MICROVISION INC
Form 10-K
March 06, 2009

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

# FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the fiscal year ended December 31, 2008

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ________ to ________

Commission file number 0-21221

Microvision, Inc.

(Exact name of Registrant as Specified in its Charter)

| **Delaware** | **91-1600822** |
| --- | --- |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification Number) |

6222 185th Ave NE
Redmond, Washington 98052

(Address of Principal Executive Offices including Zip Code)

(425) 936-6847

(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Exchange Act:

| Title of each class | Name of each exchange on which registered |
| --- | --- |
| Common Stock, $.001 par value | NASDAQ Global Market |

Securities registered pursuant to Section 12(g) of the Exchange Act:

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer as defined in Rule 405 of the Act. Yes

o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes

o No x

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes

x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes

o No x

The aggregate market value of the common stock held by non-affiliates of the registrant as of June 30, 2008 was approximately $156.3 million (based on the closing price for the registrant's Common Stock on the NASDAQ Global Market of $2.75 per share).

The number of shares of the registrant's Common Stock outstanding as of February 17, 2009 was 68,080,000.

Documents Incorporated by Reference

Portions of the registrant's definitive Proxy Statement to be filed with the Commission pursuant to Regulation 14A in connection with the registrant's Annual Meeting of Shareholders to be held on June 25, 2009 are incorporated herein by reference into Part III of this report.

Microvision, Inc.
2008 ANNUAL REPORT ON FORM 10-K

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PART I

Preliminary Note Regarding Forward-Looking Statements

*This report contains forward-looking statements, within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and is subject to the safe harbor created by those sections. Such statements may include, but are not limited to, projections of revenues, income or loss, capital expenditures, plans for product development and cooperative arrangements, future operations, financing needs or plans of Microvision, as well as assumptions relating to the foregoing. The words "anticipate," "could," "believe," "estimate," "expect," "goal," "may," "plan," "project," "will," and similar expressions identify forward-looking statements. Factors that could cause actual results to differ materially from those projected in our forward-looking statements include the following: our ability to obtain financing; market acceptance of our technologies and products; our financial and technical resources relative to those of our competitors; our ability to keep up with rapid technological change; government regulation of our technologies; our ability to enforce our intellectual property rights and protect our proprietary technologies; the ability to obtain additional contract awards and to develop partnership opportunities; the timing of commercial product launches; the ability to achieve key technical milestones in key products; and other risk factors identified below in Item 1A.*

ITEM 1. BUSINESS

Overview

We are developing miniature display and imaging engines based upon our integrated photonics module technology platform. Our technology platform combines two dimensional Micro-Electrical Mechanical system (MEMS) light scanning technologies, lasers, optics, electronics, and our system controls expertise into compact display or imaging solutions that we anticipate will lead to new applications and high-volume products in the consumer and automotive markets. Historically, we have entered into development agreements with commercial and U.S. government customers to develop advanced prototype and demonstration units based on our light scanning technologies.

In 2006, we announced our strategy to develop and supply a proprietary display engine called PicoP™. The PicoP display engine enables an ultra-miniature video projector capable of producing color rich, high resolution, large images, but is small and low power enough to be embedded directly into mobile devices, such as cell phones. PicoP-based miniature display engines are being marketed to potential original equipment manufacturer (OEM) customers who would embed them into a variety of consumer and automotive products. The primary objective for consumer applications is to provide mobile device users with a large screen viewing experience produced by a small embedded projector. Mobile devices may include cell phones, portable media players, PDAs, gaming consoles, laptop computers, digital cameras, and other consumer electronics products. These potential products would allow users to watch movies, play videos, and display images and other data onto a variety of surfaces. The PicoP display engine, with some modification, could be embedded into a vehicle or integrated into a portable standalone aftermarket device to create a head-up display (HUD) that could project point-by-point navigation, critical operational, safety and other information important to the vehicle operator. The PicoP display engine could also be modified to be embedded into a pair of glasses to provide the mobile user with a see-through or occluded personal display to view movies, play games or access other content.

The development and procurement of intellectual property rights relating to our technologies is a key aspect of our business strategy. We generate intellectual property as a result of our ongoing performance on development contracts

and our internal research and development activities. We also have acquired under license agreements exclusive rights to various technologies.

Technology

Our bi-directional MEMS scanning mirror is the key component of our integrated technology platform and is one of our core competencies. Our MEMS design is a silicon device at the center of which is a tiny mirror. This mirror is connected to small flexures which allow it to oscillate. The 2D MEMS scanner oscillates vertically and horizontally to capture (imaging) or reproduce (display) an image pixel-by-pixel. 2D MEMS scanners are used in our PicoP display engine that powers Pico Projector Displays, Vehicle Displays, and Wearable Displays. A 1D MEMS scanner used in our ROV Bar Code Scanner oscillates along one axis only and is used to capture a bar code image.

Our PicoP display engine technology platform includes a MEMS Scanner, laser light sources, electronics, and optics combined using Microvision's proprietary system control expertise, gained through years of internal research and development. Our unique display and imaging engines use a single beam of laser light and a single small scanning mirror to create a brilliant, full color, high contrast, uniform display over the entire field of view, from a small and thin package.

We believe that our proprietary light scanning technology offers significant advantages over traditional display and imaging systems. Depending on the specific product application, these advantages may include:

- Small and thin package size
- Higher brightness and contrast
- Higher resolution
- Clear text readability
- Reduced power requirements
- Simpler optical design that does not require a focusing lens
- Lower price at volume

Business Strategy

Our business strategy is to promote our technology in the form of integrated and embedded components to leading OEMs for widespread use in display and imaging product applications, as well as leverage our technology expertise into our own end-user products. Presently we are focused on the following steps to implement our business strategy:

- Target leading OEMs to integrate our PicoP display engines into their products. We have also worked with original design manufacturers and Tier 1 suppliers to produce advanced prototypes and demonstration units to be used to market to our partners' OEM customers directly by us or by our partners.
- Expand and solidify the supply chain architecture to support high volume manufacturing of the PicoP display engine, its subsystems and its components.
- Continue to promote awareness of our technology platform to all members of the value chain. We have been continually in contact with OEMs, original design manufacturers and mobile content providers to understand the features our PicoP display engines must have in order to provide desired benefits to all members of the value chain. We have and will continue to consider this information in connection with the design and development of our technology platform.
- Continue rapid advancement of our technology platform and roadmap.

Product and Marketing Focus:

Pico Projector Displays

We are working with partners to develop small projector displays as stand alone systems or embedded into mobile products. The display industry is calling this new class of projectors "pico projectors." We believe our PicoP display engine can meet the size, power and performance requirements to be embedded into portable hand-held devices including mobile phones or function as a stand alone accessory device that connects to a mobile video source such as

a personal media player, cell phone or laptop computer. We plan to enter into agreements with OEMs that will result in production and a distribution of the PicoP-based products.

In January 2009, we demonstrated our pre-production pico projector named SHOW WX™ at both Macworld in San Francisco and at the Consumer Electronics Show in Las Vegas. At 118mm long by 60mm wide by 14mm thick, it is about 25% smaller than the SHOW™ prototype that we unveiled at the 2008 Consumer Electronics Show. The SHOW WX is a battery operated plug-and-play projector that can project a full color, WVGA (848 X 480 pixels), DVD quality image with vivid colors and exceptional contrast. We plan to provide a number of these pre-production pico projectors to select OEM and carrier partners for evaluation in the first half of 2009. Initial commercial production is expected to begin in mid 2009, followed by larger commercial quantities in the second half of the year. We have entered into an agreement with a high volume manufacturer that we plan to have build the PicoP display engine and integrate it into finished products. We are evaluating multiple distribution channels to bring the first PicoP-based accessory projector to market.

Vehicle Displays

We believe an automotive head-up display (HUD) improves driver safety by reducing the distraction of looking away from the road to read information such as GPS mapping images, audio controls and other automobile instrumentation. Working independently and with Tier 1 suppliers, we have produced prototypes that demonstrate our PicoP's ability to project a high-resolution readable image during day or night onto the windshield of an automobile to provide the driver with a variety of information related to the car's operation. We believe that an automotive HUD based on the PicoP display engine offers three distinct advantages over competing head-up displays:

- Size - Our prototype display is less than half the size of current competitive offerings. This smaller form factor can accommodate a wider variety of vehicle configurations.

- Contrast Ratio - Our prototype has a contrast ratio an order of magnitude higher than current competitive offerings. The high contrast ratio allows the driver to see the display clearly in any ambient lighting conditions.

- Installation Cost - Our prototype can be electronically customized to match the unique curvature of a particular automobile's windshield, thereby reducing installation time and cost. The current competitive offerings must be manually adjusted to match the curvature of a windshield.

We have worked with various Tier 1 automotive suppliers to develop PicoP enabled HUD prototypes and market them to their OEM customers. We have also developed a portable full color head-up display demonstrator powered by the PicoP display engine to showcase the capabilities of the PicoP display engine for potential use in automobiles, specialty vehicles, trucks, buses and motor coaches. We expect that our PicoP display engine subsystem could be integrated by a Tier 1 supplier into their HUD product package for sale to automobile manufacturers or by a product integrator into an aftermarket product for direct sale to their customers.

Wearable Displays

We believe the PicoP display engine can be modified and integrated with a light-weight optical design to create a full color near-eye wearable display platform. This wearable display platform could be in the form of ruggedized helmet mounted display systems or lightweight fashionable eyewear displays. Wearable displays could be used to provide personal viewing of information that originates from a mobile device and arrives at the display through a wired or wireless connection. We believe that wearable displays based on the PicoP display engine could provide the following advantages over competing wearable display technologies:

- See-through performance - See-through eyewear displays enable the wearer to interact with the real world and their personal mobile services at the same time. Unlike competing wearable displays, a see-through display does not obstruct the wearer's vision or reduce their awareness of what is happening around them.

- Daylight readability - The high-brightness capability of color eyewear based on the PicoP display engine enables images to be clearly visible in brightly lit ambient environments, including direct sunlight. Current LCD-based head worn displays are difficult to see in bright light environments.
- Fashion and ergonomics - We are developing thin and lightweight optics that can be integrated with the PicoP display engine so that our OEM partners can design wearable displays that match conventional eyewear frames in size and weight and provide significantly improved ergonomics compared to competing wearable displays.

We are working with the US military and commercial customers to further develop the optical design and integration of the PicoP display engine for military applications such as helmet mounted displays and full color see-through eyewear. We plan to work with OEMs and system integrators to incorporate the PicoP display engine into integrated solutions for potential military and commercial customers. In 2008, we entered into contracts with commercial and government customers to develop high definition (720p) eyewear displays.

Bar Code Scanners

We currently market our line of ROV hand held bar code scanners and bar code scanner enabled enterprise solutions. The ROV Scanner incorporates our proprietary MEMS technology and is designed to accommodate mobile workers who need simple and affordable data collection solutions on the mobile platforms of their choosing. The ROV Scanner has lower power consumption and total operating cost than many competing laser bar code scanners. ROV Scanners are manufactured for us by a contract manufacturer located in Malaysia. We distribute ROV Scanners directly to end users through value added resellers, original equipment manufacturers and phone and internet orders.

Go-To-Market Strategy

We are evaluating opportunities to widely market our products using a variety of distribution channels such as establishing partnerships with OEMs and distributors and establishing infrastructure to support direct marketing through web-based, retail or other outlets. Our products may carry the Microvision brand or be branded and distributed by our OEM or distribution partners.

Certain potential applications using the PicoP display engines, such as an automotive HUD or pico projector for mobile phones, could require integration of our technology with other related technologies. In markets requiring high volume production of the PicoP display engine components or subsystems that are to be integrated with other components, we may provide designs for components, subsystems and systems to OEMs under licensing agreements.

We expect that some customers will require unique designs for their products. We expect that such relationships will generally involve a period of co-development during which engineering, manufacturing and marketing professionals from potential customers and OEMs would work with our technical staff to modify the PicoP display engine for their targeted market and application. We may charge fees to our customers or OEMs to fund the costs of the engineering effort incurred on such development projects. The nature of the relationships with such customers or OEMs may vary from partner to partner depending on the proposed specifications for the PicoP display engine, the product to be developed, and the customers' or OEMs' design, manufacturing and distribution capabilities. We believe that by limiting our own direct manufacturing investment for products, we will reduce our capital requirements and risks inherent in taking the PicoP display engine to the consumer market.

