

U.S. SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE
SECURITIES EXCHANGE ACT OF 1934.
For the quarterly period ended March 31, 2001

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____.

Commission File Number 0-21221

MICROVISION, INC.

(Exact Name of Registrant as Specified in Its Charter)

Washington
(State or Other Jurisdiction of Incorporation
or organization)

91-1600822
(I.R.S. Employer Identification No.)

19910 North Creek Parkway, Bothell, Washington 98011-3008
(Address of Principal Executive Offices)

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

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

As of April 30, 2001, 11,960,834 shares of the Company's common stock, no par value, were outstanding.

PART I
FINANCIAL INFORMATION

Item 1 - Financial Statements(unaudited)

[Consolidated Balance Sheet as of March 31, 2001 and December 31, 2000](#)

[Consolidated Statement of Operations for the three months ended March 31, 2001 and 2000](#)

[Consolidated Statement of Comprehensive Loss for the three months ended March 31, 2001 and 2000](#)

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Microvision, Inc.

Consolidated Balance Sheet
(In thousands)

March 31,
2001

December 31,
2000

(unaudited)

Assets		
Current Assets		
Cash and cash equivalents	\$22,290	\$7,307
Investment securities, available-for-sale	31,784	33,410
Accounts receivable, net of allowances of \$104 and \$93	1,181	1,033
Costs and estimated earnings in excess of billings on uncompleted contracts	1,075	2,116
Current restricted investments	-	1,125
Other current assets	2,575	976
Total current assets	58,905	45,967
Long-term investment, at cost	624	624
Property and equipment, net	7,523	7,516
Restricted investments	903	951
Receivables from related parties	1,520	1,000
Other assets	2,099	114
Total assets	\$71,574	\$56,172
Liabilities And Shareholders' Equity		
Current Liabilities		
Accounts payable	\$1,346	\$1,974
Accrued liabilities	3,402	2,359
Allowance for estimated contract losses	250	295
Billings in excess of costs and estimated earnings on uncompleted contracts	73	419
Current portion of capital lease obligations	289	317
Current portion of long-term debt	53	52
Total current liabilities	5,413	5,416
Capital lease obligations, net of current portion	118	182
Long-term debt, net of current portion	276	290
Deferred rent, net of current portion	246	242
Total liabilities	6,053	6,130
Commitments and contingencies	-	-
Minority interest	20,765	-
Shareholders' Equity		
Common stock and paid-in capital, no par value, 31,250 shares authorized; 11,938 and 11,884 shares issued and outstanding	124,396	120,506
Deferred compensation	(3,723)	(4,378)
Subscriptions receivable from related parties	(347)	(403)
Accumulated other comprehensive income	787	454
Accumulated deficit	(76,357)	(66,137)
Total shareholders' equity	44,756	50,042
Total liabilities, mandatorily redeemable convertible preferred stock and shareholders' equity	\$71,574	\$56,172

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

Microvision, Inc.

Consolidated Statement of Operations
(In thousands, except earnings per share data)
(unaudited)

Three months ended March 31,

2001	2000
Revenue	\$2,110

Revenue	\$2,337	\$2,110
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Cost of revenue	1,562	1,468
Gross margin	775	642
Research and development expense (exclusive of non-cash compensation expense of \$10 and \$3 for the three months ended March 31, 2001 and 2000, respectively)	8,067	3,596
Marketing, general and administrative expense (exclusive of non-cash compensation expense of \$453 and \$151 for the three months ended March 31, 2001 and 2000, respectively)	3,701	2,340
Non-cash compensation expense	463	154
Total operating expenses	12,231	6,090
Loss from operations	(11,456)	(5,448)
Interest income	706	452
Interest expense	(24)	(77)
Loss before minority interests	(10,774)	(5,073)
Minority interests in loss of consolidated subsidiary	554	-
Net loss	\$(10,220)	\$(5,073)
Net loss per share - basic and diluted	\$(0.86)	\$(0.48)
Weighted-average shares outstanding - basic and diluted	11,917	10,469

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

Microvision, Inc.

Consolidated Statement of Comprehensive Loss

(In thousands)
(unaudited)

	Three months ended March 31,	
	2001	2000
Net loss	\$(10,774)	\$(5,073)
Other comprehensive income (loss) -		
Unrealized gain (loss) on investment securities, available-for-sale	333	(3)
Comprehensive loss	\$(10,441)	\$(5,076)

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

Microvision, Inc.

Consolidated Statement of Cash Flows

(In thousands)
(unaudited)

	Three months ended March 31,	
	2001	2000
Cash flows from operating activities		
Net loss	\$(10,220)	\$(5,073)

Adjustments to reconcile net loss to net cash used in operations		
Depreciation	507	241
Non-cash expenses related to issuance of stock, warrants, options and amortization of deferred compensation	1,526	154
Minority interests in loss of consolidated subsidiary	(554)	-
Non-cash deferred rent	4	15
Allowance for estimated contract losses	(45)	-
Change in		
Accounts receivable	(148)	(696)
Costs and estimated earnings in excess of billings on uncompleted contracts	1,041	978
Other current assets	(597)	67
Receivables from related parties	(520)	-
Other assets	(71)	126
Accounts payable	(628)	(510)
Accrued liabilities	1,043	336
Billings in excess of costs and estimated earnings on uncompleted contracts	(346)	35
Net cash used in operating activities	(9,008)	(4,327)
Cash flows from investing activities		
Sales of investment securities	2,000	7,999
Purchases of investment securities	(41)	(5,348)
Sales of restricted investment securities	1,173	650
Purchases of property and equipment	(514)	(346)
Net cash provided by investing activities	2,618	2,955
Cash flows from financing activities		
Principal payments under capital leases	(92)	(51)
Principal payments under long-term debt	(13)	(11)
Payments received on subscriptions receivable	56	56
Net proceeds from issuance of common stock	175	2,310
Net proceeds from sale of subsidiary's equity to minority interests	21,247	-
Net cash provided by financing activities	21,373	2,304
Net increase in cash and cash equivalents	14,983	932
Cash and cash equivalents at beginning of period	7,307	2,798
Cash and cash equivalents at end of period	\$22,290	\$3,730

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

Microvision, Inc.

Consolidated Statement of Cash Flows (Continued)

(In thousands)
(unaudited)

Three months ended March 31,

2001 2000

Supplemental disclosure of cash flow information		
Cash paid for interest	\$24	\$77

Supplemental schedule of non-cash investing and financing activities

Property and equipment acquired under capital leases	\$-	\$33
Conversion of preferred stock to common stock	\$-	\$1,536

Payment for exclusive license agreement by issuance of common stock	\$971	\$377
Issuance of subsidiary common stock for exclusive license agreement	\$3,001	\$-
Exercise of stock options for subscriptions receivable	\$-	\$285
Deferred compensation - warrants, options and stock grants	\$(257)	\$182
Unrealized gain (loss) in investment securities, available-for-sale	\$333	\$(3)

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

MICROVISION, INC.
Notes to Consolidated Financial Statements
March 31, 2001

Management's Statement

The Consolidated Balance Sheet as of March 31, 2001, the Consolidated Statements of Operations, Cash Flows and Comprehensive Loss for the three months ended March 31, 2001, and March 31, 2000, 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 March 31, 2001 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, 2000. The results of operations for the three months ended March 31, 2001 are not necessarily indicative of the operating results that may be attained for the entire fiscal year.

Principles of Consolidation

The consolidated financial statements of the Company include the accounts of its majority owned subsidiary, Lumera Corporation ("Lumera"). 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 March 31, 2001 and March 31, 2000 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 March 31,	
	2001	2000
Numerator:		
Net loss available for common shareholders	\$(10,220)	\$(5,073)
Denominator:		
Basic and diluted weighted-average common shares outstanding	11,916,600	10,469,200
Basic and diluted net loss per share	\$ (.86)	\$ (.48)

As of March 31, 2001 and 2000, the Company had outstanding options and warrants to purchase 3,681,000 and 3,040,000 shares of common stock, respectively.

Equity

In March 2000, Lumera raised \$21,360,000 before issuance cost, from the issuance of 2,136,000 shares of mandatorily redeemable convertible preferred stock (the "Preferred Stock"). In addition, Lumera issued 264,000 shares of preferred stock to Microvision to retire \$2,640,000 of intercompany debt. The shares are convertible to an equal number of shares of Lumera Class A Common Stock.

