending on research and product development will grow as the Company:

- Continues development of the Company's retinal scanning display technology,
- Develops and commercializes the Optical Materials technology,

- Prepares for the planned introduction of the Company's first bar code product in September 2002,
- Accelerates development of microdisplays to meet emerging market opportunities, and
- Pursues other potential business opportunities.

Marketing, General and Administrative Expense. Marketing, general and administrative expenses include compensation and support costs for sales, marketing, management and administrative staff, and for other general and administrative costs, including legal and accounting services, consultants and other operating expenses.

The Company's marketing activities include corporate awareness campaigns, such as web site development and participation at trade shows; corporate communications initiatives; and working with potential customers and joint venture partners to identify and evaluate product applications in which the Company's technology could be integrated or otherwise used.

Marketing, general and administrative expenses in the three months ended June 30, 2002 increased by \$1.1 million, or 32%, to \$4.4 million from \$3.3 million in the same period in 2001. The increase includes increases in compensation expenses and support costs for employees and contractors. The Company expects marketing, general and administrative expenses to increase substantially in future periods as the Company:

- Adds to its sales staff,
- Makes additional investments in sales and marketing activities, and
- Increases the level of corporate and administrative activity.

During the three months ended June 30, 2002 the Company determined that one of its senior officers may have insufficient net worth and short-term earnings potential to repay loans outstanding under the Company's executive loan program. The Company recorded an allowance for doubtful accounts for receivables from related parties of \$500,000 in the three months ended June 30, 2002.

Non-Cash Compensation Expense. Non-cash compensation expense in the three months ended June 30, 2002 decreased 48% or \$366,000 to \$398,000 from \$764,000 in the same period in 2001.

The following table shows the major components of non-cash compensation expense for the three months ended June 30, 2002 and 2001, respectively.

	Three months ended June 30,	
	2002	2001
Lumera stock issued to the University of Washington	\$ 251,000	\$ 251,000
Company and Lumera stock options issued to employees	44,000	86,000
Company and Lumera stock options issued to consultants	78,000	344,000
Stock and options issued to Independent Directors	25,000	83,000
	<u>\$ 398,000</u>	<u>\$ 764,000</u>

Interest Income and Expense. Interest income in the three months ended June 30, 2002 decreased by \$442,000, or 61%, to \$281,000 from \$723,000 in the same period in 2001. This decrease resulted primarily from lower average cash and investment securities balances in the three months ended June 30, 2002 than the average cash and investment securities balances in the same period of the prior year.

Interest expense in the three months ended June 30, 2002 was consistent with the same period in 2001 as the Company's borrowings remained relatively constant.

Loss in Long-Term Investment. In December 1999, the Company invested \$624,000 in Gemfire Corporation ("Gemfire"), a privately held corporation. Gemfire is a developer of laser components for display and telecommunication applications. The Company accounts for the investment using the cost method.

In June 2002, Gemfire announced a recapitalization plan that would reduce the value of the Company's investment. In June 2002, the Company recorded an expense for a loss of the entire value of its investment in Gemfire.

SIX MONTHS ENDED JUNE 30, 2002 COMPARED TO SIX MONTHS ENDED JUNE 30, 2001

Revenue. The Company earns revenue from performance on development contracts, sales of demonstration products, and sales of Nomad. Revenue in the six months ended June 30, 2002 increased by \$4.4 million, or 108%, to \$8.5 million from \$4.1 million in the same period in 2001. For the six months ended June 30, 2002, 85% of revenue was derived from performance on development contracts with the United States government, 11% from performance on development contracts with commercial customers and the remainder from the sales of Nomad units.

Cost of Revenue. Cost of revenue for the six months ended June 30, 2002 increased by \$1.4 million, or 52%, to \$4.0 million from \$2.6 million in the same period in 2001. Total direct costs for the six months ended June 30, 2002 increased approximately 30% from the same period in 2001. The direct labor costs portion of direct cost for the six months ended June 30, 2002 increased by approximately 175% over the same period in 2001. The increase in direct labor cost was a result of the higher volume of contract work that the Company was performing and increased product costs during the six months ended June 30,

2002 compared to the same period in 2001. Research and development overhead is allocated to both cost of revenue and research and development expense based on the proportion of direct labor cost incurred in cost of revenue and research and development, respectively. As a result of the higher direct labor cost in cost of revenue for the six months ended June 30, 2002 approximately 40% more overhead was allocated to cost of revenue than in the same period in 2001.

The Company is in the early phase of Nomad production and has not achieved production volumes to support commercial production as described in SFAS No. 2 "Accounting for Research and Development Costs." The Company's costs to produce Nomad units during the six months ended June 30, 2002 were substantially higher than product revenue. The Company has classified production cost in excess of product revenue as research and development expense. When the Company reaches normal Nomad production levels all manufacturing costs will be included in cost of revenue.

Research and Development Expense. Research and development expense in the six months ended June 30, 2002 decreased by \$2.7 million, or 17%, to \$13.3 million from \$16.0 million in the same period in 2001. The decrease is partially a result of a license fee paid to the University of Washington in February 2001 for the HALO Technology. The HALO technology involves the projection of data and images onto the inside of a dome that is placed over the viewer's head. The Company issued 37,000 shares of Common Stock valued at \$1.0 million and paid \$100,000 to the University of Washington as final payment for the license.

In addition, during the six month period ended June 30, 2001 the Company recorded \$2.3 million in expense relating to light source research performed for the Company by CREE Inc. The Company's research agreement with Cree ended in April 2002, resulting in a \$900,000 cost reduction in the six-month period ended June 30, 2002.

The decrease in the HALO license fee and CREE research expense was offset by increases in other costs, which reflect the continued implementation of the Company's operating plan, which calls for building technical staff and supporting activities, establishing and equipping in-house laboratories, and developing and maintaining intellectual property.

As discussed above, due to the higher volume of work performed on revenue contracts, more indirect research and development costs were allocated to cost of revenue during the three months ended June 30 than in the comparable period in 2001.

Marketing, General and Administrative Expense. Marketing, general and administrative expenses in the six months ended June 30, 2002 increased by \$1.9 million, or 27%, to \$8.9 million from \$7.0 million in the same period in 2001. The increase includes increases in compensation expenses and support costs for employees and contractors. The Company expects marketing, general and administrative expenses to increase substantially in future periods as the Company:

- Adds to its sales and marketing staff,

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- Makes additional investments in sales and marketing activities, and
- Increases the level of corporate and administrative activity.

Non-Cash Compensation Expense. Non-cash compensation expense in the six months ended June 30, 2002 decreased 31% or \$406,000 to \$913,000 from \$1,319,000 for the same period in 2001.

The following table shows the major components of non-cash compensation expense for the six months ended June 30, 2002 and 2001, respectively.

	Six months ended June 30,	
	2002	2001
Lumera stock issued to the University of Washington	\$ 502,000	\$ 343,000
Company and Lumera stock options issued to employees	125,000	241,000
Company and Lumera stock options issued to consultants	228,000	570,000
Stock and options issued to Independent Directors	58,000	165,000
	<u>\$ 913,000</u>	<u>\$ 1,319,000</u>

Interest Income and Expense. Interest income in the six months ended June 30, 2002 decreased by \$810,000, or 57%, to \$619,000 from \$1.4 million in the same period in 2001. This decrease resulted primarily from lower average cash and investment securities balances in the six months ended June 30, 2002 than the average cash and investment securities balances in the same period of the prior year.

Interest expense in the six months ended June 30, 2002 was consistent with the same period in 2001, as our borrowings remained relatively constant.

Loss in Long-Term Investment. In December 1999, the Company invested \$624,000 in Gemfire Corporation ("Gemfire"), a privately held corporation. Gemfire is a developer of diode laser components for display and telecommunication applications. The Company accounts for the investment using the cost method.

In June 2002, Gemfire announced a recapitalization plan that would reduce the value of the Company's investment. In June 2002, the Company recorded an impairment for the entire value of its investment in Gemfire.

Liquidity and Capital Resources

The Company has funded operations to date primarily through the sale of common stock, convertible preferred stock and, to a lesser extent, revenues from development contracts and product sales. At June 30, 2002, the Company had \$23.2 million in cash, cash equivalents and investment securities.

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Cash used in operating activities totaled \$15.1 million during the six months ended June 30, 2002, compared to \$18.2 million during the same period in 2001. Cash used in operating activities for each period resulted primarily from the net loss for the period.

In July 2002 the Company reduced its workforce by approximately 7% as part of the Company's plan to reduce operating costs. The reduction was a result of eliminating and consolidating certain positions. The Company will pay approximately \$200,000 in involuntary termination benefits during the third quarter of 2002. The liability for the involuntary termination benefits did not meet the criteria for accrual established in Emerging Issues Task Force 94-3, and therefore the related expense will be recognized in the third quarter of 2002. The Company expects that its work force will grow as it continues to hire qualified sales, technical and other personnel to meet its operating plan.

Cash provided by investing activities totaled \$4.8 million during the six months ended June 30, 2002, compared to cash used in investing activities of \$2.4 million during the same period of 2001. During the six months ended June 30, 2002 the Company had net sales of investment securities of \$5.8 million compared to net purchases of investment securities of \$392,000 during the same period in 2001. The proceeds from the sales of investment securities were used to fund the Company's operations.

The Company used \$650,000 for capital expenditures during the six months ended June 30, 2002, compared to \$2.6 million during the same period in 2001. Historically, capital expenditures have been used to make leasehold improvements to leased office space and to purchase computer hardware and software, laboratory equipment and

furniture and fixtures to support growth.

Cash provided by financing activities totaled \$5.8 million during the six months ended June 30, 2002, compared to \$22.2 million during the same period in 2001. In March 2002, the Company raised \$6.0 million, before issuance costs, from the sale of 524,000 shares of its common stock at a price of \$11.50 per share. During the six months ended June 30, 2001, Lumera raised \$21.4 million, before issuance costs, from the issuance of 2,136,000 shares of mandatorily redeemable convertible preferred stock.

Future operating expenditures and capital requirements will depend on numerous factors, including the following:

- The progress of research and development programs,
- The progress in commercialization activities and arrangements,
- The cost of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights,
- Competing technological and market developments, and
- The Company's ability to establish cooperative development, joint venture and licensing arrangements.

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In order to maintain exclusive rights under its license agreements with the University of Washington, the Company is obligated to make royalty payments to the University of Washington. If the Company is successful in establishing OEM co-development and joint venture arrangements, the Company expects that its partners will fund a portion of non-recurring engineering costs for product development.

Microvision and Lumera maintain separate cash and investment accounts. Each company's cash and investments are generally used to fund its separate business activities.

