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**U.S. SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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

For the quarterly period ended September 30, 2000

**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

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**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 October 17, 2000, 11,840,281 shares of the Company's common stock, no par value, were outstanding.

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**PART I  
FINANCIAL INFORMATION**

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**Microvision, Inc.**  
**Consolidated Balance Sheet**

September 30,  
2000

December 31,  
1999

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(unaudited)

<b>Assets</b>			
<b>Current Assets</b>			
Cash and cash equivalents	\$	16,061,200	\$ 2,798,000
Investment securities available-for-sale		33,078,800	29,369,400
Accounts receivable, net of allowances of \$87,000 and \$60,000		509,400	1,024,500
Costs and estimated earnings in excess of billings on uncompleted contracts		1,734,900	2,000,400
Current restricted investments		2,250,000	650,000
Other current assets		827,800	847,700
<b>Total current assets</b>		<b>54,462,100</b>	<b>36,690,000</b>
Long-term investment, at cost		623,600	623,600
Property and equipment, net		6,287,000	3,054,700
Restricted investments		951,000	1,100,000
Receivables from related parties		400,000	—
Other assets		101,400	150,700
<b>Total assets</b>	<b>\$</b>	<b>62,825,100</b>	<b>\$ 41,619,000</b>
<b>Liabilities, Mandatorily Redeemable Convertible Preferred Stock And Shareholders' Equity</b>			
<b>Current Liabilities</b>			
Accounts payable	\$	1,396,100	\$ 1,453,100
Accrued liabilities		3,786,500	2,000,100
Allowance for estimated contract losses		437,000	—
Billings in excess of costs and estimated earnings on uncompleted contracts		160,400	167,000
Current portion of capital lease obligations		363,900	220,800
Current portion of long-term debt		50,600	46,900
<b>Total current liabilities</b>		<b>6,194,500</b>	<b>3,887,900</b>
Capital lease obligations, net of current portion		282,900	279,400
Long-term debt, net of current portion		303,100	341,500
Deferred rent, net of current portion		238,000	214,800
<b>Total liabilities</b>		<b>7,018,500</b>	<b>4,723,600</b>
Commitments and contingencies		—	—
Mandatorily redeemable convertible preferred stock, no par value, 1,600 shares authorized; 0 and 1,600 issued and outstanding		—	1,536,000
<b>Shareholders' Equity</b>			
Common stock, no par value, 31,250,000 shares authorized; 11,840,281 and 10,140,733 shares issued and outstanding		122,826,500	75,518,300
Deferred compensation		(7,407,000)	(213,100)
Subscriptions receivable from related parties		(573,200)	(349,100)
Accumulated other comprehensive gain (loss)		184,900	(60,600)
Accumulated deficit		(59,224,600)	(39,536,100)
<b>Total shareholders' equity</b>		<b>55,806,600</b>	<b>35,359,400</b>
<b>Liabilities, mandatorily redeemable convertible preferred stock and shareholders' equity</b>	<b>\$</b>	<b>62,825,100</b>	<b>\$ 41,619,000</b>

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

<b>Microvision, Inc.</b>				
<b>Consolidated Statement of Operations</b>				
	<b>Three months ended September 30,</b>		<b>Nine months ended September 30,</b>	
	<b>2000</b>	<b>1999</b>	<b>2000</b>	<b>1999</b>
	<b>(unaudited)</b>		<b>(unaudited)</b>	
Contract revenue	\$ 1,970,500	\$ 1,465,700	\$ 5,256,000	\$ 5,160,200
Cost of revenue	1,716,900	492,000	4,068,300	3,741,100
<b>Gross margin</b>	<b>253,600</b>	<b>973,700</b>	<b>1,187,700</b>	<b>1,419,100</b>

Research and development expense (exclusive of non-cash compensation expense of \$2,300 and \$9,500 for the three months and \$7,400 and \$30,800 for the nine months ended September 30, 2000, respectively)	5,732,000	3,180,900	13,851,200	6,632,300
Marketing, general and administrative expense (exclusive of non-cash compensation expense of \$479,100 and \$72,000 for the three months and \$1,143,600 and \$177,600 for the nine months ended September 30, 2000, respectively)	2,671,700	1,398,400	8,010,200	5,528,200
Non-cash compensation expense	481,400	81,500	1,151,000	208,400
<b>Total operating expenses</b>	<b>8,885,100</b>	<b>4,660,800</b>	<b>23,012,400</b>	<b>12,368,900</b>
Loss from operations	(8,631,500)	(3,687,100)	(21,824,700)	(10,949,800)
Interest income	973,100	448,200	2,268,800	637,100
Interest expense	(24,500)	(24,100)	(132,600)	(131,000)
<b>Net loss</b>	<b>(7,682,900)</b>	<b>(3,263,000)</b>	<b>(19,688,500)</b>	<b>(10,443,700)</b>
Less: Preferred dividend	—	—	—	(73,400)
Noncash beneficial conversion feature of Series B Preferred Stock	—	(606,300)	—	(1,754,300)
<b>Net loss available for common shareholders</b>	<b>\$ (7,682,900)</b>	<b>\$ (3,869,300)</b>	<b>\$ (19,688,500)</b>	<b>\$ (12,271,400)</b>
<b>Net loss per share available for common shareholders—basic and diluted</b>	<b>\$ (0.65)</b>	<b>\$ (0.41)</b>	<b>\$ (1.75)</b>	<b>\$ (1.62)</b>
<b>Weighted-average shares outstanding—basic and diluted</b>	<b>11,827,700</b>	<b>9,535,800</b>	<b>11,275,900</b>	<b>7,576,200</b>

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

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#### Microvision, Inc.

#### Consolidated Statement of Comprehensive Loss

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2000	1999	2000	1999
	(unaudited)		(unaudited)	
Net loss	\$ (7,682,900)	\$ (3,263,000)	\$ (19,688,500)	\$ (10,443,700)
Other comprehensive income—				
Unrealized gain (loss) on investment securities available-for-sale	215,200	(14,800)	245,500	13,500
<b>Comprehensive loss</b>	<b>\$ (7,467,700)</b>	<b>\$ (3,277,800)</b>	<b>\$ (19,443,000)</b>	<b>\$ (10,430,200)</b>

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

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#### Microvision, Inc.

#### Consolidated Statement of Cash Flows

	Nine Months Ended September 30,	
	2000	1999
	(unaudited)	
<b>Cash flows from operating activities</b>		
Net loss	\$ (19,688,500)	\$ (10,443,700)
Adjustments to reconcile net loss to net cash used in operations		
Depreciation	841,000	473,600
Noncash expenses related to issuance of stock, warrants, options and amortization of deferred compensation	1,151,000	208,400
Noncash deferred rent	23,200	—
Allowance for estimated contract losses	437,000	46,000
Changes in:		
Accounts receivable	515,100	15,200
Costs and estimated earnings in excess of billings on uncompleted contracts	265,500	(1,105,400)

Current restricted investments	(1,600,000)	(1,300,000)
Other current assets	19,900	(583,800)
Restricted investments	149,000	(1,100,000)
Receivables from related parties	(400,000)	—
Other assets	49,300	(69,300)
Accounts payable	(57,000)	(386,400)
Accrued liabilities	2,163,400	1,202,700
Billings in excess of costs and estimated earnings on uncompleted contracts	(6,600)	(701,700)
<b>Net cash used in operating activities</b>	<b>(16,137,700)</b>	<b>(13,744,400)</b>
<b>Cash flows from investing activities</b>		
Sales of investment securities	77,185,000	27,491,500
Purchases of investment securities	(80,648,900)	(55,417,700)
Purchases of property and equipment	(3,725,200)	(1,635,600)
<b>Net cash used in investing activities</b>	<b>(7,189,100)</b>	<b>(29,561,800)</b>
<b>Cash flows from financing activities</b>		
Principal payments under capital leases	(201,500)	(103,100)
Principal payments under long-term debt	(34,700)	(20,600)
Increase in long term-debt	—	420,000
Payment of preferred dividend	—	(73,400)
Payments received on subscriptions receivable	172,500	—
Net proceeds from issuance of common stock	36,653,700	40,485,700
Net proceeds from issuance of preferred stock	—	6,163,900
<b>Net cash provided by financing activities</b>	<b>36,590,000</b>	<b>46,872,500</b>
Net increase in cash and cash equivalents	13,263,200	3,566,300
Cash and cash equivalents at beginning of period	2,798,000	2,269,000
Cash and cash equivalents at end of period	\$ 16,061,200	\$ 5,835,300