Segment Information

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

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

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

	Three months ended March 31, 2001			
	Microvision	Lumera	Elimination	Total
Revenues	\$2,321	\$16	\$-	\$2,337
Interest revenue	1,017	43	(354)	706
Interest expense	24	354	(354)	24
Depreciation	360	147	-	507
Segment loss	7,922	2,852	(554)	10,220
Segment assets	55,252	23,493	(7,171)	71,574
Expenditures for capital assets	358	156	-	514

New Accounting Pronouncements

The Company adopted SFAS No. 133 "Accounting for Derivatives and Hedging Activities" in the quarter ended March 31, 2001. The adoption of this standard did not have a material impact on the Company's financial positions, results of operations or cash flows.

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

Forward-Looking Statements

The information set forth in this report in Item 2, "Management's Discussion and Analysis of Financial Condition and Results of Operations," and Item 3, "Quantitative and Qualitative Disclosure about Market Risk," includes "forward-looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and is subject to the safe harbor created by that section. Such statements may include, but are not limited to, projections of revenues, income or loss, capital expenditures, plans for product development and cooperative arrangements, future operations, financing needs or plans of the Company, as well as assumptions relating to the foregoing. The words "believe," "expect," "anticipate," "estimate," "project," and similar expressions identify forward-looking statements, which speak only as of the date the statement was made. Certain factors that realistically could cause results to differ materially from those projected in the forward-looking statements are set forth below under the caption "Considerations Relating to the Company's Business."

Overview

Microvision, Inc. ("Microvision" or the "Company") develops information display and related technologies that allow electronically generated images and information to be projected onto a viewer's eye. In 2000, the Company defined three distinct business platforms relating to the delivery of images and information in this manner:

- Retinal Scanning Displays - Utilizing the retinal scanning display technology to display information on the viewer's retina.
- Imaging Solutions – Utilizing proprietary scanning technology and the retinal scanning display technology to capture images and information.
- Optical Materials - Utilizing a new class of organic non-linear chromophore materials ("Optical Materials") technology to transmit information using light.

Retinal Scanning Displays

The Company has developed prototype retinal scanning display technology devices, including portable color and monochrome versions and a full color table-top version, and is currently refining and developing its retinal scanning display technology for defense, medical, industrial and consumer applications. The Company expects to commercialize its technology through the development of products and as a supplier of personal display technology to OEMs. The Company believes the retinal scanning display technology will be useful in a variety of applications, including portable communications and visual simulation that include applications requiring the superimposing of images onto the user's field of vision. The Company expects that its retinal scanning display technology will allow for the production of highly miniaturized, lightweight, battery-operated displays that can be held or worn comfortably.

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

Imaging Solutions

The Company has increased its efforts to develop products that capture images, such as bar code readers or miniature high resolution cameras, using the retinal scanning display technology and other proprietary technology. The Company believes that the basic components of the retinal scanning display system can be used to develop bar code readers or miniature high resolution cameras that have higher performance and lower cost than those currently available. The Company has developed proprietary scanner technology, which it plans to use in a low cost hand held bar code scanner targeted at consumer applications. The hand held bar code device would allow consumers to record information using the bar code reader. The user could then connect the bar code reader to a personal computer to retrieve more information from the internet. The bar code reader could be used to make purchases from a catalog, pay bills, or retrieve additional information about a product. In 2000, the Company built a prototype bar code scanner using this technology. During 2001, the Company plans to continue to refine the design of the hand held scanner and introduce the device for the consumer market in 2002.

Optical Materials

During 2000, the Company formed a subsidiary company, Lumera Corporation ("Lumera"), to develop and commercialize the Optical Materials technology and devices that utilize the properties of these proprietary materials. The subsidiary is an outgrowth of the Company's on-going work in photonics. In October 2000, Lumera entered into an exclusive license agreement with the University of Washington for certain technology relating to the Optical Materials. Lumera expects that the Optical Materials and devices made from Optical Materials will improve the performance and reduce the cost of electro-optic components used for fiber-optic telecommunications and data communications systems, phased-array antennas, optical computing and other photonics applications.

Plan of Operation

The Company plans to introduce a production version of a retinal scanning display in 2001. To support the product introduction, the Company has produced engineering prototypes of the commercial product. These prototypes are being used by our sales and marketing groups to demonstrate the technology to future potential customers and to obtain customer feedback (See Considerations Relating to the Company's Business).

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.

In addition, the Company plans to continue to pursue, obtain and perform on development contracts. The Company expects that such contracts will further the development of the retinal scanning display technology and lead to additional 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 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 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 MARCH 31, 2001 COMPARED TO THREE MONTHS ENDED MARCH 30, 2000

Contract Revenue. The Company earns revenue from performance on development contracts and sales of engineering prototypes. Contract revenue in the three months ended March 31, 2001 increased by \$200,000, or 11%, to \$2.3 million from \$2.1 million in the same period in 2000. For the three months ended March 31, 2001, all revenue was derived from performance on development contracts. The Company's customers include both the United States government and commercial enterprises.

The backlog of development contracts and product sales at March 31, 2001 was \$9.6 million of the work and product shipments, all of which, are scheduled for completion during the next twelve months.

Cost of Revenue. Cost of revenue includes both the direct and allocated 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 for the three months ended March 31, 2001 increased by \$100,000, or 6%, to \$1.6 million from \$1.5 million in the same period in 2000. The increase is attributable to higher direct cost and offset by lower overhead cost allocation to cost of revenue in the three months ended March 31, 2001 than in the same period in 2000. The higher level of direct cost is attributable to the timing and structure of the performance on development contracts. Research and development overhead is allocated to cost of revenue and research and product development expense based on the relative direct labor cost incurred in cost of revenue and research and product development respectively. The lower overhead allocation to cost of revenue is due to a higher portion of work performed on (and related overhead allocated to) research and product development.

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 and the cost of future product sales. 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 and planned future product shipments.

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 March 31, 2001 increased by \$4.5 million, or 124%, to \$8.1 million from \$3.6 million in the same period in 2000. 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 February 2001, the Company acquired a fully paid exclusive license for the "HALO" technology from the University of Washington. This technology involves the projection of data and images onto the inside of a dome that is placed over the viewer's head. The Company issued 37,000 shares of Common Stock valued at \$1.0 million and paid \$100,000 to the University of Washington for the license.

In March 2001, Lumera paid \$200,000 to the University of Washington for an exclusive royalty-bearing license relating to the Optical Material technology. In addition Lumera issued 802,414 shares of Class A Common Stock to the University of Washington pursuant to a Sponsored Research Agreement (the "Research Agreement"). The total value of the stock of \$3.0 million will be amortized over the three-year life of the Research Agreement. The total amortization expense relating to the Research Agreement during the three months ended March 31, 2001 was \$92,000. In addition, in March 2001, Lumera paid \$750,000, of which \$250,000 was recognized as expense during the three months end March 31, 2001, to the University of Washington as the first quarterly payment for the Optical Materials Research Agreement. Lumera is required to make additional equal quarterly payments to the University of Washington over the three-year term of the Research Agreement. Total research and product development expense for Lumera was approximately \$1.8 million during the three months ended March 31, 2001.

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,
- Acquiring rights to additional technologies,
- Subcontracting work to development partners, and
- Incurring related operating expenses

The Company expects that the amount of spending on research and product development will continue to grow, compared to prior years, in future quarters as the Company:

- Continues development of the Company's retinal scanning display technology,
- Develops and commercializes the Optical Materials technology,
- Prepares for the planned introduction of the Company's first commercial product in late 2001,

- Accelerates development of microdisplays to meet emerging market opportunities,
- Expands the Company's investment in bar code reader development, and
- Pursues other potential business opportunities.

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

Marketing, general and administrative expenses in the three months ended March 31, 2001 increased by \$1.4 million, or 58%, to \$3.7 million from \$2.3 million in the same period in 2000. The increase includes increases in compensation expenses and support costs for employees and contractors. The Company expects marketing, general and administrative expenses to increase substantially in future periods as the Company:

- Adds to its sales and marketing staff,
- 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 March 31, 2001 increased by \$310,000 or 207% to \$460,000 from \$150,000 in the same period in 2000. 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.
- The amortization of the excess of fair market value over the strike price for shares issued to employees and the Board of Directors

Non-cash compensation expense in 2001 includes the cost of two five-year consulting agreements that the Company entered into with two independent consultants in August 2000 to provide strategic business and financial consulting services. Compensation expense of approximately \$200,000 related to these agreements was recorded in the three months ended March 31, 2001.