At June 30, 2002, the Company had combined cash, cash equivalents and investment securities balances of \$23.2 million. Based on its current operating plan, these funds along with the additional \$3.0 million, before issuance costs raised in July 2002, will meet the Company's cash requirements through the end of the first quarter of 2003. In order to implement its operating plan thereafter, the Company will be required to raise additional financing.

Actual expenses may be greater than estimated and the Company may require additional capital earlier than anticipated to:

- Accelerate the development of retinal scanning display technology and the Optical Materials technology,
- Respond to competitive pressures, or
- Meet unanticipated development difficulties.

In addition, the Company's operating plan calls for the addition of technical and business staff and the purchase of additional computer and laboratory equipment and leasehold improvements. The operating plan also provides for the development of strategic relationships with systems and equipment manufacturers. The Company's capital requirements will depend on many factors, including, but not limited to, the rate at which the Company can, directly or through arrangements with OEMs, introduce products incorporating the retinal scanning display technology and the market acceptance and competitive position of such products.

There can be no assurance that additional financing will be available to the Company or that, if available, it will be available on acceptable terms on a timely basis. If adequate funds are not available to satisfy either short-term or long-term capital requirements, the Company may be required to reduce operations significantly.

New Accounting Pronouncements

In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." The Company adopted this statement during the first quarter of 2002. As the Company has no recorded goodwill or intangible assets, there was no initial effect from adoption of this standard.

In July 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." Adoption of this statement is required no later than January 1, 2003. The Company is currently

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assessing the impact of this statement on its results of operations, financial position and cash flows.

In October 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." FAS 144 retains the fundamental provisions of SFAS No. 121 for recognition and measurement of the impairment of long-lived assets to be held and used and for measurement of long-lived assets to be disposed of by sale. This statement applies to all long-lived assets, including discounted operations, and replaces the provisions of APB Opinion No. 30, "Reporting Results of Operations-Reporting the Effects of Disposal of a Segment of a Business", for the disposal of segments of a business. This statement requires that those long-lived assets be measured at the lower of carrying amount or fair value. Microvision adopted this statement during the first quarter of 2002 and there was no material impact on the Company's results of operations, financial position or cash flows.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." This Statement addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force (EITF) Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." The Company will be required to adopt this statement for exit or disposal activities that are initiated after December 31, 2002. The adoption of SFAS 146 will not have a significant impact on its financial position, results of operations and cash flows.

Subsequent Event

In July 2002, the Company raised \$3.0 million, before issuance costs, from the sale of 937,500 shares of common stock at \$3.20 per share and fully vested five-year warrants to purchase 234,375 shares of common stock at a price of \$4.80 per share to two investors.

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Risk Factors Relating to the Company's 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 and we anticipate an operating loss during the year ending December 31, 2002. We cannot assure you that we will ever become or remain profitable.

- As of June 30, 2002, we had an accumulated deficit of \$115.8 million.
- We incurred net losses of \$39.5 million from inception through 1999, \$26.6 million in 2000, \$34.8 million in 2001 and \$14.9 million during the six months ended June 30, 2002.

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 retinal scanning display 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 customer orders for products incorporating the retinal scanning display technology. In light of these factors, we expect to continue to incur substantial losses and negative cash flow at least through 2003 and likely thereafter. We cannot be certain that we will become profitable or achieve positive cash flow at any time in the future.

We will require additional capital to continue implementing our business plan. This may lessen the value of current stockholders' shares.

We will need additional funds in order to, among other requirements:

- further develop the retinal scanning display and optical materials technologies,
- add manufacturing capacity,
- add to our sales and marketing staff,
- develop and protect our intellectual property rights, and
- fund long-term business development opportunities.

We cannot be certain that we will be able to obtain financing when needed or on satisfactory terms, if at all. If additional funds are raised through the issuance of equity, convertible debt or similar securities, current shareholders will experience dilution and the securities issued to the new investors may have rights or preferences senior to those of the holders of our common stock. If adequate funds were not available to satisfy our short-term or long-term financial needs, we would be required to limit our operations significantly.

We cannot be certain that the retinal scanning display technology or products incorporating this technology will achieve market acceptance. If the retinal scanning display technology does not achieve market acceptance, our revenues may not grow.

Our success will depend in part on customer acceptance of the retinal scanning display technology. The retinal scanning display technology may not be accepted by manufacturers who use display technologies in their products or by consumers of these products. To be accepted, the retinal scanning display technology must meet the expectations of our potential customers in the defense, medical, industrial and consumer markets. If our technology fails to achieve market acceptance, we may not be able to continue to develop the retinal scanning display technology.

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

Our common stock is listed for quotation on the Nasdaq National Market. To keep our listing on this market, we must meet Nasdaq's listing maintenance standards. If the bid price of our common stock falls below \$1.00 for an extended period, or we are unable to continue to meet Nasdaq's listing maintenance standards for any other reason, our common stock could be delisted from the Nasdaq National Market. If our common stock were delisted, we likely would seek to list the common stock on the Nasdaq SmallCap 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 SmallCap 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 National 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 National 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 National Market. While the penny stock rules should not affect the quotation of our common stock on the Nasdaq National 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. During the third quarter of 2002 the market price of our stock has traded below \$5.00 per share.

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

The retinal scanning display and products that may incorporate this technology will compete with established manufacturers of miniaturized cathode ray tube and flat panel display devices, many of which have substantially greater financial, technical and other resources than us and many of

which are also developing miniature displays. 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 electronic information display industry and the optical switching industries have been characterized by rapidly changing technology, accelerated product obsolescence and continuously evolving industry standards. Our success will depend upon our ability to further develop the retinal scanning display and the optical materials technologies 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 development.

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

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

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

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

We began production of Nomad, our first commercial product, in December 2001. Through June 2002, we have not built Nomads in the volumes necessary for profitable production. We must improve our manufacturing processes and efficiency to build Nomads profitably.

In addition, we have developed demonstration units incorporating the retinal scanning technology, and demonstration units have been built using the optical materials technology. However, we must undertake additional research, development and testing before we are able to produce additional products for commercial sale. Product development delays or the inability to enter into relationships with potential product development partners may delay or prevent us from introducing products for commercial sale.

If we are unable to adequately protect our proprietary technology with patents and other intellectual property rights, we may be unable to compete with other companies.

Our 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 retinal scanning display and related technologies. We also rely on proprietary optical materials technology licensed from the University of Washington. Although our licensors have patented and applied for patents on various aspects of the retinal scanning display technology and applied for patents on various aspects of the optical materials technology, and although we have patented and continue to file our own patent applications covering retinal scanning display features, optical materials technology and related technologies, we cannot be certain as to the degree of protection offered by these patents or as to the likelihood that patents will be issued from the pending patent applications. Moreover, these patents may have limited commercial value or may lack sufficient breadth to protect adequately the aspects of our technology to which the patents relate. We cannot be certain that our competitors, many of which have substantially greater resources than us and have made substantial investments in competing technologies, will not apply for and obtain patents that will prevent, limit or interfere with our ability to make and sell products incorporating our technologies.

We also rely on unpatented proprietary technology. Third parties could develop the same or similar technology or otherwise obtain access to our proprietary technology. We cannot be certain that we will be able to adequately protect our trade secrets, know-how or other proprietary information or prevent the unauthorized use, misappropriation or disclosure of such trade secrets, know-how or other proprietary information.

We could face lawsuits related to our use of the retinal scanning display technology. These suits could be costly, time consuming and reduce our revenues.

We are aware of several patents held by third parties that relate to certain aspects of retinal scanning displays. 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 the retinal scanning display technology 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 the retinal scanning display 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 retinal scanning display technology, to cease licensing the retinal scanning display technology, or to require disputed rights to be licensed from third parties. Such licenses would

increase our cost or may not be available at all. 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 revenues are highly sensitive to developments in the defense and aerospace industries.

Our revenues to date have been derived principally from product development research relating to defense applications of the retinal scanning display 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 cannot supply products in commercial quantities, we will not achieve commercial success.

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

To date, we have produced limited quantities of Nomad, and demonstration units for research, development and demonstration purposes. The cost per unit for these units 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.

If we lose the exclusive use of the virtual retinal display technology or the optical materials technology, our business operations and prospects would be adversely affected.

We acquired the exclusive rights to the virtual retinal display technology and the optical materials technology under exclusive license agreements with the University of Washington. If the University of Washington were to violate the terms of the license agreements by providing the technology to another company, our business, operations and prospects would be adversely affected. In addition, we could lose the exclusivity under the license agreement if we fail to challenge, within the designated time limits, claims that other companies are using the virtual retinal display technology in violation of our rights under the license agreement.

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We need to collaborate with third parties to be able to successfully develop products for commercial sale.

Our strategy for developing, testing, manufacturing and commercializing the retinal scanning display technology and products incorporating the retinal scanning display technology includes entering into cooperative development, 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 retinal scanning display technology or find that the development, manufacture or sale of products incorporating the retinal scanning display technology 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 efforts 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.

A substantial number of our shares may be sold into the market in the near future, which could cause the market price of our common stock to drop significantly.

As of July 31, 2002, we had outstanding:

- options to purchase an aggregate of 5,588,836 shares of common stock, and
- warrants to purchase 837,363 shares of common stock.

Sales in the public market of common stock issuable upon exercises of stock options or warrants could depress prevailing market prices for our common stock. Even the perception that such sales could occur may adversely impact the market price for our stock. A decrease in market price would decrease the value of an investment in our common stock.

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Our quarterly performance may vary substantially and this variance may decrease our stock price.

Our revenues to date have been generated 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; or
- the status of particular development programs and the timing of performance under specific development agreements.

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.

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. We have significantly expanded the scope of our operations. 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.

It may be difficult for a third party to acquire us and this could depress our stock price.

Certain provisions of Washington law and our amended and restated articles of incorporation and bylaws contain provisions that create burdens and delays if a third party were to attempt to purchase us. As a result, these provisions could limit the price that investors are willing to pay for our stock. These provisions:

- authorize our board of directors, without further shareholder approval, to issue preferred stock that has rights superior to those of the common stock. Potential purchasers may pay less for us because the preferred stockholders may use their rights to take value from us; and
- provide that written demand of at least 30% of the outstanding capital stock is required to call a special meeting of the shareholders, which may be needed to approve our sale. The delay that this creates could deter a potential purchaser.

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Additional risks associated with the Lumera business.

We cannot be certain that our optical materials will achieve market acceptance.

Lumera's success will depend in part on the commercial acceptance of the optical materials technology. The optical switching industry is currently fragmented with many competitors developing different technologies. We expect that only a few of these technologies ultimately will gain market acceptance. The optical materials may not be accepted by original equipment manufacturers and systems integrators of optical switching networks. To be accepted, the optical material must meet the technical and performance requirements of our potential customers in the telecommunications industry. If our optical materials technology fails to achieve market acceptance, we may not be able to continue to develop the technology.