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

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**Microvision, Inc.**

**Consolidated Statement of Cash Flows (Continued)**

	Nine Months Ended September 30,	
	2000	1999
	(unaudited)	
<b>Supplemental disclosure of cash flow information</b>		
Cash paid for interest	\$ 132,600	\$ 131,000
<b>Supplemental schedule of noncash investing and financing activities</b>		
Property and equipment acquired under capital leases	\$ 348,100	\$ 234,100
Beneficial conversion feature of Series B Preferred Stock	\$ —	\$ 1,754,300
Conversion of preferred stock to common stock	\$ 1,536,000	\$ 4,334,000
Payment for exclusive license agreement by issuance of common stock	\$ 377,000	\$ —
Exercise of stock options for subscriptions receivable	\$ 396,600	\$ 171,600
Deferred compensation—stock grants, warrants and options	\$ 8,344,900	\$ 247,400
Unrealized gain in investment securities available-for-sale	\$ 245,500	\$ 13,500

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

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## Management's Statement

The Consolidated Balance Sheet as of September 30, 2000, the Consolidated Statements of Operations and Comprehensive Loss for the three and nine months ended September 30, 2000, and September 30, 1999, and the Consolidated Statement of Cash Flows for the nine months ended September 30, 2000 and September 30, 1999 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, results of operations and cash flows at September 30, 2000 and all periods presented, have been made. 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, 1999. The results of operations for the three and the nine month periods ended September 30, 2000 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"), its majority owned subsidiary. Lumera is engaged in the research and development of new materials and devices that utilize organic non-linear optical materials. All material intercompany accounts and transactions have been eliminated in consolidation.

## 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 September 30, 2000 and September 30, 1999 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:

	Three months ended September 30,		Nine months ended September 30,	
	2000	1999	2000	1999
<b>Numerator:</b>				
Net loss available for common shareholders	\$ (7,682,900)	\$ (3,869,300)	\$ (19,688,500)	\$ (12,271,400)
<b>Denominator:</b>				
Basic and diluted weighted-average common shares outstanding	11,827,700	9,535,800	11,275,900	7,576,200
Basic and diluted net loss per share	\$ (.65)	\$ (.41)	\$ (1.75)	\$ (1.62)

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As of September 30, 2000 the Company had outstanding options and warrants to purchase 3,430,332 shares of common stock.

## Shareholders' Equity

In March 2000, the Company redeemed 1,600 shares of Series B-2 mandatorily redeemable convertible preferred stock and issued 100,000 shares of common stock to the holder thereof.

In April 2000, the Company raised \$25.0 million from the issuance of 500,000 shares of common stock to Cree, Inc. and General Electric Pension Trust. At the same time, the Company entered into a two year, \$10.0 million extension of an agreement with Cree, Inc. to continue development of semiconductor light-emitting diodes and laser diodes for application with the Company's proposed display and imaging products. The Company must pay \$4.5 million during the first year of the extension in four equal quarterly payments. As of September 30, 2000, the Company made two payments under the agreement. The Company has pledged investments of \$2.3 million as security for a letter of credit, which will be used to fund the remaining payments under the first year of the extension. During the second year of the extension, the Company is required to pay the remaining \$5.5 million in four equal quarterly payments.

In April 2000, the Company raised \$7.5 million from the exercise by a private investor of a warrant to purchase 418,848 shares of common stock at a price of \$17.91 per share.

In June 2000, the Company raised \$1.9 million from the exercise by a private investor, who is also a director, of an option to purchase 100,000 shares of common stock at a price of \$19.20 per share.

In August 2000, the Company entered into five-year consulting agreements with two independent consultants to provide strategic business and financial consulting services. Under the terms of the agreements each consultant received a warrant to purchase 100,000 shares of common stock at an exercise price of \$34.00 per share. The total value of the warrants, of \$6.4 million, has been recorded as deferred compensation and will be expensed over the five-year term of the agreements.

### Subsequent Event

In October 2000, Lumera entered into an exclusive license agreement with the University of Washington to license certain organic non-linear optical chromophore materials technology. Under the terms of the agreement, Lumera agreed to pay \$200,000 and issued 802,414 shares of Lumera common stock to the University of Washington. In addition, Lumera must pay ongoing royalties based on revenue from products incorporating the licensed technology. Lumera also entered into a three year sponsored research agreement with the University of Washington to fund continued development work on organic non-linear optical materials.

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## 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 "Considerations Related to the Company's Business."

## Overview

The Company began operations in May 1993 to develop and commercialize technology for displaying images and information onto the retina of the eye. Retinal scanning display technology creates a high resolution, full motion image by scanning a low power beam of colored light to "paint" rows of pixels on the viewer's eye. In certain applications, the image appears in the viewer's field of view as if the viewer were only an arm's length away from a high quality video screen. The retinal scanning display technology can also be used to superimpose an image on the viewer's field of vision, enabling the viewer to see data or images in the context of his or her natural surroundings. In each case, a high resolution, bright image is created.

In 1993, the Company acquired an exclusive license to the Virtual Retinal Display, a specific type of retinal scanning display, from the University of Washington and entered into a research agreement with the University of Washington to further develop the Virtual Retinal Display technology. Since completing its initial public offering in August 1996, the Company has established and equipped in-house laboratories and transferred the research and development relating to the Virtual Retinal Display from the University of Washington to its in-house laboratories. The Company has continued to develop the Virtual Retinal Display technology as part of its broader research and development efforts relating to the retinal scanning display technology.

The Company currently has several prototype versions of the retinal scanning displays, including monochromatic and color portable units and a full color benchtop model. The Company expects to continue funding prototype and demonstration versions of products incorporating its technology at least through 2001.

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In conjunction with developing the retinal scanning display technology, the Company is developing components that can be integrated into different product offerings. The Company has defined the following key product offerings for further development:

- High Performance— High fidelity displays for use in general simulation avionics, medical and entertainment applications
- Compact— Lightweight, see-through, wearable systems for hands free applications in the industrial, medical and defense markets
- Microdisplay— Highly miniaturized display systems to be incorporated into OEM products including cellular telephones, personal digital assistants, and digital camcorders/cameras
- Image Capture— Systems to capture data such as bar code readers, scientific images and surgical cameras
- Projection— Fixed systems to replace desktop computer monitors or rear projector systems

In June 2000, the Company demonstrated its first miniature display utilizing three microminiature light emitting diode lamps to create a full-color high resolution video image.

During the nine months ended September 30, 2000, the Company sold additional engineering prototype units of its first commercial retinal scanning display product.

## Plan of Operation

The Company plans to introduce a production version of the retinal scanning display in 2001. To support the product introduction the Company has produced engineering prototypes of the commercial product. The Company has sold six of these units to customers for product testing and integration. Other units are being used by our sales and marketing groups to demonstrate the technology to future potential customers and to obtain customer feedback. Sales of production version retinal scanning displays may not occur however, until substantially later, if at all.

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

The Company also 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 technology and lead to commercial products. The Company also plans to invest funds for ongoing innovation and improvements to the retinal scanning display technology. 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, marketing, technical and other personnel and to continue investing in laboratory facilities and equipment to achieve development and production objectives.

## LUMERA CORPORATION

### Overview

The Company formed a subsidiary company, Lumera Corporation (Lumera), to develop and commercialize a new class of organic non-linear optical chromophore materials or Optical Materials and devices that utilize the optical properties of these Optical Materials. The Optical Materials are polymers that have been specifically treated to act as optical wave-guides. By adjusting the composition

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of the polymer, the wave guide properties of these Optical Materials can be changed to meet different commercial applications. Lumera licensed the Optical Materials technology from the University of Washington in October 2000. Lumera expects that these materials and devices made from them will improve the performance and reduce the

cost of electro-optic components used for fiber-optic telecommunications and data communications systems, phased-array radar systems, optical computing and other photonics applications. Lumera expects that devices made from these Optical Materials will provide important components in all-optical telecommunication switching.

Lumera has established and built in-house laboratories to develop and characterize new materials, create new device designs and perform small-scale production of new devices and systems based on the Optical Materials. Lumera also entered into a three year sponsored research agreement with the University of Washington to fund continued development work on optical materials. Lumera currently has eleven full time employees including chromophore chemists, material scientists and device engineers. To date, all Lumera operations have been funded by Microvision. As of September 30, 2000, the Company has incurred \$800,000 in expenses and invested \$2.2 million on capital assets. As of September 30, 2000, the Company owned 88% of Lumera.

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 address the fundamental limitations of materials currently used in EO modulators. The advantage of Lumera's approach is that the Optical Materials can be chemically designed and manipulated 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 SEPTEMBER 30, 2000 COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 1999

*Contract Revenue.* The Company earns revenue from performance on development contracts and sales of engineering prototypes. Contract revenue in the three months ended September 30, 2000 increased by \$500,000, or 34%, to \$2.0 million from \$1.5 million in the same period in 1999. For the three months ended September 30, 2000, 95% of revenue was derived from performance on development contracts.