Interest Income and Expense. Interest income in the three months ended March 31, 2001 increased by \$250,000, or 56%, to \$700,000 from \$450,000 in the same period in 2000. This increase resulted primarily from higher average cash and investment securities balances in the three months ended March 31, 2001 than the average cash and investment securities balances in the same period of the prior year.

Interest expense in the three months ended March 31, 2001 was consistent with the same period in 2000.

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 March 31, 2001, the Company had \$54.1 million in cash, cash equivalents and investment securities.

Cash used in operating activities totaled \$9.0 million during the three months ended March 31, 2001 compared to \$4.3 million during the same period in 2000. Cash used in operating activities for each period resulted primarily from the net loss for the period.

Cash provided by investing activities totaled \$2.6 million during the three months ended March 31, 2001, compared to \$3.0 million during the same period of 2000. The decrease resulted from less activity in the Company's available-for-sale investment security portfolio.

The Company used \$500,000 for capital expenditures during the three months ended March 31, 2001 compared to \$300,000 during the same period in 2000. 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.

Cash provided by financing activities totaled \$21.4 million during the three months ended March 31, 2001, compared to \$2.3 million during the same period in 2000. During the three months ended March 31, 2001 Lumera raised \$21.4 million, before issuance costs, from the issuance of 2,136,000 shares of mandatorily redeemable convertible preferred stock.

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

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

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 March 31, 2001 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,
- 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.

New Accounting Pronouncements

The Company adopted SFAS No. 133 "Accounting for Derivatives and Hedging Activities" in the quarter ended March 31, 2001. The adoption of this standard did not have a material impact on the Company's financial positions results of operations or cash flows.

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.

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

The electronic information display industry and the optical switching industries have been characterized by rapidly changing technology, accelerated product obsolescence and continuously evolving industry standards. Our success will depend upon our ability to further develop the retinal scanning display 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 regulations that could increase our development and production costs.

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

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

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 and our other licensors to maintain the proprietary nature of the retinal scanning display and related technologies. We also rely on proprietary Optical Materials technology licensed from the University of Washington. Although our licensors have patented 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.

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

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

We are aware of several patents held by third parties that relate to certain aspects of retinal scanning displays. These patents could be used as a basis to challenge the validity of the University of Washington's patents, to limit the scope of the University of Washington's patent rights or to limit the University of Washington's ability to obtain additional or broader patent rights. A successful challenge to the validity of the University of Washington'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 of Washington 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 technology that we are

able to produce.

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

To date, we have produced 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.

If we lose the exclusive use of the Virtual Retinal Display technology or the Optical Materials technology, our business operations and prospects would be adversely affected.

We acquired the exclusive rights to the Virtual Retinal Display technology and the Optical Materials technology under exclusive license agreements with the University of Washington. If the University of Washington were to violate the terms of the license agreements by providing the technology to another company, our business, operations and prospects would be adversely affected. In addition, we could lose the exclusivity under the license agreement if we fail to challenge, within the designated time limits, claims that other companies are using the Virtual Retinal Display technology in violation of our 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, OEMs and other third parties. We cannot be certain that we will be able to negotiate arrangements on acceptable terms, if at all, or that these arrangements will be successful in yielding commercially viable products. If we cannot establish these arrangements, we would require additional capital to undertake such activities on our own and would require extensive manufacturing, sales and marketing expertise that we do not currently possess and that may be difficult to obtain. In addition, we could encounter significant delays in introducing the retinal scanning display technology or find that the development, manufacture or sale of products incorporating the retinal scanning display technology would not be feasible. To the extent that we enter into cooperative development, sales and marketing or other joint venture arrangements, our revenues will depend upon the efforts of third parties. We cannot be certain that any such arrangements will be successful.

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, research and product development, and manufacturing. Competition for qualified personnel in these fields is intense, and the inability to attract and retain additional highly skilled personnel, or the loss of key personnel, could reduce our revenues and adversely affect our business.

We 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 March 31, 2001, we had an accumulated deficit of \$76.4 million.
- We incurred net losses of \$22.9 million from inception through 1998, \$16.7 million in 1999, \$26.6 million in 2000, and \$10.2 million during the three months ended March 31, 2001.

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 2001, and possibly thereafter. 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 likely 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 April 30, 2001, we had outstanding:

- options to purchase an aggregate of 3,158,000 shares of Microvision common stock, and
- warrants to purchase 463,000 shares of Microvision 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.

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, head count 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. Many companies, with 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 the telecommunications market could represent a significant portion of our future revenues. Developments that adversely affect the telecommunications sector, including delays in traffic growth, government regulation or a general economic downturn, could slow or halt our revenue growth.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Substantially all of the Company's cash equivalents and investment securities are at fixed interest rates and, as such, the fair value of these instruments is affected by changes in market interest rates. Due to the generally short-term maturities of these investment securities, the Company believes that the market risk arising from its holdings of these financial instruments is not significant. A one-percent change in market interest rates would have approximately a \$341,000 impact on the fair value of the investment securities.

Presently, all of the Company's development contract payments are made in U.S. dollars and, consequently, the Company believes it has no foreign currency exchange rate risk. However, in the future the Company may enter into development contracts in foreign currencies which may subject the Company to foreign exchange rate risk. The Company does not have any derivative instruments and does not presently engage in hedging transactions.

The weighted average maturities of cash equivalents and investment securities, available-for-sale, as of March 31, 2001, are as follows.

	Amount	Percent
Cash	\$19,967	37.0%
Less than one year	13,585	25.1%
One to two years	18,014	33.3%
Two to three years	2,508	4.6%
	\$54,074	100.0%

ITEM 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- 10.1 Independent Director Stock Option Plan, as amended.
- 10.2 Investor Right's Agreement, dated as of March 14, 2001 by and between Lumera Corporation and certain investors.

(b) Reports on Form 8-K

The Company filed one current report on Form 8-K for the event of March 14, 2001 during the quarterly period ended March 31, 2001.

SIGNATURES

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

MICROVISION, INC.

Date: May 14, 2001

/s/ Richard F. Rutkowski

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

Date: May 14, 2001

/s/ Jeff Wilson

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
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10.1	Independent Director Stock Option Plan, as amended.
10.2	Investor Right's Agreement, dated as of March 14, 2001 by and between Lumera Corporation and certain investors.

MICROVISION, INC.

INDEPENDENT DIRECTOR STOCK OPTION PLAN

MICROVISION, INC. INDEPENDENT DIRECTOR STOCK OPTION PLAN

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

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

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

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

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

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

3. **Stock Subject to This Plan.** Subject to adjustment as provided below and in Section 9 hereof, the stock subject to this Plan shall be the Common Stock, and the total number of shares of Common Stock to be delivered on the exercise of all options granted under this Plan shall not exceed 150,000 shares as such Common Stock was constituted on the date on which this Plan was first adopted by the Board of Directors as set forth on the last page hereof. If any option granted under this Plan expires, is surrendered, exchanged for another option,

canceled or terminated for any reason without having been exercised in full, the unpurchased shares subject thereto shall again be available for purposes of this Plan, including for replacement options that may be granted in exchange for such surrendered, canceled or terminated options. Shares issued on exercise of options granted under this Plan may be subject to restrictions on transfer, repurchase rights or other restrictions as determined by the Plan Administrator.

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

5. Independent Director Stock Options.

5.1 Awards. The Plan Administrator shall grant to each Independent Director an option to purchase 5,000 shares of Common Stock on the date upon which he or she is elected, re-elected or appointed to the Board of Directors of the Company.

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

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

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

5.5 Termination of Options.

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

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

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

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

7. Exercise.

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

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

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

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

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

9. Adjustments On Changes in Capitalization.

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

9.2 Effect of Certain Events.

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

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

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

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

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

10. Securities Regulations.

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

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

11. Amendment and Termination.

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

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

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

12. Miscellaneous.

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

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

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

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

Plan adopted by the Board of Directors on February 16, 2000.

Plan approved by the shareholders on June 22, 2000.

Plan amended by the Board of Directors on October 19, 2000.

Plan amended by the Board of Directors on February 13, 2001.