Our lack of the financial and technical resources relative to our competitors may affect our ability to commercialize the optical materials.

The optical switching market is a highly competitive market. Other companies, that have substantially greater financial, technical and other resources than us, are working on competing technologies. 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 technology could cause our optical materials technology not to become commercially viable, which could reduce the value of our business.

Lumera's revenues are highly sensitive to developments in the telecommunications industry.

Lumera's expected revenues will be derived from product sales to original equipment manufacturers and system integrators in the telecommunications industry. We believe that sales of potential products in this market could represent a significant portion of our future revenues. Developments that adversely affect the telecommunications sector, including delays in traffic growth, government regulation or a general economic downturn, could slow or halt our revenue growth.

We expect the current downturn in the telecommunications sector will have the following effects on Lumera:

- Reduced capital spending and technology investment by telecommunication companies may make it more difficult for our potential products to gain market acceptance. Customers may be less willing to purchase new technology such as ours or invest in new technology development when they have limited cash.
- Potential customers for our future products are very focused on reducing cost. This has reduced profit margins for telecommunications equipment suppliers. Therefore, our future products must compete with products that are less expensive than before the telecommunications downturn.

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- The building of a high-speed telecommunications infrastructure has slowed. Currently companies are building networks using 10-gigabyte modulators, which has delayed the need for 40-gigabyte modulators. We believe that our potential products will compete more effectively with existing technologies at higher modulating speeds.

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

Substantially all of the Company's cash equivalents and investment securities are at fixed interest rates and, as such, the fair value of these instruments is affected by changes in market interest rates. Due to the generally short-term maturities of these investment securities, the Company believes that the market risk arising from its holdings of these financial instruments is not material. A one-percent change in market interest rates would have approximately a \$131,000 impact on the fair value of the investment securities.

The Company's investment policy restricts investments to ensure principal preservation and liquidity. The Company invests cash that it expects to use within approximately sixty days in U.S. treasury-backed instruments. The Company invests cash in excess of sixty days of its requirements in high quality investment securities. The investment securities portfolio is limited to U.S. government and U.S. government agency debt securities and other high-grade securities generally with maturities of three years or less.

The weighted average maturities of cash equivalents and investment securities available-for-sale as of June 30, 2002, are as follows.

	Amount	Percent
Cash and equivalents	\$ 1,132,000	4.9%
Less than one year	15,590,000	67.1%
One to two years	5,463,000	23.5%
Two to three years	1,053,000	4.5%
	<u>\$ 23,238,000</u>	<u>100.0%</u>

Presently, all of the Company's development contract payments are denominated in U.S. dollars and, consequently, the Company believes it has no foreign currency exchange rate risk. However, in the future the Company may enter into development contracts in foreign currencies that may subject the Company to foreign exchange rate risk. As of June 30, 2002 the Company has an open forward contract to purchase 12,745,000 Yen (approximately \$100,000) which matures in September 2002. The contract was entered into as a foreign currency hedge for a firm purchase commitment by the Company. The transaction is accounted for as a fair value hedge as defined by FAS 133 "Accounting for Derivatives". The Company intends to enter into foreign currency hedges to offset the exposure to currency fluctuations when it enters into contracts denominated in foreign currencies.

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ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company's Annual Shareholder's Meeting was held on May 20, 2002. The following proposals were introduced and voted on:

Proposal No. 1 - Election of Directors

Name	Votes For	Votes Withheld
Richard F. Rutkowski	12,400,380	177,797
Stephen R. Willey	12,400,380	177,797
Richard A. Raisig*	12,400,380	177,797
Jacqueline Brandwynne	12,400,380	177,797
Jacob Brouwer	12,400,380	177,797
Richard A. Cowell	12,400,380	177,797
Walter J. Lack	12,400,380	177,797
William A. Owens	12,400,380	177,797
Robert A. Ratliffe	12,400,380	177,797
Dennis Reimer	12,400,380	177,797

*Subsequent to the annual shareholders meeting Mr. Raisig resigned from the Board of Directors. Mr. Raisig continues to serve as Vice President, Operations and Chief Financial Officer.

Proposal No. 2 - Proposal to amend the Company's 1996 Stock Option Plan to increase the number of shares of common stock reserved for issuance under the plan.

For	3,839,603
Against	1,789,902
Abstained	13,191

Proposal No. 3 - Proposal to amend the Company's Independent Director Stock Option Plan

For	4,243,421
Against	1,337,183
Abstained	62,093

Proposal No. 4 - Proposal to approve a special grant of options to purchase common stock made to the Independent Directors of the Company on October 24, 2001.

For	4,576,856
Against	999,390
Abstained	66,453

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ITEM 6. Exhibits and Reports on Form 8-K

(a) Exhibits

10.1 1996 Independent Director Stock Option Plan, as Amended

10.2 1996 Stock Option Plan, as Amended

99.1 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

99.2 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

(b) Reports on Form 8-K

None

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SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MICROVISION, INC.

Date: August 14, 2002

/s/ Richard F. Rutkowski
Richard F. Rutkowski

President, Chief Executive Officer
(Principal Executive Officer)

Date: August 14, 2002

/s/ Jeff Wilson
Jeff Wilson
Vice President, Accounting
(Principal Accounting Officer)

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EXHIBIT INDEX

The following documents are filed herewith or have been included as exhibits to previous filings with the Securities and Exchange Commission and are incorporated by reference as indicated below.

<u>Exhibit Number</u>	<u>Description</u>
10.1	1996 Independent Director Stock Option Plan, as Amended
10.2	1996 Stock Option Plan, as Amended
99.1	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
99.2	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

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MICROVISION, INC.
INDEPENDENT DIRECTOR STOCK OPTION PLAN

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1. *Purpose.* The purpose of the Independent Director Stock Option Plan (the “Plan”) is to provide a means by which Microvision, Inc. (the “Company”), may attract and retain the best available personnel as non-employee directors of the Company (“Independent Directors”) and of its subsidiaries and to provide added incentive to such persons by increasing their ownership interest in the Company.

2. *Administration.* This Plan shall be administered by the Board of Directors of the Company (the “Board”) or, if the Board shall authorize a committee of the Board to administer this Plan, by such committee to the extent so authorized; provided, however, that only the Board may suspend, amend or terminate this Plan as provided in Section 11.1. The administrator of this Plan is referred to as the “Plan Administrator.”

2.1 *Procedures.* The Board shall designate one member of the Plan Administrator as chairman. The Plan Administrator may hold meetings at such times and places as it shall determine. The acts of a majority of the members of the Plan Administrator present at meetings at which a quorum exists, or acts approved in writing by all Plan Administrator members, shall constitute valid acts of the Plan Administrator.

2.2 *Powers.* Subject to the specific provisions of this Plan, the Plan Administrator shall have the authority, in its discretion: (a) to grant the stock options described in Section 5; (b) to determine, in accordance with Section 5.2 of this Plan, the exercise price per share of options; (c) to interpret this Plan; (d) to prescribe, amend and rescind rules and regulations relating to this Plan; (e) to determine the terms and provisions of each option granted and, with the consent of the Optionee, modify or amend each option; (f) to defer, with the consent of the Optionee, or to accelerate the exercise date of any option; (g) to waive or modify any term or provision contained in any option applicable to the underlying shares of common stock of the Company (the “Common Stock”); (h) to authorize any executive officer to execute on behalf of the Company any instrument required to effectuate the grant of an option; and (i) to make all other determinations deemed necessary or advisable for the administration of this Plan. The interpretation and construction by the Plan Administrator of any terms or provisions of this Plan, any option issued hereunder or of any rule or regulation promulgated in connection herewith and all actions taken by the Plan Administrator shall be conclusive and binding on all interested parties. The Plan Administrator may delegate administrative functions to individuals who are officers or employees of the Company.

2.3 *Limited Liability.* No member of the Board or the Plan Administrator or officer of the Company shall be liable for any action or inaction of the entity or body, or another person or, except in circumstances involving bad faith, of himself or herself. Subject only to compliance with the explicit provisions hereof, the Board and Plan Administrator may act in their absolute discretion in all matters related to the Plan.

2.4 *Securities Exchange Act of 1934.* At any time that the Company has a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), this Plan shall be administered in accordance with Rule 16b-3 adopted under the Exchange Act and Section 162(m) of the Internal Revenue Code of 1986, as amended (the “Code”), and the regulations, proposed and final, thereunder, as all may be amended from time to time.

3. *Stock Subject to This Plan.* Subject to adjustment as provided below and in Section 9 hereof, the stock subject to this Plan shall be the Common Stock, and the total number of shares of Common Stock to be delivered on the exercise of all options granted under this Plan shall not exceed 500,000 shares as such Common Stock was constituted on the date on which this Plan was first adopted by the Board as set forth on the last page hereof. If any option granted under this Plan expires, is surrendered, exchanged for another option, canceled or terminated for any reason without having been exercised in full, the unpurchased shares subject thereto shall again be available for purposes of this

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Plan, including for replacement options that may be granted in exchange for such surrendered, canceled or terminated options. Shares issued on exercise of options granted under this Plan may be subject to restrictions on transfer, repurchase rights or other restrictions as determined by the Plan Administrator.

4. *Eligibility.* The Plan Administrator shall award options to any current or future Independent Director of the Company, and may award options to any current or future non-employee director of any subsidiary thereof. As used in this Plan, the term "subsidiary" of the Company shall mean any corporation or other business entity in which the Company owns, directly or indirectly, stock or other equity interests equal to 50% or more of the total combined voting power of all classes of stock or other equity interests thereof. To the extent that the Plan Administrator awards options hereunder to a non-employee director of any subsidiary of the Company, the term "Independent Director" as used herein shall refer to such person and the term "Company," as required by the context, shall refer to the subsidiary and not to Microvision, Inc. Any party to whom an option is granted under this Plan is referred to as an "Optionee."

5. *Independent Director Stock Options.*

5.1 *Awards.*

(a) *Mandatory Awards.* The Plan Administrator shall grant to each Independent Director (i) an option to purchase 15,000 shares of Common Stock on the date upon which he or she is first elected or appointed to the Board, such option to be fully vested and exercisable as of the date of election or appointment, and (ii) an option to purchase an additional 15,000 shares of Common Stock on the date upon which he or she is (A) first elected or appointed to the Board and (B) subsequently reelected to the Board, which options shall vest in accordance with Section 5.3.

(b) *Discretionary Awards.* The Plan Administrator shall have the authority, but not the obligation, to grant to each or any Independent Director an option to purchase any number of shares of Common Stock as the Plan Administrator may in its discretion determine, subject to the limitations set forth in Section 3, which option shall vest and shall have an exercise price as the Plan Administrator may in its discretion determine.