The backlog of development contracts and product sales at September 30, 2000 was \$7.3 million, all of which work and product shipments are scheduled for completion during the next twelve months. The Company's customers include both the United States government and commercial enterprises.

*Cost of Revenue.* Cost of revenue includes both the direct and indirect costs of performing on development contracts. Indirect costs include staff and related support costs associated with building

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the Company's technical capabilities and capacity to perform on development contracts the Company expects to enter into in the future.

Cost of revenue in the three months ended September 30, 2000 increased by \$1.2 million, or 249%, to \$1.7 million from \$500,000 in the same period in 1999. The increase is attributable to higher direct cost and overhead cost allocation to cost of revenue in the three months ended September 30, 2000 than in the same period in 1999. The higher level of direct cost is attributable to the timing and structure of the performance on development contracts. Cost of revenue for the three months ended September 30, 2000 includes \$400,000 for estimated losses on development contracts that were not completed at September 30, 2000. Research and development overhead is allocated based on the relative direct labor cost incurred in cost of revenue and research and development expense.

The Company expects that cost of revenue will increase in the future. This increase will likely result from additional development contract work that the Company expects to perform. As a percentage of revenue, the company expects the cost of revenue to decline over time as the Company realizes economies of scale associated with higher levels of development contract business.

*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 September 30, 2000 increased by \$2.5 million, or 80%, to \$5.7 million from \$3.2 million in the same period in 1999. The increase reflects 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.

The Company believes that a substantial level of continuing research and development expense will be required to develop 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:

- Hiring additional technical and support personnel,
- Expanding and equipping in-house laboratories,
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Acquiring rights to additional technologies,

- Subcontracting work to development partners, and

- Incurring related operating expenses

The Company expects that the rate of spending on research and product development will continue to grow in future quarters as we:

- Continue development of the Company's retinal scanning display technology,

- Develop and commercialize the Optical Materials technology,

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- Prepare for the planned introduction of the Company's first commercial product in mid 2001,

- Accelerate development of microdisplays to meet emerging market opportunities,

- Expand the Company's investment in bar code reader development, and

- Pursue 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, consultants, and other operating expenses.

Marketing, general and administrative expenses in the three months ended September 30, 2000 increased by \$1.3 million, or 91%, to \$2.7 million from \$1.4 million in the same period in 1999. The increase includes increased compensation 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,

- 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 three months ended September 30, 2000 increased by \$400,000 or 491% to \$500,000 from \$100,000 in the same period in 1999. Non-cash compensation expense includes the amortization of the value of stock options granted to individuals who are not employees or directors of the Company for services provided to the Company.

In August 2000, the Company entered into five-year consulting agreements with two independent consultants to provide strategic business and financial consulting services. Under the terms of the agreements each consultant received a warrant to purchase 100,000 shares of common stock at an exercise price of \$34.00 per share. The total value of the warrants, or \$6.4 million, has been recorded as deferred compensation and will be expensed over the five-year term of the agreements.

*Interest Income and Expense.* Interest income in the three months ended September 30, 2000 increased by \$600,000, or 117%, to \$1.0 million from \$400,000 in the same period in 1999. This increase resulted primarily from higher average cash and investment securities balances in the three months ended September 30, 2000 than the average cash and investment securities balances in the same period of the prior year.

Interest expense in the three months ended September 30, 2000 was consistent with the same period in 1999.

#### **NINE MONTHS ENDED SEPTEMBER 30, 2000 COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 1999**

*Contract Revenue.* The Company earns revenue from performance on development contracts and sales of engineering prototypes. Contract revenue in the nine months ended September 30, 2000 increased by \$100,000, or 2%, to \$5.3 million from \$5.2 million in the same period in 1999. For the nine months ended September 30, 2000, 90% of revenue was derived from performance on development contracts.

During the nine months ended September 30, 2000, the Company completed work on its two largest development contracts. After completion of work on these contracts, the Company received a

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contract modification for \$7.8 million to perform additional work on both contracts. The beginning and end of a contract term are typically the low points of activity on a contract. The beginning of a contract term is normally used for planning and subcontractor selection. The end of a contract term is normally used for final demonstrations to the customer and report preparation. This lower level of activity during the nine months ended September 30, 2000 was the primary reason for low growth in revenue compared to the same period in 1999.

*Cost of Revenue.* Cost of revenue includes both the direct and indirect costs of performing on development contracts. 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 in the nine months ended September 30, 2000 increased by \$400,000, or 9%, to \$4.1 million from \$3.7 million in the same period in 1999. Cost of revenue for the nine months ended September 30, 2000 includes \$400,000 for the estimated loss on development contracts that were not completed at September 30, 2000, which is the



primary reason for the increase in cost of revenue over the same period in 1999.

*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, outside development and processing work,
- Fees and expenses related to patent applications, prosecution and protection, and
- Other operating expenses.

Included in research and development expenses are costs incurred in acquiring and maintaining licenses of technology from other companies. The Company has expensed all research and development costs.

Research and development expense in the nine months ended September 30, 2000 increased by \$7.3 million, or 109%, to \$13.9 million from \$6.6 million in the same period in 1999. The increase reflects 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.

In April 2000, the Company entered into a \$10.0 million extension of an agreement with Cree, Inc. to continue development of semiconductor light emitting diodes and laser diodes. The Company must pay \$4.5 million during the first year of the extension in four equal quarterly payments. As of September 30, 2000, the Company has made two payments under this agreement. The Company has pledged investments of \$2.3 million as security for a letter of credit, which will be used to fund the remaining payments under the first year of the extension. During the second year of the extension, the Company is required to pay the remaining \$5.5 million in four equal quarterly payments.

The Company believes that a substantial level of continuing research and development expense will be required to develop commercial products using the retinal scanning display 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:

- Hiring additional technical and support personnel,
- Expanding and equipping in-house laboratories,
- Acquiring rights to additional technologies, and

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- Subcontracting development work to development partners.

The Company expects that the rate of spending on research and product development will continue to grow in future quarters as we:

- Continue development of the Company's retinal scanning display technology,
- Develop and commercialize the Optical Materials technology,
- Prepare for the expected introduction of the Company's first commercial product in mid 2001,
- Accelerate development of microdisplays to meet emerging market opportunities,
- Expand the Company's effort in bar code reader development, and
- Pursue 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, consultants, and other operating expenses.

Marketing, general and administrative expenses in the nine months ended September 30, 2000 increased by \$2.5 million, or 45%, to \$8.0 million from \$5.5 million in the same period in 1999. The increase includes increased compensation 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,
- 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 nine months ended September 30, 2000 increased by \$1.0 million or 452%, to \$1.2 million from

\$200,000 in the same period in 1999. Non-cash compensation expense includes the amortization of the value of stock options granted to individuals who are not employees or directors of the Company for services provided to the Company.

In August 2000, the Company entered into five-year consulting agreements with two independent consultants to provide strategic business and financial consulting services. Under the terms of the agreements each consultant received a warrant to purchase 100,000 shares of common stock at an exercise price of \$34.00 per share. The total value of the warrants, of \$6.4 million, has been recorded as deferred compensation and will be expensed over the five-year life of the agreements.

*Interest Income and Expense.* Interest income in the nine months ended September 30, 2000 increased by \$1.7 million, or 256%, to \$2.3 million from \$600,000 in the same period in 1999. This increase resulted primarily from higher average cash and investment securities balances in the nine months ended September 30, 2000 than the average cash and investment securities balances in the same period of the prior year.

Interest expense in the nine months ended September 30, 2000 increased slightly to \$132,600 from \$131,000 in the same period in 1999.

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## 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, contract revenue. At September 30, 2000, the Company had \$52.3 million in cash, cash equivalents and investment securities.

Cash used in operating activities totaled \$16.1 million during the nine months ended September 30, 2000 compared to \$13.7 million during the same period in 1999. Cash used in operating activities during the nine months ended September 30, 2000 includes an increase in restricted cash of \$1.6 million which will be used to fund future payments to Cree, Inc. under the development agreement discussed above. Cash used in operating activities for each period resulted primarily from the net loss for the period.

Cash used in investing activities totaled \$7.2 million during the nine months ended September 30, 2000, compared to \$29.6 million during the same period of 1999. The decrease in cash used in investing activities resulted primarily from investing the proceeds from the redemption of the publicly traded warrants during the nine months ended September 30, 1999.

The Company used \$3.7 million for capital expenditures during the nine months ended September 30, 2000 compared to \$1.6 million during the same period in 1999. 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. The Company expects capital expenditures to continue to increase substantially as the Company continues to expand operations. As of September 30, 2000 the Company had commitments to purchase approximately \$1.0 million in leasehold improvements and additional laboratory equipment, primarily for Lumera.