LUMERA CORPORATION
INVESTORS' RIGHTS AGREEMENT

MARCH 14, 2001

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LUMERA CORPORATION
INVESTORS' RIGHTS AGREEMENT

This Investors' Rights Agreement (the "[Agreement](#)") is made as of the 14 day of March, 2001, by and among Lumera Corporation, a Washington corporation (the "[Company](#)") and the investors listed on [Exhibit A](#) hereto, each of which is herein referred to as an "[Investor](#)."

RECITALS

WHEREAS, the Company and certain Investors have entered into a Series A Preferred Stock Purchase Agreement (the "[Purchase Agreement](#)") of even date herewith pursuant to which the Company desires to sell to such Investors and such Investors desire to purchase from the Company shares of the Company's Series A Preferred Stock;

WHEREAS, a condition to the Investors' obligations under the Purchase Agreement is that the Company and the Investors enter into this Agreement in order to provide the Investors with (i) certain rights to register shares of the Company's Class A Common Stock issuable upon conversion of the Series A Preferred Stock held by the Investors, (ii) certain rights to receive or inspect information pertaining to the Company, and (iii) a right of participation with respect to certain issuances by the Company of its securities; and

WHEREAS, the Company desires to induce certain of the Investors to purchase shares of Series A Preferred Stock pursuant to the Purchase Agreement by agreeing to the terms and conditions set forth herein.

NOW, THEREFORE, in consideration of the mutual promises, representations, warranties, covenants and conditions set forth in this Agreement and in the Purchase Agreement, the parties hereto agree as follows:

1. **Registration Rights. The Company and the Investors covenant and agree as follows:**

1.1 **Definitions . For purposes of this Section 1:**

(a) The terms "[register](#)," "[registered](#)," and "[registration](#)" refer to a registration effected by preparing and filing a registration statement or similar document in compliance with the Securities Act of 1933, as amended (the "[Securities Act](#)"), and the declaration or ordering of effectiveness of such registration statement or document;

(b) The term "[Registrable Securities](#)" means (i) the shares of Class A Common Stock issuable or issued upon conversion of the Series A Preferred Stock

purchased pursuant to the Purchase Agreement and (ii) any other shares of Class A Common Stock of the Company issued as (or issuable upon the conversion or exercise of any warrant, right or other security which is issued as) a dividend or other distribution with respect to, or in exchange for or in replacement of, the shares listed in (i); provided, however, that the foregoing definition shall exclude in all cases any Registrable Securities sold by a person in a transaction in which his or her rights under this Agreement are not assigned. Notwithstanding the foregoing, Class A Common Stock or other securities shall only be treated as Registrable Securities if and so long as they have not been (A) sold to or through a broker or dealer or underwriter in a public distribution or a public securities transaction, or (B) sold in a transaction exempt from the registration and prospectus delivery requirements of the Securities Act under Section 4(l) thereof or Rule 144 thereunder so that all transfer restrictions, and restrictive legends with respect thereto, if any, are removed upon the consummation of such sale;

(c) The number of shares of “Registrable Securities then outstanding” shall be determined by the number of shares of Class A Common Stock outstanding which are, and the number of shares of Class A Common Stock issuable pursuant to then exercisable or convertible securities which are, Registrable Securities;

(d) The term “Holder” means any person owning or having the right to acquire Registrable Securities or any assignee thereof in accordance with Section 1.12 of this Agreement;

(e) The term “Form S-3” means such form under the Securities Act as in effect on the date hereof or any successor form under the Securities Act;

(f) The term “SEC” means the Securities and Exchange Commission; and

(g) The term “Qualified IPO” means a firm commitment underwritten public offering by the Company of shares of its Common Stock pursuant to a registration statement under the Securities Act, with a public offering price per share of not less than \$10 and which results in aggregate cash proceeds to the Company of an amount equal to or greater than \$20,000,000 (net of underwriting discounts and commissions).

1.2 Request for Registration

(a) If the Company shall receive at any time after the earlier of (i) March __, 2004 or (ii) six (6) months after the effective date of the first registration statement for a public offering of securities of the Company (other than a registration statement relating either to the sale of securities to employees of the Company pursuant to a stock option, stock purchase or similar plan approved by the Board of Directors of the Company or an SEC Rule 145 transaction approved by the Board of Directors of the Company), a written request from the Holders of at least 30% of the Registrable Securities then outstanding that the Company file a registration statement under the Securities Act covering the registration of not less than 30% of the Registrable Securities then outstanding with an anticipated aggregate gross offering price of at least \$10,000,000, then the Company shall, within ten (10) days of the receipt thereof, give written notice of such request to all Holders and shall, subject to the limitations of subsection 1.2(b), use reasonable efforts to effect as soon as practicable, and in any event within 90 days of the receipt of such request, the registration under the Securities Act of all Registrable Securities which the Holders request to be registered within fifteen (15) days of the mailing of such notice by the Company in accordance with Section 3.3. Subject to the limitations of this Section 1.2, the Company may also include shares of its capital stock in such registration.

(b) If the Holders initiating the registration request hereunder (“Initiating Holders”) intend to distribute the Registrable Securities covered by their request by means of an underwriting, they shall so advise the Company as a part of their request made pursuant to this Section 1.2 and the Company shall include such information in the written notice referred to in subsection 1.2(a). The underwriter will be selected by a majority in interest of the Initiating Holders and shall be reasonably acceptable to the Company. In such event, the right of any Holder to include his Registrable Securities in such registration shall be conditioned upon such Holder’s participation in such underwriting and the inclusion of such Holder’s Registrable Securities in the underwriting (unless otherwise mutually agreed by a majority in interest of the Initiating Holders and such Holder) to the extent provided herein. All Holders proposing to distribute their securities through such underwriting shall (together with the Company as provided in subsection 1.5(e)) enter into an underwriting agreement in customary form with the underwriter or underwriters selected for such underwriting. Notwithstanding any other provision of this Section 1.2, if the underwriter advises the Initiating Holders in writing that marketing factors require a limitation of the number of shares to be underwritten, then the Initiating Holders shall so advise all Holders of Registrable Securities which would otherwise be underwritten pursuant hereto, and the number of shares of Registrable Securities that may be included in the underwriting shall be allocated among all Holders thereof, including the Initiating Holders, in proportion (as nearly as practicable) to the amount of Registrable Securities of the Company owned by each Holder; provided, however, that the number of shares of Registrable Securities to be included in such underwriting shall not be reduced unless all other securities are first entirely excluded from the underwriting; provided, further, that notwithstanding the foregoing, if the University of Washington (the “University”) requests pursuant to the Restricted Stock Purchase Agreement dated October 20, 2000 between the University and the Company to include in a registration pursuant to this Section 1.2 shares of the Company’s Class A Common Stock held by the University (the “UW Shares”), the number of securities to be registered in such registration shall be allocated to each Holder and the University in proportion (as nearly as practicable) to the amount of the Company’s securities held by each Holder exercising its rights hereunder and the University (so long as, in a registration subsequent to the Company’s initial public offering, the number of UW Shares is not reduced below twenty percent (20%) of the number of securities to be registered in such registration.

(c) Notwithstanding the foregoing, if the Company shall furnish to Holders requesting a registration statement pursuant to this Section 1.2, a certificate signed by the President of the Company stating that in the good faith judgment of the Board of Directors of the Company, the filing would interfere with a material financing, corporate reorganization, acquisition, merger, consolidation or other material fact or event, the Company shall have the right to defer such filing for a period of not more than ninety (90) days after receipt of the request of the Initiating Holders; provided, however, that the Company may not utilize this right more than once in any twelve-month period.

(d) In addition, the Company shall not be obligated to effect, or to take any action to effect, any registration pursuant to this Section 1.2:

(i) After the Company has effected two (2) registrations pursuant to this Section 1.2 and such registrations have been declared or ordered effective;

(ii) During the period starting with the date sixty (60) days prior to the Company’s good faith estimate of the date of filing of, and ending on a date one hundred eighty (180) days after the effective date of, a registration subject to Section 1.3 hereof; provided that the Company is in good faith using reasonable efforts to cause such registration statement to become effective; or

(iii) If the Initiating Holders propose to dispose of shares of Registrable Securities that may be immediately registered on Form S-3 pursuant to a request made pursuant to Section 1.4 below.