(c) *Special One-Time Grant.* The Plan Administrator shall grant to each Independent Director serving as of October 25, 2001, an option to purchase 10,000 shares of Common Stock, which option shall have a grant date of October 25, 2001, shall have an exercise price determined in accordance with Section 5.2 and shall vest concurrently with the options granted under the Plan to Independent Directors on June 6, 2001.

5.2 *Exercise Price.* The exercise price of options issued under the Plan will be the average closing price of the Company's Common Stock as reported on the Nasdaq National Market or, if the Common Stock is no longer listed thereon, such other principal exchange or market (including the over-the-counter market) for the Company's Common Stock, during the ten (10) trading days prior to the date of grant.

5.3 *Vesting.* To ensure that the Company will achieve the purposes of and receive the benefits contemplated in this Plan, options granted pursuant to the Plan will become vested in full as of the earlier of (i) the day prior to the date of the Company's Annual Meeting of Shareholders next following the date of grant, or (ii) one year from the date of grant, provided the Independent Director continues to serve as an Independent Director of the Company or is employed by the Company or a subsidiary of the Company as of such vesting date.

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5.4 *Nontransferability.* Options granted under this Plan and the rights and privileges conferred hereby may not be transferred, assigned, pledged or hypothecated in any manner (whether by operation of law or otherwise) other than by will or by the applicable laws of descent and distribution, shall not be subject to execution, attachment or similar process, and shall be exercisable during the Optionee's lifetime only by the Optionee. Any purported transfer or assignment in violation of this provision shall be void.

5.5 *Termination of Options.*

(a) *Generally.* Unless earlier termination results from the application of the provisions of this Section 5.5, each option granted hereunder shall expire and all rights of the Optionee thereunder shall cease and terminate on the tenth anniversary of the date of its grant.

(b) *Disability or Death.* If an Optionee is unable to continue his or her service as an Independent Director of the Company as a result of his or her permanent and total disability (as defined in Section 22(e)(3) of the Code) or death, all unvested options issued under the Plan to such Optionee will become vested immediately as of the date of disability or death. In such an event, the option may be exercised at any time before the earlier of (i) the expiration date of the option or (ii) twelve (12) months after the date of (A) permanent and total disability or (B) death (by the person or persons to whom such Optionee's rights under the option shall pass by the Optionee's will or by the applicable laws of descent and distribution), for up to the full number of shares of Common Stock covered thereby.

(c) *Failure to Exercise Option; Expiration.* To the extent that an Optionee fails to exercise an option within the period provided in this Section 5.5, all rights to purchase shares of Common Stock pursuant to such options shall cease and terminate.

6. *Option Agreements.* Options granted under this Plan shall be evidenced by written stock option agreements (the "Option Agreements") that shall contain such terms, conditions, limitations and restrictions as the Plan Administrator shall deem advisable and that are consistent with this Plan. All Option Agreements shall include or incorporate by reference the applicable terms and conditions contained in this Plan.

7. *Exercise.*

7.1 *Procedure.* Subject to Section 5.3 above, each option may be exercised in whole or in part; provided, however, that no fewer than 100 shares (or the remaining shares then purchasable under the option, if less than 100 shares) may be purchased on any exercise of any option granted hereunder and that only whole shares will be issued pursuant to the exercise of any option (the number of 100 shares shall not be changed by any transaction or action described in Section 9 unless the Plan Administrator determines that such a change is appropriate). Options shall be exercised by delivery to the Secretary of the Company or his or her designated agent of notice of the number of shares with respect to which the option is being exercised, together with payment in full of the exercise price and any applicable withholding taxes.

7.2 *Payment.* Payment of the option exercise price shall be made in full when the notice of exercise of the option is delivered to the Secretary of the Company or his or her designated agent and shall be by personal, bank certified or cashier's check or through irrevocable instructions to a stock broker to deliver the amount of sales proceeds necessary to pay the appropriate exercise price and withholding tax obligations, all in accordance with applicable governmental regulations, for the shares of Common Stock being purchased. The

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Plan Administrator may determine at any time before exercise that additional forms of payment will be permitted.

7.3 *Withholding.* Before the issuance of shares of Common Stock on the exercise of an option, the Optionee shall pay to the Company the amount of any applicable federal, state or local tax withholding obligations. The Company may withhold any distribution in whole or in part until the Company is so paid. The Company shall have the right, subject to applicable law, to withhold such amount from any other amounts due or to become due from the Company to the Optionee, or to retain and withhold a number of shares having a market value not less than the amount of such taxes required to be withheld by the Company, to reimburse it for any such taxes and cancel (in whole or in part) any such shares so withheld.

7.4 *Conditions Precedent to Exercise.* The Plan Administrator may establish conditions precedent to the exercise of any option, which shall be described in the relevant Option Agreement.

8. *Foreign Qualified Grants.* Options under this Plan may be granted to Independent Directors of the Company who reside in foreign jurisdictions. The Board may adopt supplements to the Plan as needed to comply with the applicable laws of such foreign jurisdictions and to give Optionees favorable treatment under such laws; provided, however, that no award shall be granted under any such supplement on terms more beneficial to such Optionees than those permitted by this Plan.

9. *Adjustments On Changes in Capitalization.*

9.1 *Stock Splits, Capital Stock Adjustments.* The aggregate number of shares for which options may be granted under this Plan, the number and class of shares covered by each outstanding option and each such option shall all be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock of the Company resulting from a stock split, stock dividend or consolidation of shares or any like capital stock adjustment.

9.2 *Effect of Certain Events.*

(a) *Change in Control.* In the event of a Change in Control (hereinafter defined), any unvested options issued under the Plan will vest automatically upon the closing of the event causing the Change in Control. For the purpose of this Section 9.2, a "Change in Control" means the sale of more than 50% of the voting control of the Company or its business to a third party, whether by means of merger, triangular merger, consolidation, sale of stock, sale of assets or similar transaction, but excluding (i) any transaction among affiliated persons that does not result in a material change in ultimate ownership of the Company by individuals, or (ii) any transaction for the principal purpose of funding the operations of the Company.

(b) *Liquidation; Dissolution.* If the Company is liquidated or dissolved, options shall be treated in accordance with Section 9.2(a).

(c) *Recapitalizations.* If the outstanding Common Stock of the Company is hereafter increased or decreased or changed into or exchanged for a different number or kind of shares or other securities of the Company or of another corporation by reason of any reorganization, merger, consolidation, plan of exchange, recapitalization, reclassification, stock split-up, combination of shares or dividend payable in shares, (other than in the case of a Change in Control) appropriate adjustment shall be made by the Company in the number and kind of shares issuable on exercise of the Options granted hereunder, so that the Optionee's proportionate interest before and after the occurrence of the event is maintained.

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9.3 *Fractional Shares.* If the number of shares covered by any option is adjusted, any fractional shares resulting from such adjustment shall be disregarded and each such option shall cover only the number of full shares resulting from such adjustment.

9.4 *Determination of Board to Be Final.* All adjustments under this Section 9 shall be made by the Board, and its determination as to what adjustments shall be made, and the extent thereof, shall be final, binding and conclusive.

10. *Securities Regulations.* Shares of Common Stock shall not be issued with respect to an option granted under this Plan unless the exercise of such option and the issuance and delivery of such shares pursuant thereto shall comply with all relevant provisions of law, including, without limitation, any applicable state securities laws, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, applicable laws of foreign countries and other jurisdictions and the requirements of any quotation service or stock exchange on which the shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance, including the availability of an exemption from registration for the issuance and sale of any shares hereunder. The inability of the Company to obtain, from any regulatory body having jurisdiction, the authority deemed by the Company's counsel to be necessary for the lawful issuance and sale of any shares hereunder or the unavailability of an exemption from registration for the issuance and sale of any shares hereunder shall relieve the Company of any liability with respect of the nonissuance or sale of such shares as to which such requisite authority shall not have been obtained.

As a condition to the exercise of an option, the Company may require the Optionee to represent and warrant at the time of any such exercise that the shares of Common Stock are being purchased only for investment and without any present intention to sell or distribute such shares if, in the opinion of counsel for the Company, such a representation is required by any relevant provision of the aforementioned laws. The Company may place a stop-transfer order against any shares of Common Stock on the official stock books and records of the Company, and a legend may be stamped on stock certificates to the effect that the shares of Common Stock may not be pledged, sold or otherwise transferred unless an opinion of counsel is provided (concurrent in by counsel for the Company) stating that such transfer is not in violation of any applicable law or regulation. The Plan Administrator may also require such other action or agreement by the Optionees as may from time to time be necessary to comply with the federal and state securities laws. THIS PROVISION SHALL NOT OBLIGATE THE COMPANY TO UNDERTAKE REGISTRATION OF THE OPTIONS OR STOCK THEREUNDER.

11. *Amendment and Termination.*

11.1 *Plan.* The Board may at any time suspend, amend or terminate this Plan, provided that, the approval of the Company's shareholders is necessary within twelve (12) months before or after the adoption by the Board of any amendment that will:

- (a) increase the number of shares of Common Stock to be reserved for the issuance of options under this Plan;
- (b) permit the granting of stock options to a class of persons other than those now permitted to receive stock options under this Plan; or
- (c) require shareholder approval under applicable law, including Section 16(b) of the Exchange Act.

11.2 *Automatic Termination.* Unless earlier suspended or terminated by the Board, the Plan will continue in effect until the earlier of: (i) ten (10) years from the date on which it was adopted by the Board, or (ii) the date on which all shares available for issuance under the Plan have been issued. No option may be granted after such termination or during any suspension of this Plan. The amendment or termination of this Plan shall not, without the

consent of the Optionee, alter or impair any rights or obligations under any option theretofore granted under this Plan.

12. *Miscellaneous.*

12.1 *Time of Granting Options.* The date of grant of an option shall, for all purposes, be the date on which the Independent Director is elected, re-elected or appointed to the Board, and the execution of an Option Agreement and the conditions to the exercise of an option shall not defer the date of grant.

12.2 *No Status as Shareholder.* Neither the Optionee nor any party to which the Optionee's rights and privileges under the option may pass shall be, or have any of the rights or privileges of, a shareholder of the Company with respect to any of the shares of Common Stock issuable on the exercise of any option granted under this Plan unless and until such option has been exercised and the issuance (as evidenced by the appropriate entry on the books of the Company or duly authorized transfer agent of the Company) of the stock certificate evidencing such shares.

12.3 *Reservation of Shares.* The Company, during the term of this Plan, at all times will reserve and keep available such number of shares of Common Stock as shall be sufficient to satisfy the requirements of this Plan.

13. *Effectiveness of This Plan.* This Plan shall become effective on the date on which it is adopted by the Board. No option granted under this Plan to any Independent Director of the Company shall become exercisable until the Plan is approved by the shareholders, and any option granted before such approval shall be conditioned on and is subject to such approval.