Cash provided by financing activities totaled \$36.6 million during the nine months ended September 30, 2000, compared to \$46.9 million during the same period in 1999. During the nine months ended September 30, 2000 the Company raised \$36.7 million, net of cost, from the issuance of common stock. The following is a summary of the net proceeds from issuance of common stock during the nine months ended September 30, 2000:

- \$24.0 million, net of issuance costs, from issuance of 500,000 shares of common stock to Cree, Inc. and General Electric Pension Trust,
- \$7.7 million from the exercise of warrants to purchase 437,824 shares of common stock,
- \$1.8 million, net of issuance costs, from the exercise of an option to purchase 100,000 shares of common stock, and
- \$3.2 million from exercise of employee stock options to purchase 318,152 shares of common 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. Nevertheless, the Company expects cash requirements to increase significantly each year as the Company expands its activities and operations to commercialize its technologies.

The Company believes that its cash, cash equivalents and investment securities balances at September 30, 2000 will satisfy its budgeted cash requirements for at least the next 12 months. Actual expenses, however, may be higher 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,
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Respond to competitive pressures, or

- Meet unanticipated development difficulties.

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. 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. 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.

#### **CONSIDERATIONS RELATING TO THE COMPANY'S BUSINESS**

**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 the commercial 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.

**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.

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**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 industry 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 technology and the Optical Materials technology and to introduce new products and features on a cost effective basis in a timely manner to meet evolving customer requirements and compete effectively 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 regulation 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.**

Although we have developed prototype products incorporating the retinal scanning display technology and prototype devices have been built using the Optical Materials technology, we must undertake additional research, development and testing before we are able to produce products for commercial sale. In addition, product development delays or the inability to enter into relationships with potential product development partners may delay or prevent us from introducing commercial products.

**If we are unable to adequately protect our patents and other proprietary technology, 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 (the "University") 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. Although our licensors have patented various aspects of the retinal scanning display technology and applied for patents on various aspects of Optical Materials technology, and although we 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 our products.

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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 devices. These patents could be used as a basis to challenge the validity

of the University's patents, to limit the scope of the University's patent rights or to limit the University's ability to obtain additional or broader patent rights. A successful challenge to the validity of the University's patents 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 or by the University 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, require others and us to cease selling products that incorporate retinal scanning display technology, or 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 currently lack the 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 products.

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

To date, we have produced only prototype products for research, development, and demonstration purposes. The cost per unit for these prototypes currently exceeds the level at which we could expect to profitably sell commercial versions of these products to customers. 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.

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**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. If the University 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 license agreements.

**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 working 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.

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

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

- further develop retinal scanning display technology and Optical Materials technology,
- add manufacturing capacity,
- add to our sales and marketing staff,
- develop and protect our intellectual property rights, or
- fund long-term business development opportunities.

We cannot be certain that we will be able to obtain financing when needed or that we will be able to obtain financing 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 shareholders of common stock. Moreover, 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.

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

Our success depends on our 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, engineering and product development, and manufacturing. Competition for qualified personnel in these fields is intense, and the inability to attract

and retain additional highly skilled personnel, or the loss of key personnel, could reduce our revenues and adversely affect our business.

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

We have had substantial losses since our inception and our operating losses may increase in the future. Accordingly, we cannot assure you that we will ever become or remain profitable.

- As of September 30, 2000, we had an accumulated deficit of \$59.2 million.

- We incurred net losses or net losses available for common shareholders of \$7.1 million from inception through 1995, \$3.5 million in 1996, \$4.9 million in 1997, \$7.3 million in 1998, \$16.7 million in 1999, and \$19.7 million in the nine-month period ended September 30, 2000.

Our revenues to date have been generated from development contracts and sales of engineering prototype units. We do not expect to generate significant revenues from product sales in the near future. 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 prototypes. 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 2001 and possibly thereafter. We cannot be certain that we will become profitable or achieve positive cash flow at any time in the future.

**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 October 17, 2000, we had outstanding:

- options to purchase an aggregate of 2,971,287 shares of common stock,

- warrants to purchase 459,045 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.

**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.

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**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. In addition, we plan to continue to hire a significant number of employees during the next twelve months. The growth in business, headcount 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 expand, train and manage our work force.

**It may be difficult for a third party to acquire the Company 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 when someone attempts to purchase our Company. 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 our Company because the preferred stockholders may use their rights to take value from the Company; and

- provide that written demand of at least 30% of the outstanding capital shares is required to call a special meeting of the shareholders, which may be needed to approve the sale of the Company. The delay that this creates could deter a potential purchaser.

*Additional risk 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. 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 OEMs 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 effect our ability to commercialize the Optical Materials.**

The optical switching market is a highly competitive market. Several companies, many of which have substantially greater financial, technical and other resources than us, are working on competitive 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 OEMs 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

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telecommunications sector, including delays in traffic growth, government regulation or a general economic downturn, could slow or halt our revenue growth.

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

Most 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. As of September 30, 2000, approximately \$27.5 million, or 52%, of the Company's total investment portfolio matures within one year. The Company's portfolio consists of only high-grade government agency securities and commercial paper. Accordingly, the Company believes that its interest rate risk is immaterial. In addition, substantially all of the Company's development contract payments are made in U.S. dollars and, consequently, the Company believes its foreign currency exchange rate risk is immaterial. The Company does not have any derivative instruments and does not engage in hedging transactions.

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**PART II  
OTHER INFORMATION**

**ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS**

On August 10, 2000 the Company issued warrants to purchase an aggregate of 200,000 shares of common stock to Avram Miller and Jacqueline Brandwynne for entering into certain consulting agreements with the Company. The warrants grant each of the holders the right to purchase up to 100,000 shares of common stock at a price of \$34.00 per share. This transaction did not involve a public offering and was exempt from registration under the Securities Act pursuant to Section 4(2) thereof.

**ITEM 6. Exhibits and Reports on Form 8-K**

(a.) Exhibits

- 10.1 Form of Consulting Agreement between Microvision, Inc and Avram Miller and Jacqueline Brandwynne dated August 10, 2000
- 10.2 Form of Common Stock Purchase Warrant issued to Avram Miller and Jacqueline Brandwynne dated August 10, 2000
- 27.0 Financial Data Schedule

(b.) Reports on Form 8-K

The Company filed no current reports on Form 8-K during the quarterly period ended September 30, 2000

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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.

/s/ RICHARD F. RUTKOWSKI

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Richard F. Rutkowski  
President, Chief Executive Officer  
(Principal Executive Officer)

Date: November 13, 2000

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Jeff Wilson  
Controller  
(Principal Accounting Officer)

### 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.

Exhibit Number	Description
10.1	Form of Consulting Agreement between Microvision, Inc and Avram Miller and Jacqueline Brandwynne dated August 10, 2000
10.2	Form of Common Stock Purchase Warrant issued to Avram Miller and Jacqueline Brandwynne dated
27.0	Financial Data Schedule

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**FORM OF  
CONSULTING AGREEMENT**

This Consulting Agreement ("*Agreement*"), dated as of August 10, 2000 (the "*Effective Date*"), is by and between Microvision, Inc., a Washington corporation (the "*Company*"), and (the "*Consultant*").

WHEREAS, the Company desires to enter into a relationship with Consultant pursuant to which Consultant will provide certain business and financial consulting services to the Company, and Consultant is willing to provide such services to the Company;

NOW, THEREFORE, in consideration of the mutual promises and covenants set forth below, and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto agree as follows:

**1. Services to be Provided.**

1.1 *Services.* During the term of this Agreement, Consultant will provide business and financial consulting services to the Company. The consulting services will include but not be limited to advising senior management of the Company on business development strategies, commercialization and application of the Company's technologies, strategic financial matters relating to the Company's financing activities, and strategic business alliances. During the first three years of the term, from time to time (but not less than once per calendar quarter) upon reasonable advance notice, Consultant will make herself reasonably available (in person, by telephone or by e-mail) to senior management for such consulting services. During the last two years of the term and during any Extension Period (as defined in Section 3.1(b)), Consultant will consult (in person, by telephone or by e-mail) with senior management on business and financial matters on a semi-annual basis, unless the parties otherwise mutually agree.

1.2 *Consultant's Other Business Activities.* The Company acknowledges that Consultant's duties to the Company hereunder do not constitute the principal business activity of Consultant. Subject to Consultant's confidentiality and non-disclosure obligations set forth in Section 4 hereof, nothing in this Agreement or in the scope of the obligations of Consultant pursuant hereto shall be deemed or construed to limit or restrict in any way the right of Consultant to engage in any other business activity or activities, which may include activities that are directly or indirectly competitive with the business of the Company.