Human Factors, Ergonomics and Safety

As part of our research and development activities, we conduct ongoing research on safety factors that must be addressed by products incorporating our technology, including such issues as the maximum permissible laser exposure limits established by International Electrotechnical Commission ("IEC") and others. Independent experts have concluded that laser exposure to the eye resulting from use of the light scanning displays under normal operating conditions would be below the calculated maximum permissible exposure level set by IEC.

In addition, Microvision works with and commissions outside independent experts in the field of laser safety to assist in meeting safety specifications as requested by our customers.

Competitive Conditions

The information display industry is highly competitive. Our potential display products will compete with established manufacturers of mature display technologies such as miniaturized cathode ray tube and flat panel display devices, as well as companies developing new display technologies. Our competitors include companies such as Texas Instruments Incorporated, 3M, and Light Blue Optics Ltd. in the pico projection display segment and Siemens VDO and Nippon Seiki in the vehicle displays segment, most of which have much greater financial, technical and other resources than we do. Many of our competitors are developing alternative miniature display technologies. Our competitors may succeed in developing information display technologies and products that could render our technology or our proposed products commercially infeasible or technologically obsolete.

Pico projectors are an emerging class of miniature projectors that are generally handheld, battery operated, mobile projectors. Most of the competing projectors currently on the market or planned for introduction in the next 6-12 months are primarily based on either liquid crystal on silicon (LCOS) panel solutions or Texas Instruments' DLP™ display technology. Each of these solutions can create images from a small form factor of varying resolution, brightness, image quality, battery life, and ease of use.

The information display industry has been characterized by rapid and significant technological advances. Our technology and potential products may not remain competitive with such advances, and we may not have sufficient funds to invest in new technologies, products or processes. Although we believe our technology platform and proposed display products could deliver images of a substantially better quality and resolution from a smaller form factor device than those of commercially available miniaturized liquid crystal displays and cathode ray tube based display products, manufacturers of liquid crystal displays and cathode ray tubes may develop further improvements of screen display technology that could reduce or eliminate the anticipated advantages of our proposed products.

We compete with other companies in the display industry and other technologies for government funding. In general, our government customers plan to integrate our technology into larger systems. Ongoing contracts are awarded based on our past performance on government contracts, the customer's progress in integrating our technology into the customer's overall program objectives, and the status of the customer's overall program.

The image capture industry is also highly competitive. Our current and planned bar code products will compete with existing laser and wand-type scanners produced by established bar code companies. Our current products compete on the basis of price and performance.

Intellectual Property and Proprietary Rights

We generate intellectual property as a result of our ongoing performance on development contracts and our internal research and development activities. The inventions covered by our patent applications generally relate to component miniaturization, specific implementation of various system components and design elements to facilitate mass production. We consider protection of these key enabling technologies and components to be a fundamental aspect of our strategy to penetrate diverse markets with unique products. As such, we intend to continue to develop our portfolio of proprietary and patented technologies at the system, component and process levels.

Since our inception in 1993, we have acquired under license agreements exclusive rights to various technologies, including, among others, rights related to the ability to superimpose images on the user's field of view and with a retinal display, and rights related to the design and fabrication of micro miniature devices using semiconductor fabrication techniques. In some cases, the licensors have retained limited, non-commercial rights with respect to the technology, including the right to use the technology for non-commercial research and for instructional purposes.

Some licensors have the right to consent to our sublicensing arrangements and to the prosecution and settlement by us of our of infringement disputes.

Our ability to compete effectively in the display and image capture market will depend, in part, on our ability and the ability of the licensors to maintain the proprietary nature of these technologies.

We also rely on unpatented proprietary technology. To protect our rights in these areas, we require all employees and, where appropriate, contractors, consultants, advisors and collaborators, to enter into confidentiality and non-compete agreements. There can be no assurance, however, that these agreements will provide meaningful protection for our trade secrets, know-how or other proprietary information in the event of any unauthorized use, misappropriation or disclosure of such trade secrets, know-how or other proprietary information.

Among the marks we have registered are "MicroHud" and the "tri-curve" logo with the United States Patent and Trademark Office. We have filed for registration of various other marks including "PicoP" and "ROV" with the United States Patent and Trademark Office.

Additional Information

We perform research and development to design and develop our technology platform and modifications to the PicoP display engine that will be required for specific applications. Research and development expense for the fiscal years ended December 31, 2008, 2007 and 2006 was $22.6 million, $14.9 million, and $10.7 million, respectively. Substantially all of our revenue has been generated from development contracts to develop the light scanning technology to meet customer specifications. Our customers have included both the United States government and commercial enterprises. In 2008, 34% of revenue was derived from performance on development contracts with the United States government, 40% from performance on development contracts with commercial customers and the remainder from sales of ROV and Flic units. Two commercial customers accounted for 15% and 11%, respectively, of total revenue in 2008. In 2007, 61% of revenue was derived from performance on development contracts with the United States government, 25% from performance on development contracts with commercial customers and the remainder from sales of ROV, Flic and Nomad units. One commercial customer accounted for approximately 15% of total revenue during 2007. In 2006, 51% of revenue was derived from performance on development contracts with the United States government, 24% from performance on development contracts with commercial customers and the remainder from sales of Flic and Nomad units. One commercial customer accounted for approximately 11% of total revenue during 2006. Our contracts with the United States government can be terminated for convenience by the United States government at any time. See Management's Discussion and Analysis of Financial Condition and Results of Operations.

We had a backlog of $1.2 million at December 31, 2008 compared to a backlog of $4.1 million at December 31, 2007. The backlog at December 31, 2008, is composed of $714,000 in government development contracts and $228,000 in commercial development contracts entered into through December 31, 2008 and $276,000 in orders for ROV. Microvision plans to complete all of the backlog contracts by the end of 2009.

Employees

As of February 17, 2009, we had 165 employees.

Further Information

Microvision was founded in 1993 as a Washington corporation and reincorporated in 2003 under the laws of the State of Delaware. Our principal office is located at 6222 185th Avenue NE, Redmond WA 98052 and our telephone number is 425-936-6847.

Our Internet address is www.microvision.com. We make available free of charge our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Investors can access this material by visiting our website, clicking on "Investors" and then on "SEC Filings."

## ITEM 1A. RISK FACTORS

### Risk Factors Relating to the Microvision Business

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

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

- As of December 31, 2008, we had an accumulated deficit of $292.0 million.
- We incurred consolidated net losses of $215.6 million from inception through 2005, $24.0 million in 2006, $19.8 million in 2007, and $32.6 million in 2008.

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

We cannot be certain that we will succeed in obtaining additional development contracts or that we will be able to obtain substantial customer orders for our products. In light of these factors, we expect to continue to incur substantial losses and negative cash flow at least through 2009 and likely thereafter. We cannot be certain that we will achieve positive cash flow at any time in the future.

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

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

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

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

Additional capital may not be available to us, or if available, on terms acceptable to us or on a timely basis. Raising additional capital may involve issuing securities with rights and preferences that are senior to our common stock and may dilute the value of current shareholders' shares. If adequate funds are not available in the next several months to fully implement our plan we will begin to reduce the scope of our business to extend our operations as we pursue other financing opportunities and business relationships. This reduction in scope could include delaying product launch and projects resulting in reductions in staff and operating costs as well as reductions in capital expenditures and investment in research and development. With these adjustments to our operating plan, we believe we currently have sufficient cash, cash equivalents, and investment securities to fund operations through at least February 28, 2010.

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

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

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

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

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

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

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

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

of our common stock to sell their securities in the secondary market. In addition, when the market price of our common stock is less than $5.00 per share, we become subject to penny stock rules even if our common stock is still listed on The NASDAQ Global Market. While the penny stock rules should not affect the quotation of our common stock on The NASDAQ Global Market, these rules may further limit the market liquidity of our common stock and the ability of investors to sell our common stock in the secondary market. The market price of our stock has mostly traded below $5.00 per share during 2008, 2007, and 2006. On February 17, 2009, the closing price of our stock was $1.34.

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

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

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

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

We may not succeed in these efforts because of:

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

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

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

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

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

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

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

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

We do not have long-term commitments from our ROV customers, and plan purchases based upon our estimates of customer demand, which may require us to contract for the manufacture of our products based on inaccurate estimates.

Our ROV sales are made on the basis of purchase orders rather than long-term commitments. Our customers may cancel or defer purchases at any time. This requires us to forecast demand based upon assumptions that may not be correct. If our customers or we overestimate demand, we may create inventory that we may not be able to sell or use, resulting in excess inventory, which could become obsolete or negatively affect our operating results. Conversely, if our customers or we underestimate demand, or if sufficient manufacturing capacity is not available, we may lose revenue opportunities, damage customer relationships and we may not achieve expected revenues.

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

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

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

In the recent past, general worldwide economic conditions have experienced a downturn due to slower economic activity, concerns about inflation, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, and adverse business conditions. Any continuation or

worsening of the current global economic and financial conditions could materially adversely affect our ability to raise, or the cost of, needed capital and could materially adversely affect our ability to commercialize products. We cannot predict the timing, strength, or duration of any economic slowdown or subsequent economic recovery, worldwide, or in the display industry.

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

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

- political and economic instability;
- high levels of inflation, historically the case in a number of countries in Asia;
- burdens and costs of compliance with a variety of foreign laws;
- foreign taxes;
- changes in tariff rates or other trade and monetary policies; and
- changes or volatility in currency exchange rates.

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

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

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

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

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

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

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

Intellectual property protection for our products is important and uncertain. If we do not obtain effective intellectual property protection for our products, processes and technology, we may be subject to increased competition. Our commercial success will depend in part on our ability and the ability of the University of Washington and our other licensors to maintain the proprietary nature of the PicoP display and other key technologies by securing valid and enforceable patents and effectively maintaining unpatented technology as trade secrets. We try to protect our proprietary technology by seeking to obtain United States and foreign patents in our name, or licenses to third-party

patents, related to proprietary technology, inventions, and improvements that may be important to the development of our business. However, our patent position and the patent position of the University of Washington and other licensors involve complex legal and factual questions. The standards that the United States Patent and Trademark Office and its foreign counterparts use to grant patents are not always applied predictably or uniformly and can change. Additionally, the scope of patents are subject to interpretation by courts and their validity can be subject to challenges and defenses, including challenges and defenses based on the existence of prior art. Consequently, we cannot be certain as to the extent to which we will be able to obtain patents for our new products and technology or the extent to which the patents that we already own or license from others protect our products and technology. Reduction in scope of protection or invalidation of our licensed or owned patents, or our inability to obtain new patents, may enable other companies to develop products that compete with ours on the basis of the same or similar technology.

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

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

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

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

During the full years 2008, 2007, and 2006, 34%, 61%, and 51% respectively, of our revenue was derived from performance on a limited number of development contracts with the U.S. government. Therefore, any significant disruption or deterioration of our relationship with the U.S. government would significantly reduce our revenues. Our government programs must compete with programs managed by other contractors for limited amounts and uncertain levels of funding. The total amount and levels of funding are susceptible to significant fluctuations on a year-to-year basis. Our competitors continuously engage in efforts to expand their business relationships with the government and are likely to continue these efforts in the future. Our contracts with the government are subject to immediate termination by the government for convenience at any time. The government may choose to use contractors with competing display technologies or it may decide to discontinue any of our programs altogether. In addition, those development contracts that we do obtain require ongoing compliance with applicable government regulations. Termination of our development contracts, a shift in government spending to other programs in which we are not involved, a reduction in government spending generally, or our failure to meet applicable government regulations could have severe consequences for our results of operations.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

We currently lease approximately 67,000 square feet of combined use office, laboratory and manufacturing space at our headquarters facility in Redmond, Washington. The 90 month lease expires in 2013.

ITEM 3. LEGAL PROCEEDINGS

We have sued our former CEO and President Richard Rutkowski and his spouse to collect $1,733,000 in outstanding loans from the Company that were due in January 2007 and remain unpaid. Counterclaims were filed by Mr. Rutkowski and his spouse, seeking to recover damages in an amount in excess of $15,000,000. We believe these claims are without merit and intend to defend them vigorously. However, an adverse outcome could have a material adverse affect on our financial condition.

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

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

There were no matters submitted to a vote of shareholders during the fourth quarter of the year ending December 31, 2008.

ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT

Executive officers are appointed by our Board of Directors and hold office until their successors are elected and duly qualified. Mr. Tokman also serves as a director of Microvision. The following persons serve as executive officers of Microvision:

Alexander Tokman, age 47, has served as President, Chief Executive Officer and a director of Microvision since January 2006. Mr. Tokman served as Microvision's President and Chief Operating Officer from July 2005 to January 2006. Mr. Tokman, a former GE executive, joined Microvision after a 10-year tenure at GE Healthcare, a subsidiary of General Electric, where he led several global businesses, most recently as General Manager of its Global Molecular Imaging and Radiopharmacy multi-technology business unit from 2003 to 2005. Prior to that, between 1995 and 2003, Mr. Tokman served in various cross-functional and cross-business leadership roles at GE where he led the definition and commercialization of several medical modalities product segments including PET/CT, which added over $500 million of revenue growth to the company within the first three years of its commercial introduction. Mr. Tokman is a certified Six Sigma and Design for Six Sigma (DFSS) Black Belt and Master Black Belt and as one of GE's Six Sigma pioneers, he drove the quality culture change across GE Healthcare in the late 1990s. From November 1989 to March 1995 Mr. Tokman served as technical programs lead and a head of I&RD at Tracor Applied Sciences a subsidiary of then Tracor, Inc. Mr. Tokman has both an M.S. and B.S. in Electrical Engineering from the University of Massachusetts, Dartmouth.

Ian D. Brown, age 46, has served as Vice President, Sales and Marketing of Microvision since February 2006. Prior to joining Microvision, from March 1994 to February 2006, Mr. Brown served in various Sales and Marketing positions with General Electric Healthcare, Americas. Most recently, from April 2004 to February 2006, Mr. Brown served as the Sales and Marketing Manager--Nuclear Medicine. From April 1989 to March 1994 Mr. Brown served as Technical Author--Nuclear Medicine Operator Documentation with IGE Medical Systems, Radlett, UK. Mr. Brown holds Ordinary & Higher National Certificates in Medical Physics & Physiological Measurements from Paddington College, London, Post Graduate Diploma in Management studies, University of Hertfordshire. He also holds a Six Sigma Black Belt.

Sid Madhavan, age 42, joined Microvision in April 2006 as Vice President of Research and Product Development. Madhavan, who worked for GE Healthcare from 1998 to 2006 where he held various management positions and most recently served as an Engineering Subsystem Manager for a $2.1 billion Molecular Imaging and Computer Tomography business, is a certified Six Sigma Black Belt and brings over fifteen years of engineering product development and global management experience. Mr. Madhavan received his B.S. degree in Electronics and Communications from Madurai Kamaraj University in India and his M.S. in Electrical Engineering from Texas A&M.

Thomas M. Walker, age 44, joined Microvision in May 2002 and serves as Vice President, General Counsel and Secretary. Prior to joining Microvision, Mr. Walker served as Senior Vice President, General Counsel and Secretary of Advanced Radio Telecom Corp., a publicly held technology and services company where he managed domestic and international legal affairs from April 1996 to April 2002. Prior to that, Mr. Walker advised publicly and privately held businesses while practicing in the Los Angeles offices of the law firms of Pillsbury Winthrop and Buchalter, Nemer Fields and Younger. Mr. Walker holds a B.A. from Claremont McKenna College and a J.D. from the

University of Oregon.

Jeff T. Wilson, age 48, has served as Chief Financial Officer since April 2006, Principal Financial Officer since January 2006 and Principal Accounting Officer of Microvision since August 1999. Mr. Wilson served as Vice President, Accounting of Microvision from April 2002 to April 2006 and as Director of Accounting of Microvision from August 1999 to March 2002. Prior to joining Microvision, from 1991 to 1999, Mr. Wilson served in various accounting positions for Siemens Medical Systems, Inc., a developer and manufacturer of medical imaging equipment. Prior to 1991, Mr. Wilson served as a manager with the accounting firm PricewaterhouseCoopers LLP. Mr. Wilson is a Certified Public Accountant. Mr. Wilson holds a B.S. in Accounting from Oklahoma State University.

## PART II

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock trades on The NASDAQ Global Market under the symbol "MVIS." As of February 17, 2009, there were approximately 375 holders of record of 68,080,000 shares of common stock outstanding. We have never declared or paid cash dividends on our common stock. We currently anticipate that we will retain all future earnings to fund the operations of our business and do not anticipate paying dividends on the common stock in the foreseeable future.

Our common stock began trading publicly on August 27, 1996. The quarterly high and low sales prices of the Company's common stock for each full quarterly period in the last two fiscal years and the year to date as reported by The NASDAQ Global Market are as follows:

| | Common Stock | |
|---|---|---|
| **Quarter Ended** | **HIGH** | **LOW** |
| **2007** | | |
| March 31, 2007 | $ 4.08 | $ 2.98 |
| June 30, 2007 | 5.90 | 3.62 |
| September 30, 2007 | 6.08 | 4.40 |
| December 31, 2007 | 4.75 | 3.83 |
| **2008** | | |
| March 31, 2008 | $ 4.65 | $ 1.82 |
| June 30, 2008 | 4.05 | 2.35 |
| September 30, 2008 | 3.16 | 1.85 |
| December 31, 2008 | 2.20 | 1.06 |
| **2009** | | |
| January 1, 2009 to February 17, 2009 | $ 2.20 | $ 1.33 |

## ITEM 6. SELECTED FINANCIAL DATA

A summary of selected financial data as of and for the five years ended December 31, 2008 is set forth below. It should be read in conjunction with our consolidated financial statements and related notes appearing elsewhere in this Form 10-K.

**Years En**

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| | | (in thousands, exce | |
| **Statement of Operations Data:** | | | |
| Revenue | $ 6,611 | $ 10,484 | $ 7,04 |
| Net loss available for common shareholders | (32,620) | (19,787) | (27,25 |
| Basic and diluted net loss per share | (0.53) | (0.40) | (0.8 |
| Weighted average shares outstanding basic and diluted | 61,643 | 49,963 | 33,57 |
| **Balance Sheet Data:** | | | |
| Cash and cash equivalents | $ 25,533 | $ 13,399 | $ 14,55 |
| Investments available-for-sale | 2,705 | 22,411 | - |
| Working capital | 24,347 | 30,043 | 19,16 |
| Total assets | 36,964 | 45,298 | 35,32 |
| Long-term liabilities | 1,776 | 2,201 | 2,61 |
| Mandatorily redeemable preferred stock | -- | -- | - |
| Total shareholders' equity (deficit) | 27,651 | 33,061 | 21,86 |

Statement of Operations data for 2004 includes financial information for our previously consolidated subsidiary Lumera. Lumera was deconsolidated in July 2004.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Overview

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

In 2006, we announced our strategy to develop and supply a proprietary display engine called PicoP to potential original equipment manufacturing (OEM) customers who will embed them into a variety of consumer and automotive products. The primary objective for consumer applications is to provide users of mobile devices with a large screen viewing experience produced by a small embedded projector. Mobile devices may include cell phones, PDA's, gaming consoles and other consumer electronics products. These potential products would allow users to watch movies, play videos, display images, and other data onto a variety of surfaces. The PicoP with some modification could be embedded into the dashboard of an automobile or an airplane or integrated into a portable aftermarket device to create a head-up display (HUD) that could project point-by-point navigation, critical operational, safety and other information important to the driver or pilot. The PicoP could be further modified to be embedded into a pair of glasses to provide the mobile user with a see-through or occluded personal display to view movies, play games or access other content.

We have incurred substantial losses since inception and expect to incur a substantial loss during the fiscal year ending December 31, 2009.

### Key Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, contract losses, bad

debts, investments and contingencies and litigation. We base our estimates on historical experience, terms of existing contracts, our evaluation of trends in the display and image capture industries, information provided by our current and prospective customers and strategic partners, information available from other outside sources, and on various other assumptions we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following key accounting policies require more significant judgments and estimates used in the preparation of its consolidated financial statements:

Revenue Recognition.

We recognize contract revenue as work progresses on long-term, cost plus fixed fee, and fixed price contracts using the percentage-of-completion method, which relies on estimates of total expected contract revenue and costs. Our revenue contracts generally include a statement of the work we are to complete and the total fee we will earn from the contract. When we begin work on the contract and at the end of each accounting period, we work with the members of our technical team to estimate the labor and material and other cost required to complete the statement of work compared to cost incurred to date. We use information provided by project mangers, vendors, outside consultants and others as we deem necessary to develop our cost estimates. Since our contracts generally require some level of technology development to complete, the actual cost required to complete a statement of work can vary from our estimated cost to complete. We have developed processes that allow us to make reasonable estimates of the cost to complete a contract. Historically, we have made only immaterial revisions in the estimates to complete the contract at each reporting period. Recognized revenues are subject to revisions as the contract progresses to completion and actual revenue and cost become certain. Revisions in revenue estimates are reflected in the period in which the facts that give rise to the revision become known. In the future, revisions in these estimates could significantly impact recognized revenue in any one reporting period. If the U.S. government cancels a contract, we would receive payment for work performed and costs committed to prior to the cancellation.

Our product sales generally include acceptance provisions. We recognize revenue for product shipments upon acceptance of the product by the customer or expiration of the contractual acceptance period.

Losses on Uncompleted Contracts

. We establish an allowance for estimated losses if a contract has an estimated cost to complete that is in excess of the remaining contract value. The entire estimated loss is recorded in the period in which the loss is first determined. We determine the estimated cost to complete a contract through a detailed review of the work to be completed, the resources available to complete the work and the technical difficulty of the remaining work. If the revised estimated cost to complete the contract is higher than the total contract revenue, the entire contract loss is recognized. The actual cost to complete a contract can vary significantly from the estimated cost, due to a variety of factors including availability of technical staff, availability of materials and technical difficulties that arise during a project. Most of our development contracts are cost plus fixed fee type contracts. Under these types of contracts, we are not required to spend more than the contract value to complete the contracted work.

Allowance for uncollectible receivables

. We maintain allowances for uncollectible receivables, including accounts receivable, cost and estimated earnings in excess of billings on uncompleted contracts and receivables from related parties. We review several factors in determining the allowances including the customer's and related party's past payment history and financial condition. If the financial condition of our customers or the related parties with whom we have receivables were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances could be required.

Inventory.

We value inventory at the lower of cost or market with cost determined on a weighted average cost basis. We review several factors in determining the market value of our inventory including evaluating the replacement cost of the raw materials and the net realizable value of the finished goods. If we do not achieve our targeted sales prices, if market conditions for our components or products were to decline or if we do not achieve our sales forecast, additional reductions in the carrying value of the inventory would be required.

Investments Available-For-Sale and Fair Value Measurements.

We account for investment securities in accordance with the provisions of Statement of Financial Accounting Standards ("FAS") No. 115, *Accounting for Certain Investments in Debt and Equity Securities* ("FAS 115") and FAS No. 157, *Fair Value Measurements* ("FAS 157"). FAS 115 addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and for investments in debt securities. FAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. Adopting FAS 157 on January 1, 2008 for financial assets and liabilities did not have a material impact on our consolidated financial position, results of operations or cash flows.

FAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in its principal or most advantageous market in an orderly transaction between market participants on the measurement date. FAS 157 establishes a three level fair value inputs hierarchy, and requires an entity to maximize the use of observable valuation inputs and minimize the use of unobservable inputs. We utilize market data, assumptions and risks we believe market participants would use in measuring the fair value of the asset or liability, including the risks inherent in the inputs and the valuation techniques. The hierarchy is summarized below.

- Level 1 - Observable inputs such as quoted prices in active markets for identical assets or liabilities
- Level 2 - Observable inputs such as quoted prices for similar assets or liabilities in markets that are not sufficiently active to qualify as level 1 or, other observable inputs
- Level 3 - Unobservable inputs for which there is little or no market data, which requires us to develop our own assumptions, which are significant to the measurement of the fair values

Estimating valuation inputs and selecting and applying valuation methods may require significant judgments by management. Changes in the estimated inputs and valuation methods could result in materially different values, credits and charges presented in the consolidated financial statements.

The investments are stated at fair value and classified as cash and cash equivalents or current investment securities available-for-sale on the consolidated balance sheets with unrealized gains and losses included in the consolidated statements of comprehensive loss. We classify investment securities available-for-sale purchased with 90 days or less remaining until contractual maturity as cash equivalents on the balance sheet in "Cash and cash equivalents." Interest income, realized gains and losses, and other- than-temporary impairments are recognized in the period earned or incurred, and presented separately in the consolidated statements of operations. Changes in the fair values of derivatives are realized in the period of remeasurement and recorded in "Gain (loss) on derivative instruments, net" in the consolidated statements of operations. The cost of securities sold is based on the specific identification method.