Plan adopted by the Board on February 16, 2000.

Plan approved by the shareholders on June 22, 2000.

Plan amended by the Board on October 19, 2000.

Plan amended by the Board on February 13, 2001.

Plan amended by the Board on October 25, 2001.

Plan amended by the Board on December 20, 2001.

Plan amended by the Board on February 13, 2002.

MICROVISION, INC.
1996 STOCK OPTION PLAN,
AS AMENDED

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MICROVISION, INC.

**1996 STOCK OPTION PLAN,
AS AMENDED**

1. *Purpose.* The purpose of the 1996 Stock Option Plan (the "Plan") is to provide a means by which Microvision, Inc. (the "Company"), may attract, reward, and retain the services or advice of current or future employees, officers, consultants or independent contractors of, and other advisors to, the Company and to provide added incentives to them by encouraging stock ownership in the Company.

2. *Administration.* This Plan shall be administered by the Board of Directors of the Company (the "Board") or, if the Board shall authorize a committee to administer this Plan, by such committee to the extent so authorized; provided, however, that only the Board of Directors may suspend, amend or terminate this Plan as provided in Section 13, and provided further that a committee that includes officers of the Company shall not be permitted to grant options to persons who are officers of the Company. The administrator of this Plan is referred to as the "Plan Administrator."

2.1 *Procedures.* The Board of Directors shall designate one member of the Plan Administrator as chairman. The Plan Administrator may hold meetings at such times and places as it shall determine. The acts of a majority of the members of the Plan Administrator present at meetings at which a quorum exists, or acts approved in writing by all Plan Administrator members, shall constitute valid acts of the Plan Administrator.

2.2 *Powers.* Subject to the specific provisions of this Plan, the Plan Administrator shall have the authority, in its discretion: (a) to grant the stock options described in Section 5, including Incentive Stock Options and Non-Qualified Stock Options, and to designate each option granted as an Incentive Stock Option or a Non-Qualified Stock Option; (b) to determine, in accordance with Section 5.1(f) of this Plan, the fair market value of the shares of Common Stock subject to options; (c) to determine the exercise price per share of options; (d) to determine the Optionees to whom, and the time or times at which, options shall be granted and the number of shares of Common Stock to be represented by each option; (e) to interpret this Plan; (f) to prescribe, amend and rescind rules and regulations relating to this Plan; (g) to determine the terms and provisions of each option granted (which need not be identical) and, with the consent of the Optionee, modify or amend each option; (h) to reduce the exercise price per share of outstanding and unexercised options; (i) to defer, with the consent of the Optionee, or to accelerate the exercise date of any option; (j) to waive or modify any term or provision contained in any option applicable to the underlying shares of Common Stock; (k) to authorize any person to execute on behalf of the Company any instrument required to effectuate the grant of an option previously granted by the Plan Administrator; and (l) to make all other determinations deemed necessary or advisable for the administration of this Plan. The interpretation and construction by the Plan Administrator of any terms or provisions of this Plan, any option issued hereunder or of any rule or regulation promulgated in connection herewith and all actions taken by the Plan Administrator shall be conclusive and binding on all interested parties. The

Plan Administrator may delegate administrative functions to individuals who are officers or employees of the Company.

2.3 *Limited Liability.* No member of the Board of Directors or the Plan Administrator or officer of the Company shall be liable for any action or inaction of the entity or body, or another person or, except in circumstances involving bad faith, of himself or herself. Subject only to compliance with the explicit provisions hereof, the Board of Directors and Plan Administrator may act in their absolute discretion in all matters related to the Plan.

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2.4 *Securities Exchange Act of 1934.* At any time that the Company has a class of securities registered pursuant to Section 12 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), this Plan shall be administered in accordance with Rule 16b-3 adopted under the Exchange Act and Section 162(m) of the Internal Revenue Code of 1986, as amended, and the regulations, proposed and final, thereunder, as all may be amended from time to time, and each member of the Plan Administrator shall be a "disinterested director" and an "outside director" within the meaning of such Rule 16b-3 and Section 162(m), respectively.

3. *Stock Subject to This Plan.* Subject to adjustment as provided below and in Section 11 hereof, the stock subject to this Plan shall be the Company's common stock (the "Common Stock"), and the total number of shares of Common Stock to be delivered on the exercise of all options granted under this Plan shall not exceed 8,000,000 shares, as such Common Stock was constituted on the date on which this Plan was last amended by the Board as set forth on the last page hereof. If any option granted under this Plan expires, is surrendered, exchanged for another option, canceled or terminated for any reason without having been exercised in full, the unpurchased shares subject thereto shall again be available for purposes of this Plan, including for replacement options that may be granted in exchange for such surrendered, canceled or terminated options. Shares issued on exercise of options granted under this Plan may be subject to restrictions on transfer, repurchase rights or other restrictions as determined by the Plan Administrator.

4. *Eligibility.*

4.1 *Optionees.* The Plan Administrator may award options to any current or future employee, officer, consultant or independent contractor of, or other advisor to, the Company or its subsidiaries. Non-employee directors of the Company shall not be eligible to participate in the Plan. Any party to whom an option is granted under this Plan is referred to as an "Optionee."

4.2 *Subsidiaries.* As used in this Plan, the term "subsidiary" of a company shall include any corporation in which such company owns, directly or indirectly, at the time of the grant of an option hereunder, stock having 50% or more of the total combined voting power of all classes of stock thereof.

5. *Awards.* The Plan Administrator, from time to time, may take the following actions, separately or in combination, under this Plan: (a) grant Incentive Stock Options, as defined in Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), to any employee of the Company or its subsidiaries, as provided in Section 5.1 of this Plan; (b) grant options other than Incentive Stock Options ("Non-Qualified Stock Options"), as provided in Section 5.2 of this Plan; (c) grant options to officers, employees and others in foreign jurisdictions, as provided in Section 7 of this Plan; and (d) grant options in certain acquisition transactions, as provided in Section 8 of this Plan. No employee may be granted options to acquire more than 100,000 shares in any fiscal year of the Company.

5.1 *Incentive Stock Options.* Incentive Stock Options shall be subject to the following terms and conditions:

(a) Incentive Stock Options may be granted under this Plan only to employees of the Company or its subsidiaries, including employees who are directors.

(b) No employee may be granted Incentive Stock Options under this Plan to the extent that the aggregate fair market value, on the date of grant, of the Common Stock with respect to which Incentive Stock Options are exercisable for the first time by that employee during any calendar year, under this Plan and under any other incentive stock option plan (within the meaning of Section 422 of the Code) of the Company or any

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subsidiary, exceeds \$100,000. To the extent that any option designated as an Incentive Stock Option exceeds the \$100,000 limit, such option shall be treated as a Non-Qualified Stock Option. In making this determination, options shall be taken into account in the order in which they were granted, and the fair market value of the shares of Common Stock shall be determined as of the time that the option with respect to such shares was granted.

(c) An Incentive Stock Option may be granted under this Plan to an employee possessing more than 10% of the total combined voting power of all classes of stock of the Company (as determined pursuant to the attribution rules contained in Section 424(d) of the Code) only if the exercise price is at least 110% of the fair market value of the Common Stock subject to the option on the date the option is granted, as described in Section 5.1(f) of this Plan, and only if the option by its terms is not exercisable after the expiration of five years from the date it is granted.

(d) Except as provided in Section 5.5 of this Plan, no Incentive Stock Option granted under this Plan may be exercised unless at the time of such exercise the Optionee is employed by the Company or any subsidiary of the Company and the Optionee has been so employed continuously since the date such option was granted.

(e) Subject to Sections 5.1(c) and 5.1(d) of this Plan, Incentive Stock Options granted under this Plan shall continue in effect for the period fixed by the Plan Administrator, except that no Incentive Stock Option shall be exercisable after ten years from the date it is granted.

(f) The exercise price shall not be less than 100% of the fair market value of the shares of Common Stock covered by the Incentive Stock Option at the date the option is granted. The fair market value of shares shall be the closing price per share of the Common Stock on the date of grant as reported on a securities quotation system or stock exchange. If such shares are not so reported or listed, the Plan Administrator shall determine the fair market value of the shares of Common Stock in its discretion.

(g) The provisions of clauses (b) and (c) of this Section shall not apply if either the applicable sections of the Code or the regulations thereunder are amended so as to change or eliminate such limitations or to permit appropriate modifications of those requirements by the Plan Administrator.

5.2 *Non-Qualified Stock Options.* Non-Qualified Stock Options shall be subject to the following terms and conditions:

(a) The exercise price may be more or less than or equal to the fair market value of the shares of Common Stock covered by the Non-Qualified Stock Option on the date the option is granted, and the exercise price may fluctuate based on criteria determined by the Plan Administrator. The fair market value of shares of Common Stock covered by a Non-Qualified Stock Option shall be determined by the Plan Administrator, as described in Section 5.1(f).

(b) Unless otherwise established by the Plan Administrator, any Non-Qualified Stock Option shall terminate ten years after the date it is granted.

5.3 *Vesting.* To ensure that the Company will achieve the purposes of and receive the benefits contemplated in this Plan, any option granted to any Optionee hereunder shall be exercisable according to the vesting schedule, if any, established by the Plan Administrator and set forth in the Option Agreement issued to each Optionee.

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5.4 *Nontransferability.* Options granted under this Plan and the rights and privileges conferred hereby may not be transferred, assigned, pledged or hypothecated in any manner (whether by operation of law or otherwise) other than by will or by the applicable laws of descent and distribution, shall not be subject to execution, attachment or similar process, and shall be exercisable during the Optionee's lifetime only by the Optionee. Any purported transfer or assignment in violation of this provision shall be void.

5.5 *Termination of Options.*

(a) *Generally.* Unless otherwise determined by the Plan Administrator or specified in the Optionee's Option Agreement, if the Optionee's employment or service with the Company terminates for any reason other than for cause, resignation in lieu of dismissal, retirement, disability or death, and unless by its terms the option sooner terminates or expires, then the Optionee may exercise, for a three-month period, that portion of the Optionee's option that was exercisable at the time of such termination of employment or service (provided the conditions of Section 6.4 and any other conditions specified in the Option Agreement shall have been met by the date of exercise of such option).