1.3 *Effect of Consultant's Disability.* Consultant shall not be liable for loss or damage resulting from any delay or non-performance, or be held in breach hereof, in the event that Consultant is unable to provide consulting services hereunder by reason of any medically determinable physical or mental impairment, provided that Consultant gives the Company written notice of such disability and, upon the reasonable request of the Company, evidence thereof.

**2. Compensation and Expense Reimbursement.**

2.1 *Warrant.* In consideration of the execution and delivery of this Agreement by Consultant, upon execution hereof the Company will issue and deliver to Consultant a warrant, in substantially the form attached hereto at *Annex A*, to purchase 100,000 shares of the Company's common stock (the "*Warrant Shares*") at an exercise price of \$34.00 per share (the "*Warrant*").

2.2 *Registration Rights.* The Company shall grant registration rights to Consultant, pursuant to the terms and conditions set forth in that certain Registration Rights Agreement of even date herewith (the "*Registration Rights Agreement*"), with respect to the resale of the Warrant Shares.

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2.3 *Lock-up.* From the Effective Date hereof until the expiration of the applicable lock-up period as set forth below, Consultant will not offer, sell, contract to sell, pledge or otherwise dispose of, directly or indirectly, that number of Warrant Shares as set forth below, or enter into a transaction that would have the same effect, without the prior written consent of the Company (the "*Lock-Up*"):

Number of Warrant Shares Subject to Lock-Up	Lock-Up Period Expiration Date
75,000	June 7, 2001
50,000	June 7, 2002
25,000	June 7, 2003

From and after the expiration of the applicable Lock-Up period, Consultant shall be entitled to sell or otherwise dispose of that number of Warrant Shares that are no longer subject to the Lock-Up (e.g., as of and from June 7, 2001, 50,000 Warrant Shares shall not be subject to the Lock-Up), provided that such sale or other disposition complies with applicable securities laws. Notwithstanding the foregoing, the Lock-Up shall be terminated and of no further force or effect in the event that this Agreement is terminated in the event of Consultant's death or pursuant to Section 3.3(b)(i) hereof.

2.4 *Reimbursable Expenses.* The Company shall reimburse Consultant in accordance with the Company's travel expense policy for reasonable travel and entertainment expenses incurred on Company business in connection with performance of the services contemplated hereby, including but not limited to reimbursement for mileage, first-class airfare, hotel, meals and such other non-travel and entertainment expenses as may be approved in advance by the Company ("*Reimbursable Expenses*").

**3. Term and Termination.**

3.1 *Term.*

(a) This Agreement shall commence on the Effective Date and shall remain in effect for five years, unless extended pursuant to Section 3.1(b) or terminated pursuant to Section 3.3.

(b) If Consultant notifies the Company, in accordance with Section 1.3, that she is unable to provide consulting services by reason of any medically determinable physical or mental impairment, then the term of this Agreement shall be extended for a period equivalent to the period commencing on the date that Consultant so notifies the Company and ending on the date on which Consultant notifies the Company that she is no longer unable to provide consulting services (the "*Extension Period*"); provided, however, that the Extension Period shall not exceed six months for Consultant's cumulative period of disability, regardless of the number of disability notices that Consultant delivers to the Company in accordance with Section 1.3 or the duration of any particular disability period.

3.2 *No Automatic Renewal.* This Agreement will not be subject to any implied or automatic renewals, and any relationship between the parties after the term hereof will be the subject of a new agreement. The parties may extend the term or any subsequent term of this Agreement by executing a separate written agreement of extension.



### 3.3 Termination.

(a) The Company may terminate this Agreement for any reason or for no reason upon thirty days written notice to Consultant.

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(b) This Agreement shall terminate upon Consultant's death. Consultant may terminate this Agreement for "cause" upon thirty days written notice to the Company. For purposes of this Section 3.3(b), "cause" shall mean:

(i) Consultant's permanent and total disability (as defined in Section 22(e)(3) of the Internal Revenue Code of 1986, as amended);

(ii) if the Company (1) ceases to carry on business as a going concern; (2) commences a voluntary case or proceeding, or consents to the entry of an order for relief against it in an involuntary case or proceeding, pursuant to or within the meaning of applicable federal bankruptcy or state insolvency, creditors' rights or similar laws; (3) consents to the appointment under applicable bankruptcy, insolvency, creditors' rights or similar laws of a receiver, trustee, assignee, liquidator, sequestrator or similar official of it or for all or substantially all of its property; or (4) makes a general assignment for the benefit of its creditors;

(iii) if the development or commercialization of microdisplay technologies ceases to constitute a continuing material business of the Company;

(iv) the Company's breach of a material obligation to Consultant under this Agreement, the Warrant, or the Registration Rights Agreement, which breach remains uncured by the Company thirty (30) days after receipt by the Company of notice from Consultant asserting such breach;

(v) the completion of a tender offer, exchange offer, merger, consolidation, reorganization, or other business combination, sale of assets or contested election, or any combination of the foregoing, immediately subsequent to which not less than a majority of the directors of the Company prior to the transaction do not continue to serve as directors of the Company or its successor after the transaction; provided that, if such a transaction occurs during the first three years of the term of this Agreement, then Consultant shall give the Company or its successor not less than ninety days (and not thirty days) written notice of termination; or

(vi) the resignation or termination of Richard F. Rutkowski and Stephen R. Willey as executive officers of the Company.

(c) Consultant shall be entitled to payment for all Reimbursable Expenses incurred up to the date of termination.

(d) Upon termination of this Agreement by the Company pursuant to Section 3.3(a) or by Consultant pursuant to Section 3.3(b), Consultant shall have no further obligation to provide consulting services to the Company and, except as otherwise provided for in Section 12 hereof, shall have no liability to the Company with respect thereto.

### 4. Confidential Information.

In the course of providing services to the Company under this Agreement, Consultant will be exposed to the Company's confidential and proprietary information. Consultant's use of all such Confidential Information (as defined below) of the Company shall be in accordance with this Section 4.

4.1 *Definition of Confidential Information.* "Confidential Information" shall mean any trade secret of the Company or other information relating to the Company, its business or operations (including, but not limited to, any and all pricing, customer, business, financial or technical information, studies, rules, data or analyses, design specifications, and research and development plans), that is disclosed to Consultant by the Company (whether disclosed orally, in writing, or in electronic or other form) during the term of this Agreement. Confidential Information shall not include information that: (i) was

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generally known to the public as of the Effective Date; (ii) becomes generally known to the public after the Effective Date other than as a result of the act or omission of Consultant; (iii) was known to Consultant, without restriction on disclosure, prior to the disclosure thereof by the Company, as demonstrated by contemporaneous written evidence of such prior knowledge; (iv) is disclosed to Consultant by a third party without breach thereby of any confidentiality or non-disclosure obligation to the Company; or (v) is required to be disclosed by statute, regulation, court order, subpoena, request for production of documents, administrative order or other process of law; provided, however, that prior to disclosure under (v) above, Consultant shall notify the Company of the required disclosure, allow the Company adequate opportunity to seek, at the Company's expense, an appropriate protective order, injunction, or waiver of compliance, and disclose only such information as is necessary to comply with the required disclosure.

4.2 *Ownership of Confidential Information.* The Company shall retain all right, title and interest to the Confidential Information, and disclosure thereof by the Company to Consultant shall not be deemed to grant to Consultant any license or right to use the Confidential Information except incidentally in connection with providing services to the Company hereunder.

4.3 *Non-Disclosure Obligation.* Consultant acknowledges the competitive value and confidential nature of the Confidential Information and the damage that could result to the Company if the Confidential Information is disclosed to any third party. Consultant agrees to keep the Confidential Information confidential, to use the Confidential Information solely for the purpose of providing services to the Company as contemplated by this Agreement, and not to use the Confidential Information for Consultant's own purposes or in any manner detrimental to the Company.

4.4 *Security Measures.* Consultant shall protect the Confidential Information with security safeguards at least as great as those to which Consultant accords to her own confidential business information. Consultant may disclose Confidential Information to Consultant's agents on a need-to-know basis, provided that Consultant has first executed appropriate written agreements with such agents sufficient to enable Consultant to comply with this Section 4.

4.5 *Remedy for Breach.* It is understood and agreed that breach of this Section 4 by Consultant would cause irreparable harm to the Company and that money damages would be an inadequate remedy for any such breach. The Company shall be entitled to injunctive or other equitable relief as a remedy for any such breach or threatened breach. Consultant agrees to waive any requirement that the Company be required to post a bond or other security for the granting of any equitable relief. No failure or delay in exercising any right, power or privilege under this Section 4 shall operate as a waiver thereof, nor shall any single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any right, power or privilege hereunder.