Employee Share-Based Compensation.

We issue share-based compensation to employees in the form of options exercisable into our common stock and restricted or unrestricted shares of our common stock. We account for employee share-based compensation under the guidance provided by Financial Accounting Standards Board ("FASB") Statement No. 123(R), *Share-Based Payment* ("FAS123(R)"). The value of equity shares is determined using the fair value method, which is based on the number of shares granted and the closing price of our common stock on the NASDAQ Global Market on the date of grant. The value of options is determined using the Black-Scholes option pricing model with estimates of option lives, stock price volatilities and interest rates, then expensed over the periods of service allowing for pre-vest forfeitures. This widely accepted method results in reasonable option values and interperiod expense allocation, and comparability across companies. Changes in the estimated inputs or using other option valuation methods could result in materially different option values and share-based compensation expense.

The key accounting policies described above are not intended to be a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by generally accepted accounting principles, with no need for us to apply judgment or make estimates. There are also areas in which our judgment in selecting any available alternative would not produce a materially different result to our consolidated financial statements. Additional information about our accounting policies, and other disclosures required by generally accepted accounting principles, are set forth in the notes to our consolidated financial statements.

Inflation has not had a material impact on our revenues, or income from continuing operations over the three most recent fiscal years.

Results of Operations

YEAR ENDED DECEMBER 31, 2008 COMPARED TO YEAR ENDED DECEMBER 31, 2007

Contract Revenue.

| (in thousands) | 2008 | % of contract revenue | 2007 | % of contract revenue | $ ch |
|---|---|---|---|---|---|
| Government revenue | $ 2,237 | 45.9 | $ 6,430 | 71.4 | $ (4 |
| Commercial revenue | 2,637 | 54.1 | 2,580 | 28.6 | |
| Total contract revenue | $ 4,874 | | $ 9,010 | | $ (4 |

We earn contract revenue from performance on development contracts with the United States government and commercial customers. Our contract revenue in a particular period is dependent upon when we enter into a contract, the value of the contracts we have entered into, and the availability of technical resources to perform work on the contracts.

Contract revenue from government contracts was substantially lower during 2008 than in 2007 due to reduced contract activity and lower beginning backlog in 2008 compared to the previous year. We expect that we will have fewer opportunities to enter into new development contracts as we move closer to the commercialization of products based on our PicoP display engine.

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

In December 2007, we entered into a $1 million contract with a commercial customer to develop prototype units based on our PicoP technology, for evaluation of future consumer electronics product applications. The development work under this contract was initiated and fully completed in 2008.

Our backlog of development contracts at December 31, 2008 was $714,000 in government contracts and $228,000 in commercial contracts compared to $2.0 million in government contracts and $1.8 million in commercial contracts at December 31, 2007. The decrease in backlog from 2007 is primarily attributed to completion of government and commercial development contracts in 2007 and early 2008. We plan to complete the entire contract backlog during 2009.

Product Revenue.

| (in thousands) | 2008 | % of product revenue | 2007 | % of product revenue | $ ch |
|---|---|---|---|---|---|
| Bar code revenue | $ 1,737 | 100.0 | $ 1,393 | 94.5 | $ |
| Nomad revenue | 0 | 0.0 | 81 | 5.5 | |
| Total product revenue | $ 1,737 | | $ 1,474 | | $ |

Bar code revenue includes the sales of ROV and our discontinued Flic bar code scanners. The increase in bar code

revenue for the year ended December 31, 2008 compared to the same period in 2007 was due to the increased sales of our ROV product line.

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

The backlog of product orders at December 31, 2008 was approximately $276,000, compared to $245,000 at December 31, 2007, all of which is scheduled for delivery during 2009.

Cost of Contract Revenue.

| (in thousands) | 2008 | % of contract revenue | 2007 | % of contract revenue | $ ch |
|---|---|---|---|---|---|
| Cost of contract revenue | $ 1,708 | 35.0 | $ 4,916 | 54.6 | $ (3 |

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

The cost of contract revenue as a percentage of revenue was lower in 2008 than in 2007 as a result of negotiating better terms on contracts and from the sale of prototype units that have been previously expensed to internally funded programs.

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

Cost of Product Revenue.

| (in thousands) | 2008 | % of product revenue | 2007 | % of product revenue | $ ch |
|---|---|---|---|---|---|
| Cost of product revenue | $ 2,143 | 123.4 | $ 1,690 | 114.7 | $ |

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

Our overhead, which includes the costs of procuring, inspecting and storing material, facility and depreciation costs, is allocated to inventory, cost of product revenue, cost of contract revenue, and research and development expense based on the proportion of direct material purchased for the respective activity. During 2008 and 2007, we expensed approximately $143,000 and $289,000, respectively, of manufacturing overhead associated with production capacity in excess of production requirements.

The increase in cost of product revenue for 2008 compared to 2007 was a result of increased revenue from the sales of ROV and the increase in inventory write-downs during the respective periods. In 2008, cost of product revenue included $475,000 of inventory write-downs compared to $84,000 for the same period in 2007.

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

Research and Development Expense.

| (in thousands) | 2008 | 2007 | $ change | % change |
|---|---|---|---|---|
| Research and development | $ 22,575 | $ 14,944 | $ 7,631 | 51.1 |

Research and development expense consists of:

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

In addition, we allocate our research and development resources based on the business opportunity of the available projects, the skill mix of the resources available and the contractual commitments we have made to customers. In order to accelerate our time to market and because contract revenue was lower for the year ended December 31, 2008 compared to the same period in 2007, we directed more of our research and development work to internally funded projects compared to the same period last year. We have increased spending in research and development as part of our strategy to accelerate the time to market for products based on the PicoP. The increase in cost is primarily attributable to increases in payroll costs and contracted services.

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

Sales, Marketing, General and Administrative Expense.

| (in thousands) | 2008 | 2007 | $ change | % change |
|---|---|---|---|---|
| Sales, marketing, general and administrative | $ 15,730 | $ 15,779 | $ (49) | (0.3) |

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

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

Interest Income and Expense.

| (in thousands) | 2008 | 2007 | $ change | % change |
|---|---|---|---|---|
| Interest income | $ 1,130 | $ 1,358 | $ (228) | (16.8) |

| | 2008 | 2007 | $ change | % change |
|---|---|---|---|---|

| (in thousands) | | | | |
|---|---|---|---|---|
| Interest expense | $ 48 | $ 513 | $ (465) | (90.6) |

The decrease in interest income in 2008 from 2007 results primarily from lower interest rates on our investment securities compared to 2007.

In March and December 2005, we issued convertible notes (the "Notes") with an aggregate principal amount of $20 million. The last payment on the Notes was made in March 2007, resulting in a decrease in interest expense for the year ended December 31, 2008 compared to the same period in 2007.

Impairment of investment securities, available-for-sale.

| (in thousands) | 2008 | 2007 | $ change | % change |
|---|---|---|---|---|
| Impairment of investments, available-for-sale | $ (300) | $ 0 | $ (300) | n/a |

At December 31, 2008, our marketable securities portfolio included $3.0 million par value AAA rated student loan auction-rate securities ("SLARS"). Based on the length of the historical duration of failed SLARS auctions and significant uncertainty of the prospective duration of inactivity and lack of liquidity in the SLARS market, we determined that the estimated fair values of the SLARS were less than par value and the impairments were other-than-temporary. We used a discounted cash flow model, with rates adjusted for liquidity, to determine the estimated fair values of the SLARS as of December 31, 2008. We recorded an "impairment of investment securities, available-for-sale" of $300,000 for the period ended December 31, 2008.

Gain (Loss) on Derivative Instruments, Net.

| (in thousands) | 2008 | 2007 | $ change | % change |
|---|---|---|---|---|
| Gain (loss) on derivative instruments, net | $ 2,196 | $ (483) | $ 2,679 | (554.7) |

We issued warrants to purchase 2,302,000 shares of common stock in connection with the issuance of the Notes. The warrants met the definition of derivative instruments that must be accounted for as liabilities under the provisions of Emerging Issues Task Force ("EITF") Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* ("EITF 00-19"), because we cannot engage in certain corporate transactions affecting the common stock unless we made a cash payment to the holders of the warrants. In July 2008, warrants to purchase 750,000 shares of common stock expired unexercised. We record changes in the fair values of the warrants in the statement of operations each period. We valued the remaining warrants to purchase 1,552,000 shares of common stock at December 31, 2008 using the Black-Scholes option pricing model with the following assumptions: expected volatility of 72%; expected dividend yield of 0%; risk free interest rates ranging from 0.6% to 0.8%; and contractual lives ranging from 1.2 years to 1.9 years. The change in value of the warrants of $2.3 million in 2008 was recorded as a non-operating gain and is included in "Gain (loss) on derivative instruments, net" in the consolidated statement of operations.

Prior to December 9, 2008 we held warrants to purchase 170,500 shares of Lumera common stock. On December 9, 2008, Lumera merged with GigOptix, LLC and the combined company will conduct business as GigOptix, Inc. Our Lumera warrants were exchanged for warrants to purchase shares of the new company's common stock, after applying a 0.125 exchange ratio and exercise price escalation. As of December 31, 2008, the fair value of the warrants was determined to be zero and the change in value of $130,000 in 2008 was recorded as a loss to "Gain (loss) on derivative instruments, net."

Gain on sale of investment in Lumera.

Gain on sale of securities of equity investment:

| (in thousands) | 2008 | 2007 | $ change | % change |
|---|---|---|---|---|
| Gain on sale of investment in Lumera | $ 0 | $ 6,606 | $ (6,606) | (100.0) |

During 2007, we sold 1,714,000 shares of Lumera common stock for gross proceeds of $8.7 million and we recorded a gain of $6.6 million.

As result of the merger discussed above, the 36,000 shares of Lumera common stock we held were exchanged for 5,000 shares of GigOptix common stock.

Income Taxes.

No provision for income taxes has been recorded because we have experienced net losses from inception through December 31, 2008. At December 31, 2008, we had net operating loss carry-forwards of approximately $217.6 million for federal income tax reporting purposes. In addition, we have research and development tax credits of $4.3 million. The net operating loss carry forwards and research and development credits available to offset future taxable income, if any, will expire in varying amounts from 2009 to 2027 if not previously utilized. In certain circumstances, as specified in the Internal Revenue Code, a 50% or more ownership change by certain combinations of our shareholders during any three-year period would result in a limitation on our ability to utilize a portion of our net operating loss carry-forwards. We have determined that such a change of ownership occurred during 1995 and that the annual utilization of loss carry-forwards generated through the period of that change will be limited to approximately $761,000. An additional change of ownership occurred in 1996 and the annual limitation for losses generated in 1996 is approximately $1.6 million.

We adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. We did not have any unrecognized tax benefits which would require an adjustment to the January 1, 2007 beginning balance of retained earnings. We did not have any unrecognized tax benefits at December 31, 2007 or at December 31, 2008.

We recognize interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2008 and 2007, we recognized no interest and penalties.

YEAR ENDED DECEMBER 31, 2007 COMPARED TO YEAR ENDED DECEMBER 31, 2006

Contract Revenue.

| (in thousands) | 2007 | % of contract revenue | 2006 | % of contract revenue | $ ch |
|---|---|---|---|---|---|
| Government revenue | $ 6,430 | 71.4 | $ 3,586 | 68.0 | $ 2 |
| Commercial revenue | 2,580 | 28.6 | 1,689 | 32.0 | |
| Total contract revenue | $ 9,010 | | $ 5,275 | | $ 3 |

Contract revenue was higher during 2007 than in 2006, due to higher beginning government contract backlog and an increased level of activity on commercial contracts compared to the prior year.

In May 2007, we announced that we had entered into a $3.2 million contract with the U.S. Air Force to provide a lightweight, see-through, full-color eyewear display prototype to the government. The contract, which continued a development activity with the Air Force, specified the development, design, verification, testing, and delivery of a lightweight, see-through full-color wearable display for evaluation by several DOD project offices.

Our backlog of development contracts at December 31, 2007 was $$2.0 million in government contracts and $1.8 million in commercial contracts compared to $5.2 million in government contracts and $1.6 million in commercial contracts at December 31, 2006.