(b) *For Cause; Resignation.* Unless otherwise determined by the Plan Administrator or specified in the Optionee's Option Agreement:

(i) If an Optionee is terminated for cause or resigns in lieu of dismissal, any option granted hereunder shall be deemed to have terminated as of the time of the first act that led or would have led to the termination for cause or resignation in lieu of dismissal, and such Optionee shall thereupon have no right to purchase any shares of Common Stock pursuant to the exercise of such option, and any such exercise shall be null and void. Termination for "cause" shall include (i) the violation by the Optionee of any reasonable rule or policy of the Company; (ii) any willful misconduct or gross negligence by the Optionee in the responsibilities assigned to him or her; (iii) any willful failure to perform his or her job as required to meet the objectives of the Company; (iv) any wrongful conduct of an Optionee that has an adverse impact on the Company or that constitutes a misappropriation of the assets of the Company; (v) unauthorized disclosure of confidential information; or (vi) the Optionee's performing services for any other company or person that competes with the Company while he or she is employed by or provides services to the Company, without the written approval of the chief executive officer of the Company. "Resignation in lieu of dismissal" shall mean a resignation by an Optionee of employment with or service to the Company if (i) the Company has given prior notice to such Optionee of its intent to dismiss the Optionee for circumstances that constitute cause, or (ii) within two months of the Optionee's resignation, the chief operating officer or the chief executive officer of the Company or the Board of Directors determines, which determination shall be final and binding, that such resignation was related to an act that would have led to a termination for cause.

(ii) If an Optionee resigns from the Company, the right of the Optionee to exercise his or her option shall be suspended for a period of two months from the date of resignation, unless the chief executive officer of the Company or the Board of Directors determines otherwise in writing. Thereafter, unless there is a determination that the Optionee resigned in lieu of dismissal, the option may be exercised at any time before the earlier of (i) the expiration date of the option (which shall have been similarly suspended) or (ii) the expiration of three months after the date of resignation, for that portion of the Optionee's option that was exercisable at the time of such resignation (provided the conditions of Section 6.4

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and any other conditions specified in the Option Agreement shall have been met at the date of exercise of such option).

(c) *Retirement.* Unless otherwise determined by the Plan Administrator or specified in the Optionee's Option Agreement, if an Optionee's employment or service with the Company is terminated with the Company's approval for reasons of age, the Option may be exercised at any time before the earlier of (a) the expiration date of the option or (b) the expiration of three months after the date of such termination of employment or service, for that portion of the Optionee's option that was exercisable at the time of such termination of employment or service (provided the conditions of Section 6.4 and any other conditions specified in the Option Agreement shall have been met at the date of exercise of such option).

(d) *Disability.* Unless otherwise determined by the Plan Administrator or specified in the Optionee's Option Agreement, if an Optionee's employment or relationship with the Company terminates because of a permanent and total disability (as defined in Section 22(e)(3) of the Code), the option may be exercised at any time before the earlier of (a) the expiration date of the option or (b) the expiration of 12 months after the date of such termination, for up to the full number of shares of Common Stock covered thereby, including any portion not yet vested (provided the conditions of Section 6.4 and any other conditions specified in the Option Agreement shall have been met by the date of exercise of such option).

(e) *Death.* Unless otherwise determined by the Plan Administrator or specified in the Optionee's Option Agreement, in the event of the death of an Optionee while employed by or providing service to the Company, the option may be exercised at any time before the earlier of (a) the expiration date of the option or (b) the expiration of 12 months after the date of death by the person or persons to whom such Optionee's rights under the option shall pass by the Optionee's will or by the applicable laws of descent and distribution, for up to the full number of shares of Common Stock covered thereby, including any portion not yet vested (provided the conditions of Section 6.4 and any other conditions specified in the Option Agreement shall have been met by the date of exercise of such option).

(f) *Extension of Exercise Period Applicable to Termination.* The Plan Administrator, at the time of grant or at any time thereafter, may

extend the one-month, three-month and 12-month exercise periods to any length of time not longer than the original expiration date of the option, and may increase the portion of an option that is exercisable, subject to such terms and conditions as the Plan Administrator may determine; provided, that any extension of the exercise period or other modification of an Incentive Stock Option shall be subject to the written agreement and acknowledgment by the Optionee that the extension or modification disqualifies the option as an Incentive Stock Option.

(g) *Failure to Exercise Option.* To the extent that the option of any deceased Optionee or of any Optionee whose employment or service terminates is not exercised within the applicable period, all rights to purchase shares of Common Stock pursuant to such options shall cease and terminate.

(h) *Transfers; Leaves.* For purposes of this Section 5.5, a transfer of employment or other relationship between or among the Company and/or any subsidiaries shall not be deemed to constitute a termination of employment or other cessation of relationship with the Company or any of its subsidiaries. For purposes of this Section 5.5, with respect to Incentive Stock Options, employment shall be deemed to continue while the Optionee is

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on military leave, sick leave or other bona fide leave of absence (as determined by the Plan Administrator) in accordance with the policies of the Company.

6. *Exercise.*

6.1 *Procedure.* Subject to the provisions of Section 5.3 above, each option may be exercised in whole or in part; provided, however, that no fewer than 100 shares (or the remaining shares then purchasable under the option, if less than 100 shares) may be purchased on any exercise of any option granted hereunder and that only whole shares will be issued pursuant to the exercise of any option (the number of 100 shares shall not be changed by any transaction or action described in Section 8 or Section 11 unless the Plan Administrator determines that such a change is appropriate). Options shall be exercised by delivery to the Secretary of the Company or his or her designated agent of notice of the number of shares with respect to which the option is exercised, together with payment in full of the exercise price and any applicable withholding taxes.

6.2 *Payment.* Payment of the option exercise price shall be made in full when the notice of exercise of the option is delivered to the Secretary of the Company or his or her designated agent and shall be in cash or bank certified or cashier's check or through irrevocable instructions to a stock broker to deliver the amount of sales proceeds necessary to pay the appropriate exercise price and withholding tax obligations, all in accordance with applicable governmental regulations, for the shares of Common Stock being purchased. The Plan Administrator may determine at the time the option is granted for Incentive Stock Options, or at any time before exercise for Non-Qualified Stock Options, that additional forms of payment will be permitted.

6.3 *Withholding.* Before the issuance of shares of Common Stock on the exercise of an option, the Optionee shall pay to the Company the amount of any applicable federal, state or local tax withholding obligations. The Company may withhold any distribution in whole or in part until the Company is so paid. The Company shall have the right to withhold such amount from any other amounts due or to become due from the Company to the Optionee, including salary (subject to applicable law) or to retain and withhold a number of shares having a market value not less than the amount of such taxes required to be withheld by the Company to reimburse it for any such taxes and cancel (in whole or in part) any such shares so withheld.

6.4 *Conditions Precedent to Exercise.* The Plan Administrator may establish conditions precedent to the exercise of any option, which shall be described in the relevant Option Agreement.

7. *Foreign Qualified Grants* Options under this Plan may be granted to officers and employees of the Company and other persons described in Section 4 who reside in foreign jurisdictions as the Plan Administrator may determine from time to time. The Board of Directors may adopt supplements to the Plan as needed to comply with the applicable laws of such foreign jurisdictions and to give Optionees favorable treatment under such laws; provided, however, that no award shall be granted under any such supplement on terms more beneficial to such Optionees than those permitted by this Plan.

8. *Corporate Mergers, Acquisitions, Etc.* The Plan Administrator may also grant options under this Plan having terms, conditions and provisions that vary from those specified in this Plan provided that such options are granted in substitution for, or in connection with the assumption of, existing options granted, awarded or issued by another corporation and assumed or otherwise agreed to be provided for by the Company pursuant to or by reason of a transaction involving a corporate merger, consolidation, acquisition of property or stock, reorganization or liquidation to which the Company is a party.

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9. *Holding Period.* Unless otherwise determined by the Plan Administrator, if a person subject to Section 16 of the Exchange Act exercises an option within six months of the date of grant of the option, the shares of Common Stock acquired on exercise of the option may not be sold until six months after the date of grant of the option.

10. *Option Agreements.* Options granted under this Plan shall be evidenced by written stock option agreements (the "Option Agreements") that shall contain such terms, conditions, limitations and restrictions as the Plan Administrator shall deem advisable and that are consistent with this Plan. All Option Agreements shall include or incorporate by reference the applicable terms and conditions contained in this Plan.

11. *Adjustments On Changes in Capitalization.*

11.1 *Stock Splits, Capital Stock Adjustments.* The aggregate number and class of shares for which options may be granted under this Plan, the number and class of shares covered by each outstanding option and the exercise price per share thereof (but not the total price), and each such option, shall all be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock of the Company resulting from a stock split, stock dividend or consolidation of shares or any like capital stock adjustment.

11.2 *Effect of Merger, Sale of Assets, Liquidation or Dissolution.*

(a) *Mergers, Sale of Assets, Other Transactions.* In the event of a merger, consolidation or plan of exchange to which the Company is a party or a sale of all or substantially all of the Company's assets (each, a "Transaction"), the Board of Directors, in its sole discretion and to the extent possible under the structure of the Transaction, shall select one of the following alternatives for treating outstanding options under this Plan:

(i) Outstanding options shall remain in effect in accordance with their terms;

(ii) Outstanding options shall be converted into options to purchase stock in the corporation that is the surviving or acquiring corporation in the Transaction. The amount, type of securities subject thereto and exercise price of the converted options shall be determined by the Board of Directors of the Company, taking into account the relative values of the companies involved in the Transaction and the exchange rate, if any, used in determining shares of the surviving corporation to be issued to holders of shares of the Company. Unless otherwise determined by the Board of Directors, the converted options shall be vested only to the extent that the vesting requirements relating to options granted hereunder have been satisfied;

(iii) The Board of Directors provides a period before the consummation of the Transaction during which outstanding options shall be exercisable to the extent vested and, on the expiration of such period, all unexercised options shall immediately terminate. The Board of Directors, in its sole discretion, may accelerate the vesting of such options so that they are exercisable in full during such period; or

(iv) The Board of Directors shall take such other action with respect to outstanding options as the Board deems to be in the best interests of the Company.

(b) *Liquidation; Dissolution.* If the Company is liquidated or dissolved, options shall be treated in accordance with Section 11.2(a)(iii).

11.3 *Fractional Shares.* If the number of shares covered by any option is adjusted, any fractional shares resulting from such adjustment shall be disregarded and each such option shall cover only the number of full shares resulting from such adjustment.

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11.4 *Determination of Board to Be Final* All adjustments under this Section 11 shall be made by the Board of Directors, and its determination as to what adjustments shall be made, and the extent thereof, shall be final, binding and conclusive. Unless an Optionee agrees otherwise, any change or adjustment to an Incentive Stock Option shall be made, if possible, in such a manner so as not to constitute a “modification,” as defined in Section 424(h) of the Code, and so as not to cause the Optionee’s Incentive Stock Option to fail to continue to qualify as an Incentive Stock Option.