4.6 *Post-Termination Obligation.* Not later than thirty (30) days after the expiration of this Agreement or upon termination hereof, Consultant shall return to the Company all tangible embodiments of Confidential Information in Consultant's care, custody or control.

### 5. Indemnification and Relationship of the Parties.

5.1 *Limitation of Liability and Indemnification.* Each party hereto shall indemnify and hold the other (and, with respect to the Company as indemnitee, its directors, officers, agents, employees or subcontractors and, with respect to Consultant as indemnitee, her agents, employees or subcontractors) harmless for losses resulting from and to the extent of its own willful misconduct or gross negligence arising from or incident to the performance of services contemplated by this Agreement. Neither the Company nor Consultant

shall be responsible for any incidental, indirect, consequential, punitive or special damages (including loss of profits or business interruption) sustained by the other.

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## 5.2 Damages for Failure to Provide Consulting Services.

(a) If, during the first three years of the term, Consultant fails to make herself reasonably available (in person, by telephone or by e-mail) to senior management from time to time (but not less once per calendar quarter) upon reasonable advance notice, for consulting services, then the Company shall be entitled to notify Consultant of such failure to perform hereunder. If Consultant continues to fail to make herself reasonably available (in person, by telephone or by e-mail) to senior management within thirty calendar days notice thereof, then Consultant shall deliver to the Company, not more than five business days after expiration of such thirty day period:

(i) that number of Warrants equal to the product of 75,000 (the number of Warrant Shares subject to the Lock-Up as of the Effective Date) and a fraction, the numerator of which shall be the number of calendar days between the date the Company notified Consultant of her failure to perform hereunder and the date of the third annual anniversary of the Effective Date, and the denominator of which shall be 1095 (the number of calendar days in the first three years of the term hereof) (the "*Damages Warrants*"), plus a bank certified or cashier's check in the amount of fifty thousand dollars (\$50,000) (the "*Damages Payment*").

(ii) If Consultant does not own a sufficient number of Warrants to satisfy her obligation to deliver the Damages Warrants to the Company, then, in addition to the Damages Payment, Consultant shall deliver to the Company, not more than five business days after expiration of the thirty day period referenced in Section 5.2(a), (x) all Warrants then-owned by Consultant, and (y) the Adjusted Market Value (as defined below) of that number of shares of common stock of the Company equivalent to the number of Warrant Shares issued (or, if Consultant has transferred Warrants in accordance with the terms thereof, that would have been issuable) upon exercise of that number of Warrants equal to the Damages Warrants less the number of Warrants then-owned by Consultant (such shares of common stock are referred to herein as the "*Damages Shares*").

(b) For purposes of Section 5.2(a)(ii), "*Adjusted Market Value*" means:

(i) the product of (x) the Damages Shares and (y) the closing price of the Company's common stock on the Nasdaq National Market, or such other principal market or exchange on which the Company's common stock may then be listed or traded, on the date on which the Company first notifies Consultant of her non-performance in accordance with Section 5.2(a) (the "*Market Price*");

(ii) less the aggregate exercise price of the Warrants exercised (or, if Consultant has transferred Warrants in accordance with the terms thereof, that would have been exercisable) for the number of shares of common stock that constitute the Damages Shares;

provided that the Consultant shall be entitled to subtract from the Adjusted Market Value the "Tax Cost," as determined herein, of including compensation in income upon exercise (or deemed exercise) of the Warrants and deducting the amount of the repayment of Adjusted Market Value to the Company.

(c) For purposes of Section 5.2(b), the "Tax Cost" shall be determined as follows:

(i) The receipt of income and the repayment of Adjusted Market Value shall be deemed to have occurred in the taxable year of repayment; and

(ii) The Tax Cost shall be the excess of (a) the federal income tax liability of the Consultant for the taxable year of repayment calculated with the income and repayment described in clause (i) above over (b) the federal income tax liability of Consultant for the

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taxable year of repayment calculated without the income and repayment described in clause (i) above.

(iii) In making the calculations described in clause (ii) above, the deduction for the repayment shall be a deduction which is not a "miscellaneous itemized deduction" as defined in Section 67(b) of the Internal Revenue Code of 1986, as amended, if Consultant is advised by her usual tax advisers or, upon the request of Consultant, other tax advisers reasonably selected by the Company, that she has a reasonable reporting position that the deduction is not a "miscellaneous itemized deduction."

The calculation described in clause (ii) shall be provided to the Company for its approval and consent in advance of any subtraction from Adjusted Market Value. If the Company does not approve or consent to, the calculation of Tax Cost, the calculation shall be submitted to a nationally recognized firm of independent certified public accountants (other than the Company's independent auditors) reasonably selected and paid by the Company for a re-determination, consistent with clauses (i), (ii) and (iii) above, which shall be final and binding on Consultant and the Company; provided that, in the event that such re-determination discloses an error in the calculation of Tax Cost that would have resulted in an underpayment of Adjusted Market Value equal to or greater than twenty percent (20%) of the Adjusted Market Value required to be paid to the Company, then Consultant shall reimburse the Company for all reasonable expenses relating to the re-determination.

(d) Consultant may, in her discretion, pay the Adjusted Market Value to the Company (i) by bank certified or cashier's check or (ii) in shares of the Company's common stock (which number of shares shall be equal to the Adjusted Market Value divided by the Market Price).

(e) For purposes of Section 5.2(a), Consultant shall have "failed to make herself reasonably available to senior management of the Company" if, during any particular calendar quarter, she repeatedly and consistently is unavailable to provide consulting services as required pursuant to Section 1.1.

(f) If, during the last two years of the term of this Agreement and any Extension Period, Consultant fails to consult (in person, by telephone or by e-mail) with senior management on business and financial matters on a semi-annual basis, then the Company shall be entitled to notify Consultant of such failure to perform hereunder. If Consultant fails to make herself reasonably available (in person, by telephone or by e-mail) to senior management within thirty calendar days of such notice, then Consultant shall deliver to the Company, not more than five business days after expiration of the thirty day performance period, a bank certified or cashier's check in the amount of fifty thousand dollars (\$50,000), if the failure to perform occurs during the fourth year of the term, or twenty-five thousand dollars (\$25,000), if the failure to perform occurs during the fifth year of the term or any Extension Period.

(g) This Section 5.2 shall constitute the Company's sole remedy for Consultant's failure to perform in accordance with Section 1.1 hereof, provided that the limitations set forth herein shall not affect the Company's right to any insurance proceeds arising as a result of Consultant's non-performance under Section 1.1. This Section 5.2 reflects the negotiated agreement of the parties, and Consultant's liability under Section 5.2 is intended to be proportional to the actual harm that the Company would incur in the event of Consultant's non-performance under Section 1.1.

5.3 *Relationship of Parties.* The Company and Consultant agree that Consultant shall perform services hereunder as an independent contractor and that Consultant shall retain control over and responsibility for her own operations and personnel, if any. Nothing herein shall create any partnership, agency, employment or similar relationship between the parties. Consultant will not, by reason of this

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Agreement, be entitled to participate in workers' compensation, retirement, insurance or any benefit under any Company benefit or other employee plan. The Company will not withhold or pay any income or payroll taxes on behalf of Consultant. Neither party, nor their principals or employees, shall have authority to contract in the name of or bind the other, except as expressly agreed to in writing by the parties.

#### **6. Publicity.**

Consultant shall permit the Company to use her name in press releases announcing her relationship with the Company, subject to Consultant's review and approval of the text of any proposed press release.

#### **7. Notices.**

All notices, requests, and other communications hereunder shall be deemed to be duly given if hand delivered or sent by overnight courier with guaranteed next day delivery, by confirmed facsimile transmission, or by U.S. mail, postage prepaid, return receipt requested, addressed to the other party at the address as set forth below:

To the Company:	Microvision, Inc. Attn: Richard Raisig 19910 North Creek Parkway Bothell, WA 98011-3008 Fax: (425) 481-1625
With a copy to:	Stoel Rives, LLP Attn: Christopher J. Voss One Union Square, Suite 3600 600 University Street Seattle, Washington 98101-3197 Fax: (206) 386-7500
To Consultant:	
With a copy to:	Squadron, Ellenoff, Plesent & Sheinfeld, LLP Attn: Jeffrey W. Rubin 551 Fifth Avenue New York, NY 10176 Fax: (212) 697-6686

Any notice or other communication hereunder shall be effective upon actual delivery. Either party may change the address or facsimile number to which notices for such party shall be addressed by providing notice of such change to the other party in the manner set forth in this Section 7.