Product Revenue.

| (in thousands) | 2007 | % of product revenue | 2006 | % of product revenue | $ ch |
|---|---|---|---|---|---|
| Bar code revenue | $ 1,393 | 94.5 | $ 1,589 | 89.9 | $ |
| Nomad revenue | 81 | 5.5 | 179 | 10.1 | |
| Total product revenue | $ 1,474 | | $ 1,768 | | $ |

In May 2007, we announced the launch of ROV, our new bar code scanner product. We had planned to begin commercial shipments of ROV during the third quarter of 2007. During our Beta evaluation, we determined that ROV did not meet our quality standards and we delayed the launch of ROV production until we could correct the deficiencies. Commercial shipments of ROV began during the fourth quarter of 2007.

The decrease in bar code revenue in 2007 compared to 2006 was the result of the timing of the release of ROV. We believe that many of our customers were waiting for the availability of ROV before placing orders for our bar code scanning products.

The decrease in Nomad revenue was the result of our decision in June 2006 to no longer promote the Nomad product. The Nomad had not gained the commercial acceptance we had planned when it was introduced.

The backlog of product orders at December 31, 2007 was approximately $245,000, compared to $353,000 at December 31, 2006.

Cost of Contract Revenue.

| (in thousands) | 2007 | % of contract revenue | 2006 | % of contract revenue | $ ch |
|---|---|---|---|---|---|
| Cost of contract revenue | $ 4,916 | 54.6 | $ 3,398 | 64.4 | $ 1 |

The cost of contract revenue as a percentage of revenue was lower in 2007 than in 2006 as a result of negotiating better terms on contracts entered into in late 2006 and early 2007. We target a gross margin for each contract of at least 40%; however, the gross margin can vary based on the technical challenges encountered in completing the contract.

Cost of Product Revenue.

| (in thousands) | 2007 | % of product revenue | 2006 | % of product revenue | $ ch |
|---|---|---|---|---|---|
| Cost of product revenue | $ 1,690 | 114.7 | $ 4,768 | 269.7 | $ (3 |

During 2007 and 2006, we expensed approximately $289,000 and $1,224,000, respectively, of manufacturing overhead associated with production capacity in excess of production requirements.

The decline in cost of product revenue as a percentage of product revenue for 2007 compared to 2006 is attributable to the following factors:

- The decision in June 2006 to no longer support the Nomad product line. During 2006, we recorded expenses of $1.2 million associated with the Nomad product line that were not repeated in 2007.
- Reduced direct cost and overhead on the Flic product line resulting in a savings of approximately 108% for the year ended December 31, 2007 compared to the same period in 2006.
- The absence of losses associated with noncancelable purchase contracts. In 2006, we recorded a loss of $310,000 to cost of product revenue as a result of commitments to purchase materials for the Flic scanner that were in excess of our estimated future proceeds from the sale of the Flic scanners.

Research and Development Expense.

| (in thousands) | 2007 | 2006 | $ change | % change |
|---|---|---|---|---|
| Research and development | $ 14,944 | $ 10,715 | $ 4,229 | 39.5 |

The increase in research and development expense in 2007 compared to 2006 was the result of our increased spending as part of our strategy to accelerate the time to market for products based on the PicoP. The increase in cost was primarily attributable to increases in payroll costs and contracted services.

Sales, Marketing, General and Administrative Expense.

| (in thousands) | 2007 | 2006 | $ change | % change |
|---|---|---|---|---|
| Sales, marketing, general and administrative | $ 15,779 | $ 17,362 | $ (1,583) | (9.1) |

In early 2006, we announced our plan to reduce spending in sales, marketing, general and administrative expenses. The decrease in sales, marketing, general and administrative expense in 2007 compared to 2006 is the result of the cost reduction efforts.

Interest Income and Expense.

| (in thousands) | 2007 | 2006 | $ change | % change |
|---|---|---|---|---|
| Interest income | $ 1,358 | $ 719 | $ 639 | 88.9 |

| (in thousands) | 2007 | 2006 | $ change | % change |
|---|---|---|---|---|

| | | | | |
|---|---|---|---|---|
| Interest expense | $ 513 | $ 5,753 | $ (5,240) | (91.1) |

The increase in interest income in 2007 from 2006 results from higher average cash and investment securities balances.

In March and December 2005, we issued convertible notes (the "Notes") with an aggregate principal amount of $20 million. The last payment on the Notes was made in March 2007, resulting in a decrease in interest expense for the year ended December 31, 2007 compared to the same period in 2006.

Gain (Loss) on Derivative Instruments, Net.

The following table shows the gain on derivative instruments, net:

| **(in thousands)** | **2007** | **2006** | **$ change** | **% change** |
|---|---|---|---|---|
| Gain (loss) on derivative instruments, net | $ (483) | $ 1,627 | $ (2,110) | (129.7) |

In connection with the issuance of the Notes in 2005, we concluded that the note holders' right to convert all or a portion of the Notes into our common stock is an embedded derivative instrument as defined by FAS 133, *Accounting for Derivative Instruments and Hedging Activities* ("FAS 133"). We determine the value of the derivative features at each balance sheet date using the Black-Scholes option pricing model. We retired the Notes in March 2007 and decreased the value of the derivative feature to zero. The change in value of $68,000 from December 31, 2006 to the date of retirement of the Notes was recorded as a non-operating gain and is included in "Gain (loss) on derivative instruments, net" in the consolidated statement of operations.

We issued warrants to purchase 2,302,000 shares of common stock in connection with the issuance of the Notes. The warrants met the definition of derivative instruments that must be accounted for as liabilities under the provisions of EITF 00-19, because we cannot engage in certain corporate transactions affecting the common stock unless we made a cash payment to the holders of the warrants. We record changes in the fair values of the warrants in the statement of operations each period. We valued the warrants at December 31, 2007 using the Black-Scholes option pricing model with the following assumptions: expected volatility of 67%, expected dividend yield of 0%, risk free interest rates ranging from 3.05% to 3.07%, and contractual lives ranging from 0.6 years to 2.9 years. The change in value of the warrants of $85,000 in 2007 was recorded as a non-operating loss and is included in "Gain (loss) on derivative instruments, net" in the consolidated statement of operations.

At December 31, 2007, we held warrants to purchase 170,500 shares of Lumera common stock. Changes in the fair value of the warrants are recorded in the statement of operations each period. As of December 31, 2007, the warrants were valued using the Black-Scholes option pricing model with the following assumptions: expected volatility of 83%, expected dividend yield of 0%, risk free interest rate of 3.11%, and contractual life of 3.2 years. As of December 31, 2007, the fair value of the warrants decreased to $130,000 and the change in value of $465,000 in 2007 was recorded as a loss to "Gain (loss) on derivative instruments, net."

Equity in losses of Lumera and Gain on sale of securities of equity investment.

Equity in losses of Lumera:

| **(in thousands)** | **2007** | **2006** | **$ change** | **% change** |
|---|---|---|---|---|
| Equity in losses of Lumera | $ 0 | $ (290) | $ 290 | (100.0) |

Gain on sale of securities of equity investment:

| (in thousands) | 2007 | 2006 | $ change | % change |
|---|---|---|---|---|
| Gain on sale of investment in Lumera | $ 6,606 | $ 8,738 | $ (2,132) | (24.4) |

In 2006, we sold 2.9 million shares of our Lumera common stock for $12.2 million. We recorded a "Gain on sale of investment in Lumera" of approximately $8.7 million. In January 2006, we recorded a charge of $290,000 for our proportion of Lumera net loss for the period preceding the change in accounting method which resulted from the reduction of our ownership in Lumera.

During 2007, we sold 1,714,000 shares of Lumera common stock for gross proceeds of $8.7 million and we recorded a gain of $6.6 million. As of December 31, 2007, we owned 36,000 shares of Lumera common stock.

Income Taxes.

At December 31, 2007, we had net operating loss carry-forwards of approximately $200.0 million for federal income tax reporting purposes. In addition, we had research and development tax credits of $3.6 million.

Inducement for Conversion of Preferred Stock.

| (in thousands) | 2007 | 2006 | $ change | % change |
|---|---|---|---|---|
| Inducement for conversion of preferred stock | $ 0 | $ (3,076) | $ 3,076 | (100.0) |

In September 2004, we raised $10.0 million before issuance costs of $90,000 from the sale of 10,000 shares of Series A Convertible Preferred Stock and a warrant to purchase 362,000 shares of common stock. The preferred stock terms included a dividend of 3.5% per annum, payable quarterly in cash or registered common stock, at our election, subject to certain conditions.

The net cash proceeds of $9,910,000 were allocated to the preferred stock and the warrant based on the relative fair values of the securities. The warrants were valued using the Black-Scholes option pricing model with the following assumptions: expected volatility of 75%, expected dividend yield of 0%, risk free interest rate of 3.4%, and contractual life of five years. Proceeds of $1.3 million were allocated to the warrant and recorded as an increase to additional paid-in capital.

Subsequent to the relative fair value allocation, the effective conversion price of the convertible preferred stock was less than the closing price of our common stock on the date of commitment to purchase the preferred stock, resulting in the recognition of a beneficial conversion feature in accordance with EITF No. 00-27, *Application of Issue No. 98-5 to Certain Convertible Instruments*. This beneficial conversion feature was measured at $1.2 million, which represents the difference between the fair value of the common stock and the effective conversion price. The beneficial conversion feature was recorded as additional paid-in capital and a deemed dividend to preferred stockholders. It was amortized using the effective interest method over the three year stated life of the preferred stock. During 2005, we recorded $280,000 in dividends on the preferred stock and $303,000 in amortization of the beneficial conversion feature of the preferred stock.

In May 2006, we entered into a Conversion Agreement with the holders of our preferred stock. As consideration for converting 5,000 preferred shares, we issued a total of 1,353,066 shares of our common stock, $.001 par value, of which 565,000 shares were issued as an inducement to convert ("Incentive Shares"). The value of the Incentive Shares of $2.0 million together with unamortized discounts of $0.6 million and fees of $0.1 million were recorded as

"Inducement for conversion of preferred stock" in the consolidated statement of operations.

In connection with the conversion, we agreed to register the Incentive Shares and to a 45-trading-day price protection provision. We determined that the price protection feature of the Incentive Shares included an embedded derivative feature as defined by FAS 133. We estimated the initial value of the derivative feature at conversion to be $401,000 using the Black-Scholes option pricing model with the following assumptions: expected volatility of 65%, dividend yield of 0%, risk free interest rate of 4.9%, and contractual life 0.3 years and recorded it as a non-operating expense included in "Inducement for conversion of preferred stock" in the consolidated statement of operations. The value of the price protection feature fluctuated with the value of our common stock and, to a lesser extent, with changes in valuation variables. In August 2006, the Company determined and recorded the final value and paid the liability of $1,074,000. The change in estimated fair value of the derivative feature of $673,000 was included as a non-operating expense in "Gain (loss) on Derivative instruments, net".

Liquidity and Capital Resources

We have incurred significant losses since inception. We have funded operations to date primarily through the sale of common stock, convertible preferred stock, warrants, the issuance of convertible debt and, to a lesser extent, from development contract revenues and product sales. In July 2008, we received $26.0 million, before issuance costs, from the issuance of 11,172,000 shares of our common stock and warrants exercisable for 6,703,000 shares of our common stock at $3.60 per share. At December 31, 2008, we had $28.2 million in cash, cash equivalents, and investment securities, available-for-sale. Our cash, cash equivalents, and investment securities available-for-sale balance includes $2.7 million in auction rate securities ("ARS"). There is currently no established market for these ARS and if we were required to sell them in a short period of time we may receive less than our book value for them.

Our operating plan for 2009 includes the launch of our first accessory product, further development of the PicoP display engine for embedded applications and further development of automotive HUD and eyewear applications. In order to fully fund our product launch and our other development efforts, we will require additional capital in 2009. We plan to obtain additional cash through the issuance of equity or debt securities. There can be no assurance that additional cash will be available or that, if available, it will be available on terms acceptable to us on a timely basis. If adequate funds are not available in the next several months to fully implement our plan we will begin to reduce the scope of our business to extend our operations as we pursue other financing opportunities and business relationships. This reduction in scope could include delaying product launch and development projects resulting in reductions in staff, operating costs, capital expenditures and investment in research and development. With these adjustments to our operating plan, we believe we currently have sufficient cash, cash equivalents, and investment securities to fund operations through at least February 28, 2010.