1.3 Company Registration . After the Company’s initial public offering, if (but without any obligation to do so) the Company proposes to register (including for this purpose a registration effected by the Company for shareholders other than the Holders) any of its stock under the Securities Act in connection with the public offering of such securities solely for cash (other than a registration relating solely to the sale of securities to participants in a Company stock plan approved by the Board of Directors of the Company or a transaction covered by Rule 145 under the Securities Act approved by the Board of Directors of the Company, a registration in which the only stock being registered is Common Stock issuable upon conversion of debt securities which are also being registered, or any registration on any form which does not include substantially the same information as would be required to be included in a registration statement covering the sale of the Registrable Securities), the Company shall, at such time, promptly give each Holder written notice of such registration. Upon the written request of each

Holder given within twenty (20) days after mailing of such notice by the Company in accordance with Section 3.3, the Company shall, subject to the provisions of Section 1.8, cause to be registered under the Securities Act all of the Registrable Securities that each such Holder has requested to be registered. If a Holder decides not to include any or all of its Registrable Securities in any registration statement filed by the Company, such holder shall nevertheless continue to have the right to include any Registrable Securities in any subsequent registration statement or statements as may be filed by the Company with respect to offerings of its securities, all upon the terms and conditions set forth herein.

1.4 Form S-3 Registration . In case the Company shall receive from any Holder or Holders a written request or requests that the Company effect a registration on Form S-3, with an anticipated aggregate gross offering price of not less than \$2,000,000, and any related qualification or compliance with respect to all or a part of the Registrable Securities owned by such Holder or Holders, the Company will:

(a) promptly give written notice of the proposed registration, and any, related qualification or compliance, to all other Holders; and

(b) as soon as practicable, effect such registration, up to one (1) per year, and all such qualifications and compliances as may be so requested and as would permit or facilitate the sale and distribution of all or such portion of such Holder's or Holders' Registrable Securities as are specified in such request, together with all or such portion of the Registrable Securities of any other Holder or Holders joining in such request as are specified in a written request given within twenty (20) days after receipt of such written notice from the Company; provided, however, that the Company shall not be obligated to effect any such registration, qualification or compliance, pursuant to this Section 1.4: (i) if Form S-3 is not available for such offering by the Holders; (ii) if the Holders, together with the holders of any other securities of the Company entitled to inclusion in such registration, propose to sell Registrable Securities and such other securities (if any) at an aggregate gross price to the public of less than \$2,000,000; (iii) if the Company shall furnish to the Holders a certificate signed by the President of the Company stating that in the good faith judgment of the Board of Directors of the Company, the filing would interfere with a material financing, corporate reorganization, acquisition, merger, consolidation or other material fact or event, in which event the Company shall have the right to defer the filing of the Form S-3 registration statement for a period of not more than 90 days after receipt of the request of the Holder or Holders under this Section 1.4; provided, however, that the Company shall not utilize this right more than once in any twelve month period; (iv) if the Company has, within the twelve (12) month period preceding the date of such request, already effected one registration on Form S-3 for the Holders pursuant to this Section 1.4; (v) in any particular jurisdiction in which the Company would be required to qualify to do business or to execute a general consent to service of process in effecting such registration, qualification or compliance, and in which the Company is not already qualified to do business or subject to service of process; or (vi) during the period ending one hundred eighty (180) days after the effective date of (x) a registration statement filed pursuant to Section 1.2 or a registration statement subject to Section 1.3 or (y) the registration statement for the Company's initial public offering.

(c) Subject to the foregoing, the Company shall file a registration statement covering the Registrable Securities and other securities so requested to be registered as soon as practicable after receipt of the request or requests of the Holders. Registrations effected pursuant to this Section 1.4 shall not be counted as demands for registration or registrations effected pursuant to Sections 1.2 or 1.3, respectively.

1.5 Obligations of the Company. Whenever required under this Section 1 to effect the registration of any Registrable Securities, the Company shall, as expeditiously as reasonably possible:

(a) Prepare and file with the SEC a registration statement with respect to such Registrable Securities and use reasonable efforts to cause such registration statement to become effective, and, upon the request of the Holders of a majority of the Registrable Securities registered thereunder, keep such registration statement effective for up to ninety (90) days. The Company shall not be required to file, cause to become effective or maintain the effectiveness of any registration statement that contemplates a distribution of securities on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, except for registrations pursuant to Section 1.4; provided, however, that the Company will only be required to keep such registration statement effective for up to ninety (90) days.

(b) Prepare and file with the SEC such amendments and supplements to such registration statement and the prospectus used in connection with such registration statement as may be necessary to comply with the provisions of the Securities Act with respect to the disposition of all securities covered by such registration statement for up to ninety (90) days.

(c) Furnish to the Holders such numbers of copies of a prospectus, including a preliminary prospectus, in conformity with the requirements of the Securities Act, and such other documents as they may reasonably request in order to facilitate the disposition of Registrable Securities owned by them.

(d) Use reasonable efforts to register and qualify the securities covered by such registration statement under such other securities or Blue Sky laws of such jurisdictions as shall be reasonably requested by the Holders, provided that the Company shall not be required in connection therewith or as a condition thereto to qualify to do business or to file a general consent to service of process in any such states or jurisdictions, and in which the Company is not already qualified to do business or subject to service of process.

(e) In the event of any underwritten public offering, enter into and perform its obligations under an underwriting agreement, in usual and customary form, with the managing underwriter of such offering. Each Holder participating in such underwriting shall also enter into and perform its obligations under such an agreement.

(f) Notify each Holder of Registrable Securities covered by such registration statement at any time when a prospectus relating thereto is required to be delivered under the Securities Act of the happening of any event as a result of which the prospectus included in such registration statement, as then in effect, includes an untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein not misleading in the light of the circumstances then existing, such obligation to continue for ninety (90) days.

(g) Cause all such Registrable Securities registered pursuant hereunder to be listed on each securities exchange or over-the-counter market on which similar securities issued by the Company are then listed.

(h) Provide a transfer agent and registrar for all Registrable Securities registered pursuant hereunder and a CUSIP number for all such Registrable Securities, in each case not later than the effective date of such registration.

(i) Use reasonable efforts to furnish, at the request of any Holder requesting registration of Registrable Securities pursuant to this Section 1, on the date that such Registrable Securities are delivered to the underwriters for sale in connection with a registration pursuant to this Section 1, being sold through underwriters, (i) an opinion, dated such date, of the counsel representing the Company for the purposes of such registration, in form and substance as is customarily given to underwriters in an underwritten public offering, addressed to the underwriters, and to the Holders requesting registration of Registrable Securities and (ii) a letter dated such date, from the independent certified public accountants of the Company, in form and substance as is customarily given by independent certified public accountants to underwriters in an underwritten public offering, addressed to the underwriters and to the Holders requesting registration of Registrable Securities.

1.6 Furnish Information . It shall be a condition precedent to the obligations of the Company to take any action pursuant to this Section 1 with respect

to the Registrable Securities of any selling Holder that such Holder shall furnish to the Company such information regarding itself, the Registrable Securities held by it, and the intended method of disposition of such securities as shall be required to effect the registration of such Holder's Registrable Securities. The Company shall have no obligation with respect to any registration requested pursuant to Section 1.2 or Section 1.4 of this Agreement if, as a result of the application of the preceding sentence, the number of shares or the anticipated aggregate offering price of the Registrable Securities to be included in the registration does not equal or exceed the number of shares or the anticipated aggregate offering price required to originally trigger the Company's obligation to initiate such registration as specified in subsection 1.2(a) or section 1.4, whichever is applicable.

1.7 Expenses of Registration.

(a) **Demand Registration.** All expenses other than underwriting discounts and commissions incurred in connection with registrations, filings or qualifications pursuant to Section 1.2, including (without limitation) all registration, filing and qualification fees, printers' and accounting fees, fees and disbursements of counsel for the Company, and the reasonable and documented fees and disbursements of one counsel for the selling Holders selected by them not to exceed \$15,000 shall be borne by the Company; provided, however, that the Company shall not be required to pay for any expenses of any registration proceeding begun pursuant to Section 1.2 if the registration request is subsequently withdrawn at the request of the Holders of a majority of the Registrable Securities to be registered and the Company is in compliance with this Agreement (in which case all participating Holders shall bear all such reasonable expenses in proportion to the number of shares for which registration was requested), unless the Holders of a majority of the Registrable Securities agree to forfeit their right to one demand registration pursuant to Section 1.2; provided further, however, that if at the time of such withdrawal, the Holders have learned of a material adverse change in the condition, results, business, or prospects of the Company that would adversely affect the offering and have withdrawn the request with reasonable promptness following disclosure by the Company of such material adverse change, then the Holders shall not be required to pay any of such expenses and shall retain their rights pursuant to Section 1.2.