#### **8. Applicable Law and Forum.**

This Agreement shall be governed by the laws of the State of Washington, without giving effect to its conflicts of law rules. Jurisdiction and venue for any action or proceeding hereunder shall lie in the state and federal courts located in Seattle, Washington. The parties expressly agree that all claims in respect of any such action or proceeding may be heard and determined in any such court and Consultant waives any defense of inconvenient forum to the maintenance of any action or proceeding so brought.

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#### **9. Severability.**

If one or more provisions of this Agreement are held to be unenforceable under applicable law, such provision shall be excluded from this Agreement and the balance of the Agreement shall be interpreted as if such provision were so excluded and shall be enforceable in accordance with its terms.

#### **10. Waiver and Remedies.**

No waiver of any term or condition of this Agreement shall be effective unless set forth in a written instrument duly executed by or on behalf of the party waiving such term or condition. No waiver by any party of any term or condition of this Agreement, in any one or more instances, shall be deemed to be or construed as a waiver of the same or any other term or condition of this Agreement on any future occasion. All remedies, either under this Agreement, by law or otherwise afforded, will be cumulative and not alternative.

#### **11. No Third Party Beneficiary.**

The terms and provisions of this Agreement are intended solely for the benefit of the parties hereto and their respective successors or permitted assigns, and it is not the intention of the parties to confer third-party beneficiary rights upon any other person or entity.

#### **12. Survival.**

The provisions of Sections 2.3 (except upon termination hereof pursuant to Section 3.3(b)(i)), 2.4, 4, 5.1, 5.2, 8 and 13 hereof shall survive expiration or termination of this Agreement.

#### **13. Attorneys' Fees.**

If any legal action or any arbitration or other proceeding is brought for the enforcement or interpretation of this Agreement, the Warrant, or the Registration Rights Agreement, or because of an alleged dispute, breach, default or misrepresentation in connection with or related to this Agreement, the Warrant, or the Registration Rights Agreement, the successful or prevailing party shall be entitled to recover reasonable attorneys' fees and other costs in connection with that action or proceeding, in addition to any other relief to which a party may be entitled, including those incurred on appeal or in bankruptcy proceedings.

#### **14. Assignment.**

Consultant acknowledges that the services to be rendered are unique and may not be assigned by Consultant without the prior written consent of the Company. This

Agreement will inure to the benefit of and be binding upon the parties and their permitted assigns and successors.

**15. Entire Agreement and Amendments.**

This Agreement, including *Annex A* hereto, and the Registration Rights Agreement, contain the entire agreement of the parties relating to the subject matter hereof. This Agreement shall terminate and supersede any prior written or oral agreements or understandings between the parties regarding the subject matter hereof. Any amendments or modifications to this Agreement must be in writing and executed by the party against whom enforcement is sought.

**16. Counterparts.**

This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, but all of which together shall constitute the same instrument.

IN WITNESS WHEREOF, each of the parties has duly executed this Agreement as of the date above written.

**Microvision, Inc.**

**Consultant**

By:

\_\_\_\_\_

Its:

SSN#:

\_\_\_\_\_

**QuickLinks**

[FORM OF CONSULTING AGREEMENT](#)

**FORM OF  
MICROVISION, INC.  
a Washington corporation**

**COMMON STOCK PURCHASE WARRANT**

Certificate No.

THESE WARRANTS HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT OF 1933, AS AMENDED (THE "ACT"), OR APPLICABLE STATE SECURITIES LAWS. THESE WARRANTS ARE "RESTRICTED SECURITIES" AS DEFINED IN RULE 144 UNDER THE ACT AND MAY NOT BE TRANSFERRED IN THE ABSENCE OF AN EFFECTIVE REGISTRATION STATEMENT UNDER THE ACT AND ANY APPLICABLE STATE SECURITIES LAWS OR AN OPINION OF COUNSEL ACCEPTABLE TO THE COMPANY AND ITS COUNSEL THAT SUCH REGISTRATION IS NOT REQUIRED.

This is to certify that, for value received and subject to the terms and conditions set forth below, Microvision, Inc., a Washington corporation (the "Company"), promises and agrees to sell and issue to consultant, or registered assigns, up to a total of 100,000 fully paid and nonassessable shares of Common Stock, at any time up to and until 5:00 p.m., Seattle, Washington time, on August 10, 2010, upon surrender, at the principal office of the Company referred to below, of this Warrant Certificate, a duly completed and executed Notice of Exercise in the form attached hereto, and payment therefor in lawful money of the United States at the Exercise Price as set forth in Section 1.3 below.

This Warrant Certificate is issued subject to the following terms and conditions:

1. *Definitions of Certain Terms.* Except as may be otherwise clearly required by the context, the following terms have the following meanings:

1.1 "Common Stock" means the common stock, no par value, of the Company.

1.2 "Company" means Microvision, Inc., a Washington corporation.

1.3 "Exercise Price" means \$34.00 per share or such other price at which a Warrantholder may purchase one share of Common Stock or other Securities upon exercise of Warrants, as determined from time to time pursuant to the provisions hereof.

1.4 "Securities" means the securities issued or issuable upon exercise of the Warrants or securities issued or issuable upon exercise, exchange, or conversion of such securities.

1.5 "Warrant Certificate" means a certificate evidencing Warrants.

1.6 "Warrantholder" means a record holder of Warrants or Securities.

1.7 "Warrants" means the warrants evidenced by this warrant certificate or any similar certificate issued in replacement of any such certificate.

2. *Exercise of Warrants.* All or any part of the Warrants evidenced by this Certificate may be exercised by surrendering this Warrant Certificate and the Notice of Exercise attached hereto, duly completed and executed by the Warrantholder or by his or her duly authorized attorney-in-fact, at the office of the Company, 19910 North Creek Parkway, Bothell, WA 98011-3008, or at such other office or agency as the Company may designate, accompanied by payment in U.S. funds in full, in cash or certified or cashier's check, of the Exercise Price payable with respect to the Warrants being exercised. Subject to the terms and conditions of this Warrant Certificate, the Company will, within five business days after said surrender and payment and completion of such Notice of Exercise by the Warrantholder, make arrangements with its stock transfer agent to send to the Warrantholder at the address specified in the Notice of Exercise a certificate or certificates evidencing the Securities

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subscribed for. If fewer than all the Warrants evidenced by this Warrant Certificate are exercised, the Company will, upon such exercise, execute and deliver to the Warrantholder a new Warrant Certificate (dated the date hereof), in form and tenor similar to this Warrant Certificate, evidencing the Warrants not exercised. The Securities to be issued on exercise of the Warrants will be deemed to have been issued, and any person exercising the Warrants will be deemed to have become a holder of record of those Securities, as of the close of business on the date of its surrender for exercise as provided above. The securities laws of the United States may require that a registration statement registering the Securities to be issued on exercise of the Warrants be effective, or that an exemption from registration be available, before the Company may issue the Securities to the Warrantholder. The Company will use its best efforts to take such actions under the Act and the laws of various states and other jurisdictions as may be required to cause the issuance of Securities upon exercise of Warrants to comply with applicable securities laws. However, the Company will not be required to honor the exercise of Warrants if, in the opinion of the Company's Board of Directors, upon advice of counsel, the issuance of Securities upon such exercise would be unlawful. In such event, the Company may elect to redeem Warrants submitted for exercise for a price equal to the difference between (i) the closing price of the Securities on the date of submission of the Notice of Exercise of Warrants, as reported by the principal exchange or market upon or through which the Securities are then principally traded or quoted (the "Exchange") and (ii) the Exercise Price of the Securities subscribed for in the Notice of Exercise of Warrants submitted to the Company. In the event of such redemption, the Company will pay to the Warrantholder the above-described redemption price within ten business days after the Warrantholder's submission of the Notice of Exercise of Warrants.

3. *Adjustments in Certain Events.* The number, class and price of Securities for which the Warrants may be exercised are subject to adjustment from time to time upon the happening of certain events as follows:

3.1 If the outstanding shares of Common Stock are divided into a greater number of shares or a dividend in stock is paid on the Common Stock, the number of shares of Common Stock for which the Warrants are then exercisable will be proportionately increased and the Exercise Price will be proportionately reduced. Conversely, if the outstanding shares of Common Stock are combined into a smaller number of shares of Common Stock, the number of shares of Common Stock for which the Warrants are then exercisable will be proportionately reduced and the Exercise Price will be proportionately increased. The increases and reductions provided for in this Section 3.1 will be made with the intent and, as nearly as practicable, the effect that neither the percentage of the total equity of the Company obtainable on exercise of the Warrants nor the price payable for such percentage upon such exercise will be affected by any event described in this Section 3.1.