Cash used in operating activities totaled $31.2 million during 2008, compared to $21.3 million during 2007. During 2008, the increased cash outlay was primarily driven by the acceleration of research and development activities on our PicoP and related technologies for planned PicoP and other product applications. The balance of the change was largely due to lower contract revenue in 2008 than in 2007.

We had the following material gains and charges, and changes in assets and liabilities during the year ended December 31, 2008.

- "*(Gain) loss on derivative instruments*" In connection with the issuances of our Notes in 2005, we issued warrants to purchase 2,302,000 shares of our common stock, which are accounted for as derivative security liabilities according to guidance in EITF 00-19. The value of the warrants fluctuates with our common stock price and the decreasing lives of the warrants as they approach expiration. The net decrease in our stock price during 2008 combined with decreasing terms to expiration resulted in a $2.3 million non-cash non-operating gain recorded in "(Gain) loss on derivative instruments, net" on the consolidated statements of operations and a non- cash adjustment in operating cash flows recorded to "(Gain) loss on derivative instruments" on the consolidated statements of cash flows. We record the fair values of the warrants in "Liability associated with common stock warrants" on the consolidated balance sheets. The valuation assumptions and method are detailed in the Results of Operations section above.

- "*Accounts receivable, net*" Our accounts receivable decreased by approximately $1.3 million from the end of 2007 due to lower contract revenue near the end of 2008.

- *"Billings in excess of costs and estimated earnings on uncompleted contracts"*

We ended 2008 with $908,000 less than 2007. This was mostly a result of receiving a $500,000 advance cash payment from a customer in December 2007 for contract revenue work performed in January 2008. The balance of the decrease is associated with completing contracts in the third quarter of 2008 and lower contract revenue near the end of 2008.

- *"Inventory"*

Ending inventory increased by $764,000 over 2007 as a result of the timing of our production schedule for ROV and lower than expected sales volumes. We value inventory at the lower of cost or market with cost determined on a weighted average cost basis. The following table shows the composition of the inventory at December 31, 2008 and 2007:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Raw materials | $ 45,000 | $ 122,000 |
| Work in process | -- | 10,000 |
| Finished goods | 1,480,000 | 629,000 |
| | $ 1,525,000 | $ 761,000 |

Investing Activities

Cash provided by investing activities totaled $19.0 million in 2008 compared to cash used in investing activities of $14.2 million in 2007. We invested the proceeds from our July 2008 issuance of common stock and warrants of $26.0 million, before issuance fees, into money market accounts and short term investments. As a result, the purchases and sales of these investments appear in cash and cash equivalents changes instead of in investing activities on the consolidated statements of cash flows. Cash provided by investing activities in 2008 was generated from the net sales of investment securities to fund continuing operations which were purchased in 2007. The 2007 net purchases in investing activities of $22.3 million were made with proceeds from the call of our publicly traded warrants and sale of Lumera common stock.

Financing Activities

Cash provided by financing activities totaled $24.3 million in 2008, compared to $34.4 million in 2007, largely as a result of the relative sizes of our financing transactions completed in 2008 and 2007, coupled with cash payments totaling $1.4 million in 2007 to retire our Notes. The following is a list of our securities issuances during 2008, 2007 and 2006.

- In July 2008, we raised an aggregate of $26.0 million before issuance costs of approximately $2.0 million through a registered direct public offering of 11.2 million shares of our common stock and warrants to purchase 6.7 million shares of our common stock. The warrants have an exercise price of $3.60 per share, a five year term, and are not exercisable for one year from the date of issuance. The warrants are callable after one year from the date of issuance if the average closing bid price of our stock is over $7.20 for any 20 consecutive trading days. The warrants are listed on the NASDAQ Global Market under the ticker "MVISW."

- In June 2007, we called our publicly traded warrants issued as part of a 2006 mid-year financing transaction. The warrant holders had until July 6, 2007 to exercise their warrants or the warrants would expire. We received $34.1 million from the exercise of 12,855,000 warrants.

- In November 2006, we raised $7.9 million before issuance costs of $779,000 through an underwritten public offering of 3,318,000 shares of our common stock.

- In June and July 2006, we raised an aggregate of $27.1 million before issuance costs of $2.2 million through an underwritten public offering of 11.6 million shares of our common stock and warrants to purchase 12.4 million shares of our common stock. In connection with the offering, we also issued the underwriter a warrant to acquire 537,500 warrants, identical to those sold in the offering, at an exercise price of $0.16 per warrant. The underwriter exercised the warrants for warrants in connection with the call in June 2007.

The following is a list of scheduled payments we made in connection with our Notes during 2007 and 2006.

- During 2007:
  - cash payments of $1.4 million in principal and $28,000 in interest, and
  - issued 459,000 shares of our common stock in payment of $1.4 million in principal and $21,000 in interest.
- During 2006:
  - cash payments of $9.6 million in principal and $722,000 in interest, and
  - issued 1.4 million shares of our common stock in payment of $1.7 million in principal and $88,000 in interest.

We may also raise cash through future sales of our common or preferred stock, warrants, and issuance of debt securities or through other borrowings. Should expenses exceed the amounts budgeted in our current operating plan, we may require additional cash earlier than expected to further the development of our technology, for expenses associated with product development, and to respond to competitive pressures or to meet unanticipated development difficulties. Our operating plan also provides for the development of strategic relationships with systems and equipment manufacturers that may require additional investments. There can be no assurance that additional financing will be available to us or, 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 or planned revenues are not generated, we may be required to limit our operations substantially. This limitation of operations may include reductions in staff and discretionary costs, which may include non- contractual research costs. Our cash requirements will depend on many factors, including, but not limited to, the rate at which we can, directly or through arrangements with original equipment manufacturers, introduce products incorporating our technology and the market acceptance and competitive position of such products.

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
- our ability to establish cooperative development, joint venture and licensing arrangements.

In order to maintain our exclusive rights under our license agreement with the University of Washington, we are obligated to make royalty payments to the University of Washington with respect to the Virtual Retinal Display technology. If we are successful in establishing original equipment manufacturer co- development and joint venture arrangements, we expect our partners to fund certain non-recurring engineering costs for technology development and/or for product development. Nevertheless, we expect our cash requirements to remain high as we expand our activities and operations with the objective of commercializing our light scanning technology.

The following table lists our contractual obligations (in thousands):

| | Payments Due By Period | | |
|---|---|---|---|
| | Less than 1 year | 1-3 years | 3-5 years |

| **Contractual Obligations:** | | | |
|---|---|---|---|
| Open purchase obligations * | $ 3,991 | $ 104 | $ 74 |
| Minimum payments under capital leases | 47 | 48 | -- |
| Minimum payments under operating leases | 844 | 1,774 | 1,502 |
| Minimum payments under long-term debt | 103 | 206 | 172 |
| Minimum payments under research, royalty and licensing agreements | 735 | 1,733 | 1,733 |
| Total | $ 5,720 | $ 3,865 | $ 3,481 |

* Open purchase obligations represent commitments to purchase inventory, materials, capital equipment, maintenance agreements and other goods used in the normal operation of our business.

+ License and royalty obligations continue through the lives of the underlying patents, which is currently through at least 2017.

New accounting pronouncements

In October 2008, the FASB released a FASB Staff Position, FSP FAS 157-3- *Determining the Fair Value of a Financial Asset When The Market for That Asset Is Not Active*, to clarify the application of the provisions of FAS 157 in an inactive market. Implementing of this standard upon its issuance did not have a material impact on our consolidated financial position and results of operations.

In February 2008, the FASB released a FASB Staff Position, FSP FAS 157-2- *Effective Date of FASB Statement No. 157*, which delays the effective date of FAS 157 for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis to fiscal years beginning after November 15, 2008. We are currently assessing the financial impact of FSP FAS 157-2 on our financial statements.

In June 2007, the EITF reached a final consensus on EITF Issue No. 07-1, *Accounting for Collaborative Arrangements* ("EITF 07-1"). EITF 07-1 discusses how to determine whether an arrangement constitutes a collaborative arrangement, how costs incurred and revenue generated on sales to third parties should be reported by the participants, how an entity should characterize payments made between participants and what participants should disclose in the notes to the financial statements about a collaborative arrangement. EITF 07-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. We are currently assessing the financial impact of EITF 07-1 on our financial statements.

Subsequent Events

During January 2009, we terminated 9 employees or approximately 5% of our workforce. We will record an expense of approximately $202,000 related to the severance agreements for these employees in the first quarter of 2009. We accounted for the cost associated with the work force reduction in accordance with FAS 146-*Accounting for Costs Associated with Exit or Disposal Activities,* which requires that the liability for the costs associated with the exit or disposal activity be recognized and measured at fair value in the period in which the liability is incurred.

## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate and Market Liquidity Risks

As of the end of 2008, 90% of our total cash, cash equivalents and investment securities available-for-sale have variable interest rates or are very short-term discount notes traded in active markets. Therefore, we believe our exposure to the market and interest rate risk is not material. The remaining 10% is composed of $3.0 million par

student loan auction-rate securities ("SLARS"). Our SLARS are highly rated long-term bonds and are structured with variable interest rate resets to be determined via a Dutch Auction process every 28 days. However, beginning in February 2008 as global credit markets deteriorated significantly, each auction has failed rendering the SLARS temporarily illiquid through the auction process and adverse credit market conditions have resulted in inactive secondary ARS markets. Given the adverse credit market conditions, the fair value of the principal of these bonds has become affected by changes in interest rates, the spread between short and long rates, and credit market liquidity. As a result, in the quarter ended September 30, 2008, we estimated that the fair value of our SLARS was approximately $2.7 million and that the $300,000 adjustment was other than temporary. If market conditions worsen, we may have to further adjust the estimated fair value of the SLARS, including additional charges to earnings if we believe the adjustment is other than temporary. In the event we need access to the funds invested in the SLARS, we could be required to sell these securities at an amount below our original purchase value. Any of these events could affect our consolidated financial condition, results of operations and cash flows. However, based on our current operating plan and ability to access our $25.5 million held in cash and cash equivalents and other highly liquid investments held as of December 31, 2008, we do not expect to be required to sell these securities materially below their current estimated value.

Our investment policy generally directs that the investment managers should select investments to achieve the following goals: principal preservation, adequate liquidity and return. As of December 31, 2008, our cash and cash equivalents and investments available-for-sale securities portfolio are comprised of short-term highly rated money market funds and commercial paper, and the SLARS.

The values of cash equivalents and investment securities, available-for-sale by maturity date as of December 31, 2008, are as follows (rounding problem in table):

| | Amount | Percent |
|---|---|---|
| Cash and cash equivalents | $ 16,173,000 | 57.3 % |
| Less than one year | 9,365,000 | 33.1 |
| One to two years | -- | -- |
| Greater than five years | 2,700,000 | 9.6 |
| | $ 28,238,000 | 100.0 % |

Foreign Exchange Rate Risk

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

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Report of Independent Registered Public Accounting Firm

To the Board of Directors
and Shareholders of Microvision, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, mandatory redeemable convertible preferred stock and shareholders' equity, comprehensive loss and cash flows present fairly, in all material respects, the financial position of Microvision, Inc. at December 31, 2008 and December 31, 2007, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008 based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and the financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements, financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

PricewaterhouseCoopers LLP

Seattle, Washington
March 5, 2009

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Microvision, Inc.

Consolidated Balance Sheets
(in thousands, except share and per share amounts)

| | Decem |
|---|---|
| | 2008 |
| **Assets** | |
| Current assets | |
| Cash and cash equivalents | $ 25,533 |
| Investment securities, available-for-sale | 2,705 |
| Accounts receivable, net of allowances of $57 and $123 | 537 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 695 |
| Inventory | 1,525 |
| Other current assets | 889 |
| Total current assets | 31,884 |
| Property and equipment, net | 3,701 |
| Restricted investments | 1,332 |
| Other assets | 47 |
| Total assets | $ 36,964 |
| **Liabilities and Shareholders' Equity** | |
| Current liabilities | |
| Accounts payable | $ 3,487 |
| Accrued liabilities | 3,545 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 62 |
| Liability associated with common stock warrants | 331 |
| Current portion of capital lease obligations | 41 |
| Current portion of long-term debt | 71 |
| Total current liabilities | 7,537 |
| Capital lease obligations, net of current portion | 45 |
| Long-term debt, net of current portion | 322 |
| Deferred rent, net of current portion | 1,409 |
| Total liabilities | 9,313 |
| Commitments and contingencies | -- |
| Shareholders' Equity | |
| Common stock, par value $.001; 125,000 shares authorized; 68,080 and 56,730 shares issued and outstanding | 68 |
| Additonal paid-in capital | 319,662 |
| Accumulated other comprehensive income (loss) | (38) |
| Accumulated deficit | (292,041) |

| | |
|---|---|
| Total shareholders' equity | 27,651 |
| Total liabilities and shareholders' equity | 36,964 |

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

Microvision, Inc.