(b) **Company Registration.** All expenses other than underwriting discounts and commissions incurred in connection with registrations, filings or qualifications of Registrable Securities pursuant to Section 1.3 for each Holder, including (without limitation) all registration, filing, and qualification fees, printers' and accounting fees, fees and disbursements of counsel for the Company and the reasonable and documented fees and disbursements of one counsel for the selling Holder or Holders selected by them not to exceed \$15,000 shall be borne by the Company.

(c) **Registration on Form S-3.** All expenses incurred in connection with registrations requested pursuant to Section 1.4, including (without limitation) all registration, filing, qualification, printers' and accounting fees and the reasonable and documented fees and disbursements of one counsel for the selling Holder or Holders selected by them not to exceed \$15,000 and counsel for the Company, and any underwriters' discounts or commissions associated with Registrable Securities, shall be borne by the Company.

1.8 Underwriting Requirements. In connection with any offering involving an underwriting of shares of the Company's capital stock, the Company shall not be required under Section 1.3 to include any of the Holders' securities in such underwriting unless they accept the usual and customary terms of the underwriting as agreed upon between the Company and the underwriters selected by it (or by other persons entitled to select the underwriters), and then only in such quantity as the underwriters determine in their sole discretion will not jeopardize the success of the offering by the Company. If the total amount of securities, including Registrable Securities, requested by shareholders to be included in such offering exceeds the amount of securities to be sold, other than by the Company, that the underwriters determine in their sole discretion is compatible with the success of the offering, then the Company shall be required to include in the offering only that number of such securities, including Registrable Securities, which the underwriters determine in their sole discretion will not jeopardize the success of the offering (the securities so included to be apportioned pro rata among the selling shareholders according to the total amount of securities entitled to be included therein owned by each selling shareholder or in such other proportions as shall mutually be agreed to by such selling shareholders) but in no event shall (i) any shares being sold by a shareholder exercising a demand registration right similar to that granted in Section 1.2 be excluded from such offering; (ii) or any securities held by an officer or director of the Company (or an affiliate thereof, other than Microvision, Inc. or the University of Washington) be included if any securities held by any selling Holder are excluded; provided, however, that in a registration subsequent to the Company's initial public offering the number of UW Shares is not reduced below twenty percent (20%) of the number of securities to be registered in such registration. For purposes of the preceding parenthetical concerning apportionment, for any selling shareholder which is a holder of Registrable Securities and which is a partnership or corporation, the partners, retired partners and shareholders of such holder, or the estates and family members of any such partners and retired partners and any trusts for the benefit of any of the foregoing persons shall be deemed to be a single "selling shareholder," and any pro-rata reduction with respect to such "selling shareholder" shall be based upon the aggregate amount of shares carrying registration rights owned by all entities and individuals included in such "selling shareholder," as defined in this sentence.

1.9 Delay of Registration . No Holder shall have any right to obtain or seek an injunction restraining or otherwise delaying any such registration as the result of any controversy that might arise with respect to the interpretation or implementation of this Section 1.

1.10 Indemnification . In the event any Registrable Securities are included in a registration statement under this Section 1:

(a) To the extent permitted by law, the Company will indemnify and hold harmless each Holder, any underwriter (as defined in the Securities Act) for such Holder and each person, if any, who controls such Holder or underwriter within the meaning of the Securities Act or the Securities Exchange Act of 1934, as amended (the "Exchange Act"), against any losses, claims, damages, or liabilities (joint or several) to which they may become subject under the Securities Act, the Exchange Act or other federal or state law, insofar as such losses, claims, damages, or liabilities (or actions in respect thereof) arise out of or are based upon any of the following statements, omissions or violations (each, a "Violation"): (i) any untrue statement or alleged untrue statement of a material fact contained in such registration statement, including any preliminary prospectus or final prospectus contained therein or any amendments or supplements thereto, (ii) the omission or alleged omission to state therein a material fact required to be stated therein, or necessary to make the statements therein not misleading, or (iii) any violation or alleged violation by the Company of the Securities Act, the Exchange Act, any state securities law or any rule or regulation promulgated under the Securities Act, the Exchange Act or any state securities law; and the Company will pay to each such Holder, underwriter or controlling person, as incurred, any legal or other expenses reasonably incurred by them in connection with investigating or defending any such loss, claim, damage, liability, or action; provided, however, that the indemnity agreement contained in this subsection 1.10(a) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability, or action if such settlement is effected without the consent of the Company (which consent shall not be unreasonably withheld), nor shall the Company be liable to any Holder, underwriter or controlling person for any such loss, claim, damage, liability, or action to the extent that it arises out of or is based upon a Violation which occurs in reliance upon and in conformity with written information furnished expressly for use in connection with such registration by any such Holder, underwriter or controlling person.

(b) To the extent permitted by law, each selling Holder will indemnify and hold harmless the Company, each of its directors, each of its officers who has signed the registration statement, each person, if any, who controls the Company within the meaning of the Securities Act, any underwriter, any other Holder selling securities in such registration statement and any controlling person of any such underwriter or other Holder, against any losses, claims, damages, or liabilities (joint or several) to which any of the foregoing persons may become subject, under the Securities Act, the Exchange Act or other federal or state law, insofar as such losses, claims, damages, or liabilities (or actions in respect thereto) arise out of or are based upon any Violation, in each case to the extent (and only to the extent) that such Violation occurs in reliance upon and in conformity with written information furnished by such Holder expressly for use in connection with such registration; and each such Holder will pay, as incurred, any legal or other expenses reasonably incurred by any person indemnified pursuant to this subsection 1.10(b), in connection with investigating or defending any such loss, claim, damage, liability, or action; provided, however, that the indemnity agreement contained in this subsection 1.10(b) shall not apply to amounts paid in settlement of any such loss, claim, damage, liability or action if such settlement is effected without the consent of the Holder, which consent shall not be unreasonably withheld; provided, that in no event shall any indemnity under this subsection 1.10(b) exceed the net proceeds from the offering received by such Holder, except in the case of fraud by such Holder.

(c) Promptly after receipt by an indemnified party under this Section 1.10 of notice of the commencement of any action (including any governmental action), such indemnified party will, if a claim in respect thereof is to be made against any indemnifying party under this Section 1.10, deliver to the indemnifying party a written notice of the commencement thereof and the indemnifying party shall have the right to participate in, and, to the extent the indemnifying party so desires, jointly with any other indemnifying party similarly noticed, to assume the defense thereof with counsel mutually satisfactory to the parties; provided, however, that an indemnified party (together with all other indemnified parties which may be represented without conflict by one counsel) shall have the right to retain one separate counsel, with the reasonable and documented fees and expenses to be paid by the indemnifying party, if representation of such indemnified party by the counsel retained by the indemnifying party would be inappropriate due to actual or potential differing interests between such indemnified party and any other party represented by such counsel in such proceeding. The failure to deliver written notice to the indemnifying party within a reasonable time of the commencement of any such action, if prejudicial to its ability to defend such action, shall relieve such indemnifying party of any liability to the indemnified party under this Section 1.10, but the omission so to deliver written notice to the indemnifying party will not relieve it of any liability that it may have to any indemnified party otherwise than under this Section 1.10.

(d) If the indemnification provided for in this Section 1.10 is held by a court of competent jurisdiction to be unavailable to an indemnified party with respect to any loss, liability, claim, damage or expense referred to therein, then the indemnifying party, in lieu of indemnifying such indemnified party hereunder, shall contribute to the amount paid or payable by such indemnified party as a result of such loss, liability, claim, damage, or expense in such proportion as is appropriate to reflect the relative fault of the indemnifying party on the one hand and of the indemnified party on the other in connection with the statements or omissions that resulted in such loss, liability, claim, damage or expense as well as any other relevant equitable considerations; provided, that in no event shall any contribution by a Holder under this subsection 1.10(d) exceed the net proceeds from the offering received by such Holder, except in the case of fraud by such Holder. The relative fault of the indemnifying party and of the indemnified party shall be determined by reference to, among other things, whether the untrue or alleged untrue statement of a material fact or the omission to state a material fact relates to information supplied by the indemnifying party or by the indemnified party and the parties' relative intent, knowledge, access to information, and opportunity to correct or prevent such statement or omission.