12. *Securities Regulations.*

Shares of Common Stock shall not be issued with respect to an option granted under this Plan unless the exercise of such option and the issuance and delivery of such shares pursuant thereto shall comply with all relevant provisions of law, including, without limitation, any applicable state securities laws, the Securities Act of 1933, as amended, the Exchange Act, the rules and regulations promulgated thereunder, applicable laws of foreign countries and other jurisdictions and the requirements of any quotation service or stock exchange on which the shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance, including the availability of an exemption from registration for the issuance and sale of any shares hereunder. The inability of the Company to obtain, from any regulatory body having jurisdiction, the authority deemed by the Company’s counsel to be necessary for the lawful issuance and sale of any shares hereunder or the unavailability of an exemption from registration for the issuance and sale of any shares hereunder shall relieve the Company of any liability with respect to the nonissuance or sale of such shares as to which such requisite authority shall not have been obtained.

As a condition to the exercise of an option, the Company may require the Optionee to represent and warrant at the time of any such exercise that the shares of Common Stock are being purchased only for investment and without any present intention to sell or distribute such shares if, in the opinion of counsel for the Company, such a representation is required by any relevant provision of the aforementioned laws. The Company may place a stop-transfer order against any shares of Common Stock on the official stock books and records of the Company, and a legend may be stamped on stock certificates to the effect that the shares of Common Stock may not be pledged, sold or otherwise transferred unless an opinion of counsel is provided (concurrent in by counsel for the Company) stating that such transfer is not in violation of any applicable law or regulation. The Plan Administrator may also require such other action or agreement by the Optionees as may from time to time be necessary to comply with the federal and state securities laws. THIS PROVISION SHALL NOT OBLIGATE THE COMPANY TO UNDERTAKE REGISTRATION OF THE OPTIONS OR STOCK THEREUNDER.

If any of the Company’s capital stock of the same class as the Common Stock subject to options granted hereunder is listed on a national securities exchange, all shares of Common Stock issued hereunder if not previously listed on such exchange shall be authorized by that exchange for listing thereon before the issuance thereof.

13. *Amendment and Termination.*

13.1 *Plan.* The Board of Directors may at any time suspend, amend or terminate this Plan, provided that, except as set forth in Section 8, the approval of the Company’s shareholders is necessary within twelve months before or after the adoption by the Board of Directors of any amendment that will:

- (a) increase the number of shares of Common Stock to be reserved for the issuance of options under this Plan;
- (b) permit the granting of stock options to a class of persons other than those now permitted to receive stock options under this Plan; or

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- (c) require shareholder approval under applicable law, including Section 16(b) of the Exchange Act.

13.2 *Options.* Subject to the requirements of Section 422 of the Code with respect to Incentive Stock Options and to the terms and conditions and within the limitations of this Plan, the Plan Administrator may modify or amend outstanding options granted under this Plan. The modification or amendment of an outstanding option shall not, without the consent of the Optionee, impair or diminish any of his or her rights or any of the obligations of the Company under such option. Except as otherwise provided in this Plan, no outstanding option shall be terminated without the consent of the Optionee. Unless the Optionee agrees otherwise, any changes or adjustments made to outstanding Incentive Stock Options granted under this Plan shall be made in such a manner so as not to constitute a “modification,” as defined in Section 425(h) of the Code, and so as not to cause any Incentive Stock Option issued hereunder to fail to continue to qualify as an Incentive Stock Option as defined in Section 422(b) of the Code.

13.3 *Automatic Termination.* Unless sooner terminated by the Board of Directors, this Plan shall terminate ten years from the date on which this Plan is adopted by the Board. No option may be granted after such termination or during any suspension of this Plan. The amendment or termination of this Plan shall not, without the consent of the Optionee, alter or impair any rights or obligations under any option theretofore granted under this Plan.

14. *Miscellaneous.*

14.1 *Time of Granting Options.* The date of grant of an option shall, for all purposes, be the date on which the Company completes the required corporate action relating to the grant of an option; the execution of an Option Agreement and the conditions to the exercise of an option shall not defer the date of grant.

14.2 *No Status as Shareholder.* Neither the Optionee nor any party to which the Optionee's rights and privileges under the option may pass shall be, or have any of the rights or privileges of, a shareholder of the Company with respect to any of the shares of Common Stock issuable on the exercise of any option granted under this Plan unless and until such option has been exercised and the issuance (as evidenced by the appropriate entry on the books of the Company or duly authorized transfer agent of the Company) of the stock certificate evidencing such shares.

14.3 *Status as an Employee.* Nothing in this Plan or in any option granted pursuant to this Plan shall confer on any Optionee any right to continue in the employ of the Company, or to interfere in any way with the right of the Company to terminate his or her employment or other relationship with the Company at any time for any reason.

14.4 *Reservation of Shares.* The Company, during the term of this Plan, at all times will reserve and keep available such number of shares of Common Stock as shall be sufficient to satisfy the requirements of this Plan.

15. *Effectiveness of This Plan.* This Plan shall become effective on the date on which it is adopted by the Board of Directors of the Company. No option granted under this Plan to any officer or director of the Company shall become exercisable until the Plan is approved by the shareholders, and any option granted before such approval shall be conditioned on and is subject to such approval.

Adopted by the Board of Directors on July 10, 1996, and approved by the shareholders on August 9, 1996.

Amended by the Board of Directors on November 8, 1996.

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Amended by the shareholders, pursuant to the recommendation of the Board of Directors, on October 15, 1998.

Amended by the shareholders, pursuant to the recommendation of the Board of Directors, on June 22, 2000.

Amended by the Board of Directors on October 19, 2000.

Amended by the Board of Directors on April 26, 2001.

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FORM OF SPECIAL OPTION GRANT

**MICROVISION, INC.
STOCK OPTION AGREEMENT
FOR INDEPENDENT DIRECTORS
(NON-PLAN GRANT)**

THESE OPTIONS AND THE UNDERLYING SHARES OF COMMON STOCK HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR THE SECURITIES LAWS OF ANY STATE, AND ARE BEING OFFERED IN RELIANCE UPON EXEMPTIONS FROM REGISTRATION UNDER THE ACT AND STATE SECURITIES LAWS.

«Date»

To: «Title» «First» «Mid» «Last»

You have been awarded an option to purchase the number of shares of Common Stock of Microvision, Inc. (the "Company") specified below. **The grant of this option is subject to shareholder approval and this option cannot be exercised until such approval is obtained.** The terms of your option are summarized below. A complete description of the terms and conditions to which this option is subject is set forth in the "Terms and Conditions of Grant" attached as *Exhibit A* hereto.

1. *Number of Shares.* You may purchase a maximum of «Total Shares» shares of the Company's Common Stock pursuant to this option.
2. *Date Option Granted.* October 24, 2001.
3. *Term of This Option.* Unless sooner terminated, this option must be exercised on or before «term», as described more fully in the Exercise Schedule attached as *Exhibit B* hereto.
4. *Exercise Schedule and Prices.* This option shall vest and become exercisable upon shareholder approval and have an exercise price of \$15.00 per share.
5. *How to Exercise.* To exercise this option in whole or in part (i.e., in increments of no less than 100 shares), you must deliver to the Secretary of the Company at least two full business days prior to the date on which you wish to exercise the option, a written notice of exercise and the exercise price, payable by personal, bank certified or cashier's check, for the number of shares that you desire to purchase. A form of Notice of Exercise that you may use has been attached to this Agreement as *Exhibit B*. You must pay all applicable withholding taxes upon exercise of this option. At the Company's discretion, you also may pay the exercise price through irrevocable instructions to a stock broker to deliver the amount of sales proceeds necessary to pay the exercise price and applicable withholding tax in accordance with applicable governmental regulations.

The Company also may require you to execute other documents as a condition to exercising this option. You should contact the Secretary in advance when you are

considering an exercise of this option.

6. *Termination of Option.* This option shall expire and all rights thereto shall cease and terminate in accordance with the provisions of Section 4 of the "Terms and Conditions of Grant" attached as *Exhibit A* hereto.

7. *No Transfer of Option.* This option cannot be transferred except by will or the applicable laws of descent and distribution.

8. *Certain Tax Matters.* This option is not intended to qualify as an "Incentive Stock Option" as that term is defined in Section 422A of Code and its tax consequences are different than such an option. The time at which you exercise this option or dispose of any shares thus acquired may affect significantly your resultant tax burden. You are counseled to seek tax advice in this regard.

9. *Securities Compliance.* This option cannot be exercised until it is approved by the shareholders of the Company. The Company intends to submit a proposal relating to the grant of this

and certain other options granted to the non-employee directors of the Company for approval by the shareholders at the 2002 annual meeting of shareholders. If the shareholders approve the proposal, then promptly thereafter the Company intends to register the offer and sale of the shares of Common Stock issuable upon exercise of this option under the Securities Act of 1933, as amended, by filing a registration statement on Form S-8 with the Securities and Exchange Commission. Until such registration statement becomes effective, the shares of Common Stock issuable upon exercise of this option will not be registered and the issuance thereof will be subject to applicable securities laws, as described in Section 7 of the "Terms and Conditions of Grant" attached as *Exhibit A* hereto. Shares purchased through the exercise of this option cannot be sold or otherwise transferred unless they are subsequently registered or exemptions from registration are available.

Please complete and sign the Election to Accept or Decline Stock Option attached hereto at *Exhibit C* indicating whether you accept or decline this option upon the terms set forth in this Agreement, including the Terms and Conditions of Grant, and return a copy of the Election to the Company.

Very truly yours,

MICROVISION, INC.

By

Richard A. Raisig, *Chief Financial Officer*

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Exhibit A Terms and Conditions of Grant

1. *Administration.* This option shall be administered by the Board of Directors of the Company (the "Board") or, if the Board shall authorize a committee of the Board, by such committee to the extent so authorized. The administrator of this option is referred to as the "Administrator."

1.1 *Powers.* Subject to the specific provisions of these terms and conditions, the Administrator shall have the authority, in its discretion: (a) to interpret the terms and conditions of this option; (b) to prescribe, amend, and rescind rules and regulations relating to the exercise of this option; (c) with the consent of the Optionee, modify or amend each option; (d) to reduce the exercise price per share of this option; (e) to defer, with the consent of the Optionee, or to accelerate the exercise date of any option; (f) to waive or modify any term or provision contained in this option applicable to the underlying shares of Common Stock; and (g) to make all other determinations deemed necessary or advisable for the administration of this option. The interpretation and construction by the Administrator of any terms or provisions of this option or of any rule or regulation promulgated in connection herewith and all actions taken by the Administrator shall be conclusive and binding on all interested parties. The Administrator may delegate administrative functions to individuals who are officers or employees of the Company.

1.2 *Limited Liability.* No member of the Board or the Administrator or any officer of the Company shall be liable for any action or inaction of the entity or body, or another person or, except in circumstances involving bad faith, of himself or herself, with respect to any matter related to this option. Subject only to compliance with the explicit provisions hereof, the Board and Administrator may act in their absolute discretion in all matters related to this option.