3.2 In case of any change in the Common Stock through merger, consolidation, reclassification, reorganization, partial or complete liquidation, or other change in the capital structure of the Company, then, as a condition of the change in the capital structure of the Company, lawful and adequate provision will be made so that the holder of this Warrant Certificate will have the right thereafter to receive upon the exercise of the Warrants the kind and amount of shares of stock or other securities or property to which he would have been entitled if, immediately prior to such merger, consolidation, reclassification, reorganization, recapitalization, or other change in the capital structure, the Warrantholder had held the number of shares of Common Stock obtainable upon the exercise of the Warrants. In such event, the Exercise Price will be proportionately adjusted. In any such case, appropriate adjustment will be made in the application of the provisions set forth herein with respect to the rights and

interest thereafter of the Warrantholder, to the end that the provisions set forth herein will thereafter be applicable, as nearly as reasonably may be, in relation to any shares of stock or other property thereafter deliverable upon the exercise of the Warrants. The Company will not permit any change in its

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capital structure to occur unless the issuer of the shares of stock or other securities to be received by the holder of this Warrant Certificate, if not the Company, agrees to be bound by and comply with the provisions of this Warrant Certificate.

3.3 When any adjustment is required to be made in the number of shares of Common Stock, other securities or the property purchasable upon exercise of the Warrants, the Company will promptly determine the new number of such shares or other securities or property purchasable upon exercise of the Warrants and (i) prepare and retain on file a statement describing in reasonable detail the method used in arriving at the new number of such shares or other securities or property purchasable upon exercise of the Warrants and (ii) cause a copy of such statement to be mailed to the Warrantholder within 30 days after the date when the event giving rise to the adjustment occurred.

3.4 No fractional shares of Common Stock or other Securities will be issued in connection with the adjustment of any Warrants, but the Company will pay, in lieu of fractional shares, a cash payment therefor on the basis of the closing price of the Securities as reported by the Exchange on the day immediately prior to the effective date of the adjustment.

4. *Reservation of Securities.* The Company agrees that the number of shares of Common Stock and other Securities sufficient to provide for the exercise of the Warrants upon the basis set forth above will at all times during the term of the Warrants be reserved for exercise.

5. *Validity of Securities; Transfer Taxes.* All Securities delivered upon the exercise of the Warrants in accordance with their terms will be duly and validly issued, fully-paid and non-assessable, and will be free and clear of any lien, pledge, security interest, claim, charges, encumbrance or other restriction or limitation (except with respect to restrictions on transfer under applicable securities laws) imposed on them by the Company. The Company will pay all documentary and transfer taxes, if any, in respect of the original issuance thereof upon exercise of the Warrants.

6. *Legending of Securities.* All certificates representing Securities delivered upon the exercise of the Warrants shall be impressed with a legend indicating that the Securities are not registered under the Act and reciting that the transfer thereof is restricted, such legend to be in a form acceptable to counsel for the Company.

7. *Transfer Prohibited.* The Warrants and all rights hereunder may not be transferred or assigned without the prior written approval of the Company; provided that, such approval shall not be unreasonably withheld or delayed with respect to a proposed transfer or assignment of Warrants exercisable for not less than 10,000 Securities that are not subject to a Lock-Up, as such term is defined in that certain Consulting Agreement, dated as of August 10, 2000, between \_\_\_\_\_ and the Company; and provided further that the Warrants may be transferred or assigned to the immediate family members (including grandchildren, nieces, and nephews) of the Warrantholder or to trusts or other entities for the sole benefit thereof without the Company's prior written approval, provided that the Warrantholder complies with applicable securities laws in effecting such a disposition. Except as provided for in the immediately preceding sentence, any transfer effected without the prior written approval of the Company shall be void.

8. *No Rights as a Shareholder.* Except as otherwise provided herein, the Warrantholder will not, by virtue of ownership of Warrants, be entitled to any rights as a shareholder of the Company.

9. *Ownership.* The Company, and its Transfer Agent, and any agent of the Company or its Transfer Agent may treat the bearer of this Warrant Certificate as the absolute owner of the Warrants evidenced hereby for the purpose of exercising the Warrants and for all other purposes whatsoever, and notwithstanding any notice of ownership or writing thereon, or any notice of previous loss or theft or other interest therein.

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10. *Replacement of Warrant Certificate.* On receipt of evidence reasonably satisfactory to the Company of the loss, theft, destruction or mutilation of this Warrant Certificate and, in the case of loss, theft or destruction, on delivery of an indemnity agreement reasonably satisfactory in form and substance to the Company or, in the case of mutilation, on surrender and cancellation of this Warrant Certificate, the Company at its expense shall execute and deliver, in lieu of this Warrant Certificate, a new Warrant Certificate of like tenor and amount.

11. *Notice.* Any notices required or permitted to be given hereunder may be given in writing personally or by mail or other comparable delivery service at the address determined below or at such other address as the party receiving notice has theretofore furnished to the notifying party:

If to the Company:

19910 North Creek Parkway  
P.O. Box 3008  
Bothell, WA 98011-3008  
Attn: Secretary

If to the Warrantholder:

at the address furnished by the Warrantholder  
in such Warrantholder's Notice of Exercise.

Any notice given by mail will be deemed effectively given 48 hours after mailing when deposited in the United States mail, registered or certified mail, return receipt requested, postage prepaid and addressed as specified above. Any notice given by courier or other comparable form of delivery service will be deemed effectively given at the date and time recorded for such delivery in the records of the delivery service.

12. *Applicable Law.* This Certificate will be governed by and construed in accordance with the laws of the State of Washington, without giving effect to the conflict of laws thereof.

Dated as of

MICROVISION, INC.

By:

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Richard A. Raisig  
Chief Financial Officer

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**Microvision, Inc.  
Common Stock Purchase Warrant**

**NOTICE OF EXERCISE**

To: Microvision, Inc.

(1) The undersigned hereby irrevocably exercises the right to purchase \_\_\_\_\_ shares of the common stock of Microvision, Inc., a Washington corporation, pursuant to Section 2 of the attached Warrant, and tenders herewith full payment of the exercise price for such shares.

(2) In exercising this Warrant, the undersigned hereby confirms and acknowledges that the shares of common stock to be issued upon exercise hereof are being acquired solely for the account of the undersigned and not as a nominee for any other party, and for investment, and that the undersigned will not offer, sell or otherwise dispose of any such shares of common stock acquired upon exercise of the attached Warrant except under circumstances that will not result in a violation of the Securities Act of 1933, as amended, or any applicable state securities laws.

(3) Please issue a certificate or certificates representing said shares of common stock in the name of the undersigned or in such other name(s) as is(are) specified below:

\_\_\_\_\_

(Name)

(4) Please issue a new Warrant representing any unexercised portion of the attached Warrant in the name of the undersigned or in such other name(s) as is(are) specified below:

\_\_\_\_\_

(Name)

\_\_\_\_\_

(Date)

\_\_\_\_\_

(Signature of Holder)

\_\_\_\_\_

(Address)

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(Address)

**QuickLinks**

[COMMON STOCK PURCHASE WARRANT](#)

<TABLE> <S> <C>

<ARTICLE> 5

<LEGEND>

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS OF MICROVISION, INC., NINE MONTH PERIOD ENDED SEPTEMBER 30, 2000 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

</LEGEND>

<S>	<C>
<PERIOD-TYPE>	9-MOS
<FISCAL-YEAR-END>	DEC-31-2000
<PERIOD-START>	JAN-01-2000
<PERIOD-END>	SEP-30-2000
<CASH>	16,061,200
<SECURITIES>	33,078,800
<RECEIVABLES>	596,400
<ALLOWANCES>	(87,000)
<INVENTORY>	0
<CURRENT-ASSETS>	54,462,100
<PP&E>	8,444,400
<DEPRECIATION>	(2,157,400)
<TOTAL-ASSETS>	62,825,100
<CURRENT-LIABILITIES>	6,194,500
<BONDS>	0
<PREFERRED-MANDATORY>	0
<PREFERRED>	0
<COMMON>	122,826,500
<OTHER-SE>	(67,019,900)
<TOTAL-LIABILITY-AND-EQUITY>	62,825,100
<SALES>	0
<TOTAL-REVENUES>	5,256,000
<CGS>	0
<TOTAL-COSTS>	4,068,300
<OTHER-EXPENSES>	22,985,400
<LOSS-PROVISION>	27,000
<INTEREST-EXPENSE>	(2,136,200)
<INCOME-PRETAX>	(19,688,500)
<INCOME-TAX>	0
<INCOME-CONTINUING>	(19,688,500)
<DISCONTINUED>	0
<EXTRAORDINARY>	0
<CHANGES>	0
<NET-INCOME>	(19,688,500)
<EPS-BASIC>	(1.75)
<EPS-DILUTED>	(1.75)

</TABLE>