(e) Notwithstanding the foregoing, to the extent that the provisions on indemnification and contribution contained in the underwriting agreement entered into in connection with the underwritten public offering are in conflict with the foregoing provisions, the provisions in the underwriting agreement shall control.

(f) The obligations of the Company and Holders under this Section 1.10 shall survive the completion of any offering of Registrable Securities in a registration statement and the termination of this Agreement.

1.11 Reports Under Securities Exchange Act of 1934 With a view to making available to the Holders the benefits of Rule 144 promulgated under the Securities Act and any other rule or regulation of the SEC that may at any time permit a Holder to sell securities of the Company to the public without registration or pursuant to a registration on Form S-3, the Company agrees to:

(a) make and keep public information available, as those terms are understood and defined in SEC Rule 144, at all times after ninety (90) days after the effective date of the first registration statement filed by the Company for the offering of its securities to the general public so long as the Company remains subject to the periodic reporting requirements under Sections 13 or 15(d) of the Exchange Act;

(b) take such action, including the voluntary registration of its Common Stock under Section 12 of the Exchange Act, as is necessary to enable the Holders to utilize Form S-3 for the sale of their Registrable Securities, such action to be taken as soon as practicable after the end of the fiscal year in which the first registration statement filed by the Company for the offering of its securities to the general public is declared effective;

(c) file with the SEC in a timely manner all reports and other documents required of the Company under the Securities Act and the Exchange Act; and

(d) furnish to any Holder, so long as the Holder owns any Registrable Securities, forthwith upon request (i) a written statement by the Company that it has complied with the reporting requirements of SEC Rule 144 (at any time after ninety (90) days after the effective date of the first registration statement filed by the Company), the Securities Act and the Exchange Act (at any time after it has become subject to such reporting requirements), or that it qualifies as a registrant whose securities may be resold pursuant to Form S-3 (at any time after it so qualifies), (ii) a copy of the most recent annual or quarterly report of the Company and such other reports and documents so filed by the Company, and (iii) such other information as may be reasonably requested in availing any Holder of any rule or regulation of the SEC which permits the selling of any such securities without registration or pursuant to such form.

1.12 Assignment of Registration Rights. The rights to cause the Company to register Registrable Securities pursuant to this Section 1 may be assigned (but only with all related obligations) by a Holder (i) to parent corporation of or a subsidiary of such Holder or (ii) any trust for the benefit of the Holder or a spouse or family member or (iii) to a transferee or assignee of at least 500,000 shares of such securities, provided the Company is, within a reasonable time after such transfer, furnished with written notice of the name and address of such affiliate, transferee or assignee and the securities with respect to which such registration rights are being assigned, provided such transferee shall agree to be subject to all restrictions set forth in this Agreement; and provided, further, that such assignment shall be effective only if immediately following such transfer the further disposition of such securities by the transferee or assignee is restricted under the Securities Act. For the purposes of determining the number of shares of Registrable Securities held by a transferee or assignee, the holdings of transferees and assignees of a partnership who are partners or retired partners of such partnership (including spouses and ancestors, lineal descendants and siblings of such partners or spouses who acquire Registrable Securities by gift, will or intestate succession) shall be aggregated together and with the partnership; provided that all assignees and transferees who would not qualify individually for assignment of registration rights shall have a single attorney-in-fact for the purpose of exercising any rights, receiving notices or taking any action under Section 1.

1.13 Limitations on Subsequent Registration Rights. Except for registration rights to be granted to Microvision, Inc. covering Class A Common Stock issuable upon conversion of shares of Series A Preferred Stock issuable upon exercise of warrants to be issued under the terms of the Company's Convertible Promissory Note dated February 28, 2001 payable to Microvision, Inc. (the "Convertible Note"), from and after the date of this Agreement, the Company shall not, without the prior written consent of the Holders of a majority of the outstanding Registrable Securities, enter into any agreement with any holder or prospective holder of any securities of the Company which would allow such holder or prospective holder (a) to include such securities in any registration filed under Section 1.2 hereof, unless under the terms of such agreement, such holder or prospective holder may include such securities in any such registration only to the extent that the inclusion of his securities will not reduce the amount of the Registrable Securities of the Holders which is included, (b) to make a demand registration which could result in such registration statement being declared effective prior to the earlier of either of the dates set forth in subsection 1.2(a) or within one hundred twenty (120) days of the effective date of any registration effected pursuant to Section 1.2.

1.14 "Market Stand-Off" Agreement. Each Holder hereby agrees that, during the period of duration (up to, but not exceeding, one hundred eighty (180) days) specified by the Company and an underwriter of Common Stock or other securities of the Company, following the effective date of a registration statement of the Company filed under the Securities Act, it shall not, to the extent requested by the Company and such underwriter, directly or indirectly sell, offer to sell, contract to sell (including, without limitation, any short sale), grant any option to purchase or otherwise transfer or dispose of (other than to donees who agree to be similarly bound) any securities of the Company held by it at any time during such period except Common Stock included in such registration; provided, however, that:

(a) such agreement shall be applicable only to the first such registration statement of the Company which covers Common Stock (or other securities) to be sold on its behalf to the public in an underwritten offering; and

(b) all officers and directors of the Company and all one-percent (1%) securityholders, and all other persons with registration rights (whether or not pursuant to this Agreement) enter into similar agreements, except that the University of Washington shall only be required to do so to the extent required under the terms of the Restricted Stock Purchase Agreement between the Company and the University of Washington dated October 20, 2000.

In order to enforce the foregoing covenant, the Company may impose stop transfer instructions with respect to the Registrable Securities of each Holder (and the shares or securities of every other person subject to the foregoing restriction) until the end of such period, and each Holder agrees that, if so requested, such Holder will execute an agreement in the form provided by the underwriter containing terms which are essentially consistent with the provisions of this Section 1.14.

Notwithstanding the foregoing, the obligations described in this Section 1.14 shall not apply to a registration relating solely to employee benefit plans on Form S-8 or similar forms which may be promulgated in the future, or a registration relating solely to an SEC Rule 145 transaction on Form S-4 or similar forms which may be promulgated in the future.

1.15 Termination of Registration Rights. No Holder shall be entitled to exercise any right provided for in this Section 1 after the earlier of (i) three (3) years following the consummation of a Qualified IPO, (ii) March , 2008, or (iii) such time as Rule 144 or another similar exemption under the Securities Act is available for the sale of all of such Holder's shares during a ninety (90) day period without registration.

2. Covenants of the Company

2.1 Delivery of Financial Statements. The Company shall deliver to each Holder of at least 500,000 shares of Registrable Securities:

(a) as soon as practicable, but in any event within ninety (90) days after the end of each fiscal year of the Company ending after the date hereof, an income statement for such fiscal year, a balance sheet of the Company and statement of shareholder's equity as of the end of such year, and a statement of cash flows for such year, such year-end financial reports to be in reasonable detail, prepared in accordance with generally accepted accounting principles ("GAAP"), and audited and certified by an independent public accounting firm of nationally recognized standing selected by the Company;

(b) as soon as practicable, but in any event within forty-five (45) days after the end of each of the first three (3) quarters of each fiscal year of the Company, an unaudited profit or loss statement, a statement of cash flows for such fiscal quarter, a summary of bookings and backlog and an unaudited balance sheet as of the end of such fiscal quarter;

(c) within thirty (30) days of the beginning of each fiscal year, monthly financial projections for such fiscal year, operating budgets for such fiscal year and a fiscal business plan in reasonable detail; and

(d) with respect to the financial statements called for in subsections (b) of this Section 2.1, an instrument executed by the Chief Financial Officer or President of the Company and certifying that such financials were prepared in accordance with GAAP consistently applied with prior practice for earlier periods (with the exception of footnotes that may be required by GAAP) and fairly present the financial condition of the Company and its results of operation for the period specified, subject to normal and recurring year-end audit adjustment, provided that the foregoing shall not restrict the right of the Company to change its accounting principles consistent with GAAP.

2.2 Inspection . The Company shall permit each Holder of at least 500,000 shares of Series A Preferred Stock, at such Holder's expense and at reasonable times and with advance notice, to visit and inspect the Company's properties, to examine its books of account and records and to discuss the Company's affairs, finances and accounts with its officers, all at such reasonable times as may be requested by the Investor; provided, however, that the Company shall not be obligated pursuant to this Section 2.2 to provide access to any information which it reasonably considers to be a trade secret or similar confidential information.