Consolidated Statements of Operations
(in thousands, except share and per share amounts)

| | Ye |
|---|---|
| | 2008 |
| Contract revenue | $ 4,87 |
| Product revenue | 1,73 |
| Total revenue | 6,61 |
| Cost of contract revenue | 1,70 |
| Cost of product revenue | 2,14 |
| Total cost of revenue | 3,85 |
| Gross margin | 2,76 |
| Research and development expense | 22,57 |
| Sales, marketing, general and administrative expense | 15,73 |
| Gain on disposal of fixed assets | ( |
| Total operating expenses | 38,30 |
| Loss from operations | (35,54 |
| Interest income | 1,13 |
| Interest expense | (4 |
| Impairment of investment securities, available-for-sale | (30 |
| Gain (loss) on derivative instruments, net | 2,19 |
| Other expense | (5 |
| Net loss before Lumera transactions | (32,62 |
| Equity in losses of Lumera | - |
| Gain on sale of investment in Lumera | - |
| Net loss | (32,62 |
| Stated dividend on mandatorily redeemable convertible preferred stock | - |
| Accretion to par value of preferred stock | - |
| Inducement for conversion of preferred stock | - |
| Net loss available for common shareholders | $ (32,62 |
| Net loss per share basic and diluted | $ (0.5 |
| Weighted-average shares outstanding basic and diluted | 61,64 |

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

Microvision, Inc.

Consolidated Statements of Mandatorily Redeemable Convertable Preferred Stock and Shareholders' Equity
(in thousands, except share amounts)

| | Mandatorily redeemable convertible preferred stock | | Common Stock | |
|---|---|---|---|---|
| | Shares | Amount | Shares | Par Value |
| Balance at December 31, 2005 | 5 | $ 4,166 | 25,138 | $ 25 $ |
| Amortization of share-based compensation | | | | |
| Exercise of warrants and options | | | 16 | |
| Sales of common stock and warrants (net of issuance costs of $3.0 million) | | | 14,867 | 15 |
| Conversion of preferred stock | (5) | (5,000) | 786 | 1 |
| Inducement to preferred shareholders | | | | |
| Unamortized discount and offering costs on preferred stock | | 419 | | |
| Issuance of common stock and change in warrant value to preferred shareholders | | | 565 | 1 |
| Beneficial conversion feature of mandatorily redeemable convertible preferred stock | | 278 | | |
| Non-cash accretion on mandatorily redeemable convertible preferred stock | | 137 | | |
| Issuance of common stock for payment on senior secured exchangeable convertible notes | | | 1,466 | 1 |
| Issuance of common stock for payment of interest on senior secured exchangeable convertible notes | | | 67 | |
| Issuance of common stock on preferred dividend | | | 16 | |
| Dividend on preferred stock | | | | |
| Warrants to purchase Lumera common stock | | | | |
| Allowance for doubtful accounts on receivables from related parties | | | | |
| Other comprehensive income | | | | |
| Net loss | | | | |
| Balance at December 31, 2006 | -- | -- | 42,921 | 43 |
| Amortization of share-based compensation | | | | |
| Exercise of warrants and options | | | 13,350 | 13 |
| Sales of common stock and warrants | | | | |
| Issuance of common stock for payment on senior secured exchangeable convertible notes | | | 452 | 1 |
| Issuance of common stock for payment of interest on senior secured exchangeable convertible notes | | | 7 | |
| Sale of Lumera stock held as collateral on receivables from related parties | | | | |
| Allowance for doubtful accounts on receivables from related parties | | | | |
| Other comprehensive income | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Net loss | | | | | |
| Balance at December 31, 2007 | -- | -- | 56,730 | 57 | |
| Amortization of share-based compensation | | | 35 | | |
| Exercise of warrants and options | | | 143 | -- | |
| Sales of common stock and warrants | | | 11,172 | 11 | |
| Other comprehensive income | | | | | |
| Net loss | | | | | |
| Balance at December 31, 2008 | -- | $ -- | 68,080 | $ 68 | $ |

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

Microvision, Inc.

Consolidated Statements of Comprehensive Loss
(in thousands)

| | Ye |
|---|---|
| | 2008 |
| Net loss | $ (32,62 |
| Other comprehensive gain (loss) | |
| Unrealized gain (loss) on investment securities, available-for-sale: | |
| Unrealized holding gain (loss) arising during period | (8 |
| Less: reclassification adjustment for gains realized in net loss | - |
| Net unrealized gain (loss) | (8 |
| Comprehensive loss | $ (32,70 |

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

Microvision, Inc.

Consolidated Statements of Cash Flows
(in thousands)

| | Yea |
|---|---|
| | 2008 |
| **Cash flows from operating activities** | |
| Net loss | $ (32,620 |
| Adjustments to reconcile net loss to net cash used in operations: | |
| Depreciation | 989 |
| Gain on disposal of fixed assets | (5 |
| Non-cash expenses related to issuance of stock, warrants, and options, and amortization of deferred compensation | 2,831 |
| Non-cash interest expense, net | -- |
| Loss (gain) on derivative instruments | (2,196 |
| Impairment of short-term investment securities | 300 |
| Inventory write-downs | 475 |
| Allowance for receivables from related parties | (241 |
| Equity in losses of Lumera | -- |
| Gain on sale of investment in Lumera | -- |
| Net accretion of discount on short-term investments | (97 |
| Increase in deferred rent | -- |
| Non-cash deferred rent | (275 |
| Change in: | |
| Accounts receivable | 1,348 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | (252 |
| Inventory | (1,239 |
| Other current assets | 184 |
| Other assets | -- |
| Accounts payable | 1,188 |
| Accrued liabilities | (642 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | (908 |
| Net cash used in operating activities | (31,160 |
| **Cash flows from investing activities** | |
| Sales of investment securities | 20,400 |
| Purchases of investment securities | (986 |
| Sales of restricted investment securities | -- |
| Purchases of restricted investment securities | (350 |
| Decrease in restricted investment | 143 |
| Decrease in restricted cash | -- |
| Collections of receivables from related parties | 241 |
| Sale of long-term investment - Lumera | -- |
| Proceeds on sale of property and equipment | 5 |
| Purchases of property and equipment | (495 |
| Net cash provided by (used in) investing activities | 18,958 |
| **Cash flows from financing activities** | |
| Principal payments under capital leases | (41 |
| Principal payments under long-term debt | (65 |

| | |
|---|---|
| Increase in long-term debt | -- |
| Payments on notes payable | -- |
| Payment of embedded derivative feature of preferred stock conversion | -- |
| Payment of preferred dividend | -- |
| Net proceeds from issuance of common stock and warrants | 24,442 |
| Net cash provided by financing activities | 24,336 |
| Net increase (decrease) in cash and cash equivalents | 12,134 |
| Cash and cash equivalents at beginning of period | 13,399 |
| Cash and cash equivalents at end of period | $ 25,533 |
| **Supplemental disclosure of cash flow information** | |
| Cash paid for interest | $ 48 |
| **Supplemental schedule of non-cash investing and financing activities** | |
| Property and equipment acquired under capital leases | $ -- |
| Other non-cash additions to property and equipment | $ 199 |
| Conversion of preferred stock into common stock | $ -- |
| Issuance of common stock for payment of principal and interest on senior secured exchangeable convertible notes | $ -- |
| Conversion of convertible debt into common stock | $ -- |
| Inducement for conversion of preferred stock | $ -- |

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

1. The Company

Microvision is developing compact, low power, high-resolution display and imaging systems based on its integrated photonics module technology platform. Microvision's technology has potential applications for a broad range of consumer, automotive, medical, industrial, and military products. The Company's proprietary technology platform combines bi-axial Micro-Electrical Mechanical system (MEMS) light scanning technologies, lasers, optics, electronics, with its system controls expertise to produce compact display or imaging solutions that the Company anticipates will lead to introduction of new applications and products in the consumer and automotive markets. Historically, Microvision has entered into development agreements with commercial and U.S. government customers to develop applications using its light scanning technologies. Microvision has one commercially marketed product, ROV, a hand-held bar code scanner that incorporates the Company's proprietary MEMS technology.

Microvision's strategy is to design, develop and supply a proprietary display engine called PicoP™, an ultra-miniature video projector capable of producing large, color rich, high resolution images that is small and low power enough to be embedded directly into mobile devices, such as cell phones. Microvision is also marketing PicoP-based miniature projection engines to original equipment manufacturers (OEMs) to be embedded into a variety of consumer products. The primary goal for consumer display applications is to provide users with a large screen, high resolution viewing experience from their mobile devices.

Microvision is currently developing a small accessory projector that would be the first commercial product based on its PicoP display engine. The accessory projector is expected to display images from a variety of video sources including cell phones, portable media players, PDAs, gaming consoles, laptop computers, digital cameras, and other consumer electronics products. It would allow users to watch movies, play videos, and display photos and other data onto a variety of flat or curved surfaces. Microvision expects that the accessory product will be commercially available during 2009.

The PicoP display engine, with some modification, could be embedded into a vehicle or integrated into a portable standalone aftermarket device to create a head-up display (HUD) that could project point-by-point navigation, critical operational, safety and other information important to the vehicle operator. In working with Tier 1 suppliers, the Company has produced prototypes that demonstrate the PicoP's ability to project onto an automobile windshield a high-resolution image readable during day or night. The Company believes that the PicoP display engine could also be modified to be embedded into a pair of glasses to provide a mobile user with a see-through or occluded personal display to view movies, play games or access other content. The Company has worked with the U.S. government and commercial customers to further develop the optical design and integration of the PicoP display engine for wearable applications such as helmet mounted displays and full color see-through eyewear.

Microvision has incurred significant losses since inception. The Company's operating plan for 2009 includes the launch of its first accessory product, further development of the PicoP display engine for embedded applications and further development of HUD and eyewear applications. The Company will require additional capital in 2009 to fully fund its product launch and its other development efforts.

Microvision's operating plan calls for the addition of sourcing, technical and other staff and the purchase of additional laboratory and production equipment. The Company's capital requirements will depend on many factors, including, but not limited to, the rate at which it can, directly or through arrangements with OEMs, introduce products incorporating the PicoP display engine and image capture technologies and the market acceptance and competitive position of such products, the progress of its research and development program, the cost of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights, competing technological and market

developments and the ability of the Company to establish cooperative development, joint venture and licensing arrangements. If revenues are less than anticipated, if the level and mix of revenues vary from anticipated amounts and allocations or if expenses exceed the amounts budgeted, the Company may require additional capital earlier than expected to further the development of its technologies, for expenses associated with product development, and to respond to competitive pressures or to meet unanticipated development difficulties. In addition, the Company's operating plan provides for the development of strategic relationships with systems and equipment manufacturers that may require additional investments by Microvision.

The Company plans to obtain additional cash through the issuance of equity or debt securities. There can be no assurance that additional financing will be available to the Company or that, if available, it will be available on terms acceptable to the Company or on a timely basis. If adequate funds are not available in the next several months to fully implement its plan, or planned revenues are not generated, the Company will begin to reduce the scope of its business to extend its operations as it pursues other financing opportunities and business relationships. This reduction in scope could include product launch and delaying projects resulting in reductions in staff and operating costs as well as reductions in capital expenditures and investment in research and development. With these adjustments to its operating plan, the Company believes it currently has sufficient cash, cash equivalents, and investment securities to fund operations through at least February 28, 2010.

2

. **Summary of significant accounting policies**

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles of the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Company's management has identified the following areas where significant estimates and assumptions have been made in preparing the financial statements: revenue recognition, valuation of auction-rate securities ("ARS"), allowance for uncollectible receivables and management loans, inventory valuation and valuation of derivative financial instruments.

Principles of consolidation

The consolidated financial statements include Microvision and equity investments in which Microvision has the ability to exercise significant influence but does not have voting control.