2. *Stock Subject to This Option.* If this option expires, is surrendered, exchanged for another option, canceled or terminated for any reason without having been exercised in full, the unpurchased shares subject thereto shall again be available for issuance by the Company, including for replacement options that may be granted in exchange for such surrendered, canceled or terminated options. Shares issued on exercise of this option may be subject to restrictions on transfer, repurchase rights or other restrictions as determined by the Administrator.

3. *Nontransferability.* This option and the rights and privileges conferred hereby may not be transferred, assigned, pledged or hypothecated in any manner (whether by operation of law or otherwise) other than by will or by the applicable laws of descent and distribution, shall not be subject to execution, attachment or similar process, and shall be exercisable during the Optionee's lifetime only by the Optionee. Any purported transfer or assignment in violation of this provision shall be void.

4. *Termination of Option.*

4.1 *Generally*

Unless earlier termination results from the application of the provisions of this Section 4, each option granted hereunder shall expire and all rights thereto shall cease and terminate on the tenth anniversary of the date of grant.

4.2 *Disability or Death*

If the Optionee is unable to continue his or her service as an Independent Director of the Company as a result of his or her permanent and total disability (as defined in Section 22(e)(3) of the Code) or death, all unvested options issued hereunder will become vested immediately as of the date of disability or death. In such an event, this option may be exercised at any time before the earlier of (i) the expiration date of the option or (ii) twelve (12) months after the date of (A) permanent and total disability or (B) death (by the person or persons to whom your rights

under the option shall pass by your will or by the applicable laws of descent and distribution), for up to the full number of shares of Common Stock covered thereby.

4.3 *Failure to Exercise Option; Expiration*

To the extent that an Optionee fails to exercise this option within the period provided in this Section 4, all rights to purchase shares of Common Stock pursuant to this option shall cease and terminate.

5. *Exercise.*

5.1 *Procedure*

Each option may be exercised, subject to its vesting schedule, in whole or in part; provided, however, that no fewer than 100 shares (or the remaining shares then purchasable under the option, if less than 100 shares) may be purchased on any exercise of any option granted hereunder and that only whole shares will be issued pursuant to the exercise of any option (the number of 100 shares shall not be changed by any transaction or action described in Section 6 unless the Administrator determines that such a change is appropriate). Options shall be exercised by delivery to the Secretary of the Company or his or her designated agent of notice of the number of shares with respect to which the option is being exercised, together with payment in full of the exercise price and any applicable withholding taxes.

5.2 *Payment*

Payment of the option exercise price shall be made in full when the notice of exercise of the option is delivered to the Secretary of the Company or his or her designated agent and shall be by personal, bank certified or cashier's check or through irrevocable instructions to a stock broker to deliver to the Company the amount of sales proceeds necessary to pay the appropriate exercise price and withholding tax obligations, all in accordance with applicable governmental regulations, for the shares of Common Stock being purchased. The Administrator may determine at any time before exercise that additional forms of payment will be permitted.

5.3 *Withholding*

Before the issuance of shares of Common Stock on the exercise of an option, the Optionee shall pay to the Company the amount of any applicable federal, state or local tax withholding obligations. The Company may withhold any distribution in whole or in part until the Company is so paid. The Company shall have the right, subject to applicable law, to withhold such amount from any other amounts due or to become due from the Company to the Optionee, or to retain and withhold a number of shares having a market value not less than the amount of such taxes required to be withheld by the Company, to reimburse it for any such taxes and cancel (in whole or in part) any such shares so withheld.

6. *Adjustments On Changes in Capitalization.*

6.1 *Stock Splits, Capital Stock Adjustments.* The number and class of shares covered by this option and the exercise price per share thereof (but not the total price) shall all be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock of the Company resulting from a stock split, stock dividend or consolidation of shares or any like capital stock adjustment.

6.2 *Effect of Merger, Sale of Assets, Liquidation or Dissolution.*

(a) *Mergers, Sale of Assets, Other Transactions.* In the event of a merger, consolidation or plan of exchange to which the Company is a party or a sale of all or substantially all of the Company's assets (each, a "Transaction"), the Board, in its sole discretion and to the extent

possible under the structure of the Transaction, shall select one of the following alternatives for treating this option:

(i) This option shall remain in effect in accordance with its terms;

(ii) This option shall be converted into options to purchase stock in the corporation that is the surviving or acquiring corporation in the Transaction. The amount, type of securities subject thereto and exercise price of the converted option shall be determined by the Board, taking into account the relative values of the companies involved in the Transaction and the exchange rate, if any, used in determining shares of the surviving corporation to be issued to holders of shares of the Company. Unless otherwise determined by the Board, the converted option shall be vested only to the extent that the vesting requirements relating to this option have been satisfied;

(iii) The Board provides a period before the consummation of the Transaction during which this option shall be exercisable to the extent vested and, on the expiration of such period, this option shall immediately terminate. The Board, in its sole discretion, may accelerate the vesting of this option so that it is exercisable in full during such period; or

(iv) The Board shall take such other action with respect to this option as the Board deems to be in the best interests of the Company.

(b) *Liquidation; Dissolution.* If the Company is liquidated or dissolved, options shall be treated in accordance with Section 6.2(a)(iii).

6.3 *Fractional Shares.* If the number of shares covered by this option is adjusted, any fractional shares resulting from such adjustment shall be disregarded and this option shall cover only the number of full shares resulting from such adjustment.

6.4 *Determination of Board to Be Final.* All adjustments under this Section 6 shall be made by the Board, and its determination as to what adjustments shall be made, and the extent thereof, shall be final, binding and conclusive.

7. *Securities Regulations.*

Shares of Common Stock shall not be issued with respect to this option unless the exercise of the option and the issuance and delivery of such shares pursuant hereto shall comply with all relevant provisions of law, including, without limitation, any applicable state and federal securities laws and the rules and regulations promulgated

thereunder, applicable laws of foreign countries and other jurisdictions, and the requirements of any stock exchange or market on which the shares may then be listed, and shall be further subject to the approval of counsel for the Company with respect to such compliance, including the availability of an exemption from registration for the issuance and sale of any shares hereunder. The inability of the Company to obtain, from any regulatory body having jurisdiction, the authority deemed by the Company's counsel to be necessary for the lawful issuance and sale of any shares hereunder or the unavailability of an exemption from registration for the issuance and sale of any shares hereunder shall relieve the Company of any liability with respect of the nonissuance or sale of such shares as to which such requisite authority shall not have been obtained.

As a condition to the exercise of an option, the Company may require the Optionee to represent and warrant at the time of any such exercise that the shares of Common Stock are being purchased only for investment and without any present intention to sell or distribute such shares if, in the opinion of counsel for the Company, such a representation is required by any relevant provision of the aforementioned laws. The Company may place a stop-transfer order against any shares of Common Stock on the official stock books and records of the Company, and a legend may be stamped on stock certificates to the effect that the shares of Common Stock may not be pledged, sold or otherwise transferred unless an opinion of counsel is provided (concurring in by counsel for the Company) stating

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that such transfer is not in violation of any applicable law or regulation. The Administrator may also require such other action or agreement by the Optionee as may from time to time be necessary to comply with the federal and state securities laws. THIS PROVISION SHALL NOT OBLIGATE THE COMPANY TO UNDERTAKE REGISTRATION OF THIS OPTION OR THE STOCK ISSUABLE UPON EXERCISE HEREOF.

8. *Amendment and Termination.*

8.1 *Options.* Subject to the terms and conditions hereof, the Administrator may modify or amend this option. The modification or amendment of this option shall not, without the consent of the Optionee, impair or diminish any of his or her rights or any of the obligations of the Company hereunder. Except as otherwise provided in this option, this option shall not be terminated without the consent of the Optionee.

8.2 *Automatic Termination.* Unless sooner terminated, this option shall terminate ten (10) years from the date of grant.

9. *Miscellaneous.*

9.1 *No Status as Shareholder.* Neither the Optionee nor any party to which the Optionee's rights and privileges under the option may pass shall be, or have any of the rights or privileges of, a shareholder of the Company with respect to any of the shares of Common Stock issuable on the exercise of this option unless and until this option has been exercised and the issuance (as evidenced by the appropriate entry on the books of the Company or duly authorized transfer agent of the Company) of the stock certificate evidencing such shares.

9.2 *Reservation of Shares.* The Company, during the term of this option, at all times will reserve and keep available such number of shares of Common Stock as shall be sufficient to satisfy the requirements hereof.

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Exhibit B
Notice of Exercise of Non-Qualified Stock Option

Date:

To: Microvision, Inc.

I hereby exercise the non-qualified stock option granted to me by Microvision, Inc. (the "Company") on «grant», subject to all the terms and provisions thereof, and notify the Company of my desire to purchase _____ shares of Common Stock of the Company at the exercise price of \$ _____ per share, or an aggregate exercise price of \$ _____.

I hereby deliver the full exercise price and all applicable withholding taxes with respect to this exercise as follows:

_____ personal, bank certified or cashier's check, or
_____ irrevocable instructions to a stock broker to deliver the necessary sales proceeds, all in accordance with applicable governmental regulations.

I further agree to execute such other documents as the Company may request.

By: _____

Print Name: _____

Address: _____

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Exhibit C
Election to Accept or Decline Stock Option

Date:

To: Microvision, Inc.

I ACCEPT DECLINE the non-qualified stock option granted to me pursuant to the Stock Option Agreement, dated as of _____. If I accept the grant of this option, I acknowledge that I have received and understand, and agree to, the terms of the Stock Option Agreement, including the "Terms and Conditions of Grant" attached as *Exhibit A* to the Agreement.

Yours very truly,

«First» «Last»
Optionee

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Schedule of Special Option Grants

Optionee	# of option shares
Jacqueline Brandwynne	4,030
Jacob Brouwer	8,867
Richard A. Cowell	8,867
Walter J. Lack	8,867
William A. Owens	8,867
Robert A. Ratliffe	8,867
Dennis Reimer	8,867

**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**

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, the undersigned, as Chief Executive Officer of Microvision, Inc. (the "Company"), does hereby certify that to the undersigned's knowledge:

- 1) the Company's Form 10Q for the quarterly period ended June 30, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) the information contained in the Company's Form 10Q for the quarterly period ended June 30, 2002 fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Richard F. Rutkowski

Richard F. Rutkowski
Chief Executive Officer

Dated: August 14, 2002

**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**

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, the undersigned, as Chief Executive Officer of Microvision, Inc. (the "Company"), does hereby certify that to the undersigned's knowledge:

- 1) the Company's Form 10Q for the quarterly period ended June 30, 2002 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) the information contained in the Company's Form 10Q for the quarterly period ended June 30, 2002 fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Richard A. Raisig

Richard A. Raisig
Chief Executive Officer

Dated: August 14, 2002