2.3 Right of Participation. Subject to the terms and conditions specified in this paragraph 2.3, the Company hereby grants to each Holder who holds at least 250,000 shares of Series A Preferred Stock (a "Major Investor") a right of participation with respect to future sales by the Company of its shares of, or securities convertible into or exercisable for any shares of, any class of its capital stock ("Shares").

Each time the Company proposes to issue and sell any Shares, the Company shall first make an offering of such Shares to each Major Investor in accordance with the following provisions:

(a) The Company shall deliver a notice by certified mail ("Notice") to the Major Investors stating (i) its bona fide intention to offer such Shares, (ii) the number of such Shares to be offered, and (iii) the price and terms, if any, upon which it proposes to offer such Shares.

(b) Within fifteen (15) calendar days after receiving the Notice, the Major Investor may elect to purchase or obtain, at the price and on the terms specified in the Notice, up to that portion of such Shares that equals the proportion that the number of shares of common stock issued and held, or issuable upon conversion of the Series A Preferred Stock then held, by such Major Investor bears to the total number of shares of common stock issued and held, or issuable upon conversion of all convertible or exercisable securities then held, by all the Major Investors.

(c) If not all Shares that Investors are entitled to obtain pursuant to this Section 2.3 (b) are elected to be obtained as provided in Section 2.3(b), the Company may, during the one hundred twenty (120) day period following the expiration of the period provided in Section 2.3(b) hereof, offer the remaining unsubscribed portion of such Shares to any person or persons at a price not less than, and upon terms no more favorable to the offeree than, those specified in the Notice. If the Company does not sell such Shares or enter into an agreement for the sale of the Shares within such period, or if such agreement is not consummated within sixty (60) days of the execution thereof, the right provided hereunder shall be deemed to be revived and such Shares shall not be offered unless first reoffered to the Major Investors in accordance herewith.

(d) The right of participation set forth in this Section 2.3 shall not apply to Shares issued or issuable: (i) upon conversion of shares of Series A Preferred Stock; (ii) upon conversion of Class B Common Stock into Class A Common Stock; (iii) to officers, directors or employees of, or consultants to, the Company pursuant to stock option or stock purchase plans or agreements on terms approved by the Board of Directors; (iv) in connection with equipment financings or similar transactions, or in connection with strategic investments or corporate partnering transactions, the terms of which are approved by the Board of Directors of the Corporation; (v) as a dividend or distribution on Series A Preferred Stock; (vi) under the terms of the Convertible Note; (vii) for which adjustment of the Conversion Price (as defined in the Company's Statement of Rights and Preferences for the Series A Preferred Stock (the "Statement of Rights and Preferences")) is made pursuant to the Statement of Rights and Preferences; (viii) in connection with a Qualified IPO; (ix) pursuant to the acquisition of another business entity or business segment of any such entity by the Company by merger, purchase of substantially all the assets or other reorganization whereby the Company will own more than fifty percent (50%) of the voting power of such business entity or business segment of any such entity; (x) upon the exercise, conversion or exchange of any security outstanding as of the date hereof or securities issued or issuable pursuant to subsections (i) through (ix) above; or (xi) any right, option or warrant to acquire any security convertible into the securities issued or issuable pursuant to subsections (i) through (x) above.

The right of first offer set forth in this Section 2.3 may not be assigned or transferred, except that (a) such right is assignable by each Holder to any wholly owned subsidiary or parent of, or to any corporation or entity that is, within the meaning of the Act, controlling, controlled by or under common control with, any such Holder, and (b) such right is assignable between and among any of the Holders.

2.4 Stock Vesting. All stock options and other stock equivalents issued after the date of this Agreement to employees, directors, consultants and other service providers shall be subject to vesting as determined by the Board of Directors or a committee thereof composed of non-employee directors.

2.5 Employee Non-Disclosure and Assignment of Inventions Agreement. Except as provided in the Purchase Agreement, the Company and each of its employees shall have entered into the Company's standard form Employee Agreement, in substantially the form provided to special counsel to the Investors.

2.6 IRS Ruling. Before distributing any stock of the Company to the shareholders of Microvision, Inc. ("Parent"), Parent will use its reasonable best efforts to obtain a favorable ruling from the Internal Revenue Service that the distribution qualifies for tax-free treatment under Section 355 of the Internal Revenue Code.

2.7 Termination of Covenants

(a) The covenant set forth in Section 2.1, Section 2.2, Section 2.3 and Section 2.5 shall terminate as to each Holder and be of no further force or effect (i) immediately prior to the consummation of a Qualified IPO, or (ii) when the Company shall sell, convey, or otherwise dispose of or encumber all or substantially all of its property or business or merge into or consolidate with any other corporation (other than a wholly-owned subsidiary corporation) or effect any other transaction or series of related transactions in which more than fifty percent (50%) of the voting power of the Company is disposed of, provided that this subsection (ii) shall not apply to a merger effected exclusively for the purpose of changing the domicile of the Company and which does not affect the percentage equity interests of securityholders of the Company in and to the Company.

(b) The covenants set forth in Sections 2.1 and 2.2 shall terminate as to each Holder and be of no further force or effect when the Company first becomes subject to the periodic reporting requirements of Sections 13 or 15(d) of the Exchange Act, if this occurs earlier than the events described in Section 2.7(a) above.

3. Miscellaneous.

3.1 Successors and Assigns. Except as otherwise provided in this Agreement, the terms and conditions of this Agreement shall inure to the benefit of and be binding upon the respective permitted successors and assigns of the parties (including transferees of any of the Series A Preferred Stock or any Class A Common Stock issued upon conversion thereof). Nothing in this Agreement, express or implied, is intended to confer upon any party other than the parties hereto or their respective successors and assigns any rights, remedies, obligations, or liabilities under or by reason of this Agreement, except as expressly provided in this Agreement.

3.2 Amendments and Waivers. Any term of this Agreement may be amended or waived only with the written consent of the Company and the holders of a majority of the Registrable Securities then outstanding. Any amendment or waiver effected in accordance with this paragraph shall be binding upon each holder or Holder of any Registrable Securities then outstanding, each future holder or Holder of all such Registrable Securities, and the Company.

3.3 Notices. Unless otherwise provided, any notice required or permitted by this Agreement shall be in writing and shall be deemed sufficient upon delivery, when delivered personally or by overnight courier or sent by telegram or fax, or forty-eight (48) hours after being deposited in the U.S. mail, as certified or registered mail, with postage prepaid, and addressed to the party to be notified at such party's address or fax number as set forth below or on Exhibit A hereto or as subsequently modified by written notice.

3.4 Severability. If one or more provisions of this Agreement are held to be unenforceable under applicable law, the parties agree to renegotiate such provision in good faith. In the event that the parties cannot reach a mutually agreeable and enforceable replacement for such provision, then (a) such provision shall be excluded from this Agreement, (b) the balance of the Agreement shall be interpreted as if such provision were so excluded and (c) the balance of the Agreement shall be enforceable in accordance with its terms.

3.5 Governing Law. This Agreement and all acts and transactions pursuant hereto shall be governed, construed and interpreted in accordance with the laws of the State of Washington, without giving effect to principles of conflicts of laws.

3.6 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 one and the same instrument.

3.7 Titles and Subtitles. The titles and subtitles used in this Agreement are used for convenience only and are not to be considered in construing or interpreting this Agreement.

3.8 Aggregation of Stock. All shares of the Preferred Stock held or acquired by (i) affiliated entities or persons or (ii) persons or entities under common investment management, shall be aggregated together for the purpose of determining the availability of any rights as a Holder under this Agreement.

3.9 Specific Enforcement. It is agreed and understood that monetary damages would not adequately compensate an injured party for the breach of this Agreement by any party, that this Agreement shall be specifically enforceable, and that any breach or threatened breach of this Agreement shall be the proper subject of a temporary or permanent injunction or restraining order. Further, each party hereto waives any claim or defense that there is an adequate remedy at law for such breach or threatened breach.

The parties have executed this Investors' Rights Agreement as of the date first above written.

COMPANY:

INVESTORS:

LUMERA CORPORATION

By:

By:

Name:

(print)

Title:

EXHIBIT A

INVESTORS

Name/Address/Fax No.