Cash and cash equivalents; investment securities, available-for-sale; and fair value of financial instruments

The Company's financial instruments include cash and cash equivalents, investments available-for-sale, accounts receivable, accounts payable, accrued liabilities and long-term debt. The carrying value of cash and cash equivalents, investments available-for-sale other than ARS, accounts receivable, accounts payable and accrued liabilities approximate fair value due to the short maturities. In the case of the ARS, the carrying value approximates fair value due to an other than temporary impairment adjustment. The carrying amount of long-term debt at December 31, 2008 and 2007 was not materially different from the fair value based on rates available for similar types of arrangements.

The Company accounts for investment securities in accordance with the provisions of Statement of Financial Accounting Standards ("FAS") No. 115, *Accounting for Certain Investments in Debt and Equity Securities* ("FAS 115") and FAS No. 157, *Fair Value Measurements* ("FAS 157"). FAS 115 addresses the accounting and reporting for investments in equity securities that have readily determinable fair values and for investments in debt securities. FAS

157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. FAS 157 was issued in September 2006 and the Company's adoption of FAS 157 effective January 1, 2008 for financial assets and liabilities did not have a material impact on its consolidated financial position, results of operations or cash flows.

Included in the FAS 157 framework is a three level valuation inputs hierarchy with Level 1 being inputs and transactions that can be effectively fully observed by market participants spanning to Level 3 where estimates are unobservable by market participants outside of the Company and must be estimated using assumptions developed by the Company. The Company discloses the lowest level input significant to each category of asset or liability valued within the scope of FAS 157 and the valuation method as exchange, income or use. The Company uses inputs which are as observable as possible and the methods most applicable to the specific situation of each company or valued item.

In accordance with FAS 115 and related guidance, the Company considers fair valued assets impaired when the value is less than cost. When the impairment is significant, the Company judges whether the impairment is temporary or other-than-temporary. A significant impairment is generally considered other-than-temporary in the period when there is deemed sufficient reason to conclude that the fair value of the asset is not expected to fully recover prior to the expected time of sale or maturity.

The Company's cash equivalents and investment securities available-for-sale are comprised of U.S. government and agency securities, corporate debt and, since 2007, ARS. The Company classifies investment securities available-for-sale purchased with 90 days or less remaining until contractual maturities as cash equivalents. Investment securities purchased with more than 90 days until contractual maturities are classified as current investment securities available-for-sale on the consolidated balance sheet with unrealized gains and losses included in the consolidated statement of comprehensive loss. Interest income, realized gains and losses, and other-than-temporary impairments are recognized in the period earned or incurred and presented separately in the consolidated statement of operations. Changes in the fair values of derivatives are realized in the period of remeasurement and recorded in Gain (loss) on derivative instruments, net in the consolidated statement of operations. The cost of securities sold is based on the specific identification method.

Inventory

Inventory consists of raw material, work in process and finished goods for the Company's ROV and Flic products. Inventory is recorded at the lower of cost or market with cost determined using the weighted-average method. Management periodically assesses the need to provide for obsolescence of inventory and adjusts the carrying value of inventory to its net realizable value when required. In addition, Microvision reduces the value of its inventory to its estimated scrap value when management determines that it is not probable that the inventory will be consumed through normal production during the next twelve months.

Restricted investments

As of December 31, 2008, restricted investments were in money market funds and serve as collateral for $1.3 million in irrevocable letters of credit. Two letters of credit totaling $982,000 are outstanding in connection with a lease agreement for the corporate headquarters building in Redmond, WA. The required balance decreases over the term of the lease, which expires in 2013. In addition, a $350,000 letter of credit is outstanding under the terms of a supplier agreement.

Property and equipment

Property and equipment is stated at cost and depreciated over the estimated useful lives of the assets (two to five years) using the straight-line method. Leasehold improvements are depreciated over the shorter of estimated useful

lives or the lease term.

Revenue recognition

Revenue has primarily been generated from contracts for further development of the light scanning technology and to produce demonstration units for commercial enterprises and the U.S. government.

We recognize contract revenue as work progresses on long-term cost plus fixed fee and fixed price contracts using the percentage-of-completion method, which relies on estimates of total expected contract revenue and costs. Our revenue contracts generally include a statement of the work we are to complete and the total fee we will earn from the contract. When we begin work on the contract and at the end of each accounting period, we work with the members of our technical team to estimate the labor and material and other cost required to complete the statement of work compared to cost incurred to date. We use information provided by project managers, vendors, outside consultants and others as we deem necessary to develop our cost estimates. Since our contracts generally require some level of technology development to complete, the actual cost required to complete a statement of work can vary from our estimated cost to complete. We have developed processes that allow us to make reasonable estimates of the cost to complete a contract. Historically, we have made only immaterial revisions in the estimates to complete the contract at each reporting period. Recognized revenues are subject to revisions as the contract progresses to completion and actual revenue and cost become certain. Revisions in revenue estimates are reflected in the period in which the facts that give rise to the revision become known. In the future, revisions in these estimates could significantly impact recognized revenue in any one reporting period. The U.S. government can terminate a contract with the Company at any time for convenience. If the U.S. government cancels a contract, we would receive payment for work performed and costs committed to prior to the cancellation.

The Company recognizes losses, if any, as soon as identified. Losses occur when the estimated direct and indirect costs to complete the contract exceed unrecognized revenue. The Company evaluates the reserve for contract losses on a contract-by-contract basis.

Revenue from product shipments is recognized in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition*. Revenue is recognized when the product is shipped, there is sufficient evidence of an arrangement, the selling price is fixed or determinable and collection is reasonably assured. Revenue for product shipments with acceptance provisions is recognized upon acceptance of the product by the customer or expiration of the contractual acceptance period, after which there are no rights of return. Provisions are made for warranties at the time revenue is recorded. Warranty expense was not material for any periods presented.

Concentration of credit risk and sales to major customers

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk are primarily cash equivalents, investment securities available-for-sale and accounts receivable. The Company typically does not require collateral from its customers. The Company has an investment policy that generally directs investment managers to select investments to achieve the following goals: preservation of principal, adequate liquidity and return. As of December 31, 2008, the Company's cash and cash equivalents and investments available-for-sale securities portfolio are comprised of short-term highly rated money market funds and commercial paper, and the student loan ARS ("SLARS").

As of December 31, 2008 and 2007, the Company held $3.0 million and $8.8 million in ARS, respectively. During February through May 2008, $5.8 million in municipal ARS were sold at par value leaving $3.0 million in SLARS. As of December 31, 2008, 90% of total cash and cash equivalents and investment securities available-for-sale had variable interest rates or are very short-term discount notes traded in active markets. Therefore, the Company believes its exposure to credit market and interest rate risk is not material. The remaining 10% is composed of the $3.0 million par value SLARS. The SLARS are highly rated long-term bonds and are structured with variable interest rate resets to be determined via a Dutch Auction process every 28 days. However, beginning in February 2008 as global credit markets significantly deteriorated, each auction has failed rendering the SLARS temporarily illiquid through the auction process and secondary markets for them. Given the adverse credit market conditions, the fair value of the

principal of these bonds has become affected by changes in interest rates, the spread between short and long rates, and credit market liquidity. As a result, in the quarter ended September 30, 2008, the Company estimated that the fair value of the SLARS was approximately $2.7 million and that the $300,000 adjustment was other than temporary. If market conditions worsen, the Company may have to further adjust the estimated fair value of the SLARS, including additional charges to earnings if it believes the adjustment is other than temporary. In the event the Company needs access to the funds invested in the SLARS, it could be required to sell them below the original purchase value. Any of these events could affect the Company's consolidated financial condition, results of operations and cash flows. However, based on the Company's current operating plan and ability to access its $25.5 million held in cash and cash equivalents and other highly liquid investments held as of December 31, 2008, it does not expect to be required to sell the securities materially below the current estimated value.

Concentration of Sales to Major Customers

The United States government accounted for approximately 34%, 61%, and 51% of total revenue during 2008, 2007, and 2006, respectively. Two commercial customers accounted for approximately 15% and 11%, respectively, of total revenue during 2008, one commercial customer accounted for approximately 15% of total revenue during 2007 and one commercial customer accounted for approximately 11% of total revenue during 2006. Contracts with three commercial customers represented 35%, 22%, and 17% of total revenues during 2008, 2007 and 2006, respectively. The U.S. government accounted for approximately 19% and 28% of the accounts receivable balance at December 31, 2008 and 2007, respectively.

Income taxes

Deferred tax assets and liabilities are recorded for differences between the financial statement and tax bases of the assets and liabilities that will result in taxable or deductible amounts in the future, based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense is recorded for the amount of income tax payable for the period increased or decreased by the change in deferred tax assets and liabilities during the period.

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 periods. Net loss per share assuming dilution is calculated on the basis of the weighted-average number of common shares outstanding and the dilutive effect of all potentially dilutive securities, including common stock equivalents and convertible securities. Net loss per share assuming dilution is equal to basic net loss per share because the effect of dilutive securities outstanding during the periods including options and warrants computed using the treasury stock method, is anti-dilutive.

As of December 31, 2008, 2007, and 2006, the Company excluded the following convertible securities from diluted net loss per share as the effect of including them would have been anti-dilutive. The shares shown represent the number of shares of common stock which would be issued upon conversion as of December 31, 2008, 2007, and 2006.

| | December 31, | | |
|---|---|---|---|
| | **2008** | **2007** | **2** |
| Publicly traded warrants | 6,703,000 | -- | 12,3 |
| Options and private warrants | 9,804,000 | 9,518,000 | 10,9 |
| Notes payable | -- | -- | 6 |

| 16,507,000 | 9,518,000 | 23,8 |
|---|---|---|
| =========== | =========== | ==== |

Research and development

Research and development costs are expensed as incurred.

Fair value of financial instruments

The Company's financial instruments generally include cash and cash equivalents, investments available-for-sale, accounts receivable, accounts payable, accrued liabilities and long-term debt. The carrying amount of long- term debt at December 31, 2008 and 2007 was not materially different from the fair value based on rates available for similar types of arrangements. The carrying value of the Company's financial instruments, other than ARS, approximates fair value due to the short maturities.

Long-lived assets

The Company evaluates the recoverability of its long-lived assets when an impairment is indicated based on expected undiscounted cash flows and recognizes impairment of the carrying value of long-lived assets, if any, based on the fair value of such assets.

Stock-based compensation

The Company has one stock-based incentive compensation plan as of December 31, 2008 and a separate board of director stock-based compensation plan. In June 2008, the Company determined it would no longer issue additional options from the Independent Director Stock Option Plan. Both are more fully described in Note 11.

The Company accounts for stock-based employee compensation arrangements in accordance with the provisions of FAS No. 123, as revised December 2004, *Share-Based Payment* ("FAS 123(R)"). The Company adopted FAS123(R) effective January 1, 2006. The Company accounts for non-employee share-based compensation in accordance with the provisions of FAS No. 123 and Emerging Issues Task Force ("EITF") Issue No. 96-18. The following table shows the amount of stock-based compensation expense included in the statement of operations for each period shown:

| | **Year Ended December 31,** | | |
|---|---|---|---|
| | **2008** | **2007** | **2** |
| Cost of contract revenue | $ 85,000 | $ 138,000 | $ 8 |
| Cost of product revenue | 25,000 | 20,000 | 7 |
| Research and development expense | 824,000 | 365,000 | 24 |
| Sales, marketing, general and administrative expense | 1,873,000 | 1,274,000 | 1,42 |
| | $ 2,807,000 | $ 1,797,000 | $1,82 |

Reclassifications

Certain reclassifications have been made to prior year financial statements to conform to classifications used in the current year. These reclassifications had no impact on net loss, shareholders' equity or cash flows as previously reported.

New accounting pronouncements

In October 2008, the Financial Accounting Standards Board ("FASB") released a FASB Staff Position, FSP FAS 157-3 - *Determining the Fair Value of a Financial Asset When The Market for That Asset Is Not Active*, to clarify the application of the provisions of FAS 157 in an inactive market. Implementing this standard upon its issuance did not have a material impact on the Company's consolidated financial position and results of operations.

In February 2008, the FASB released a FASB Staff Position, FSP FAS 157-2 - *Effective Date of FASB Statement No. 157*, which delays the effective date of FAS 157 for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years beginning after November 15, 2008. The Company is currently assessing the financial impact of FSP FAS 157-2 on its financial statements.

In June 2007, the EITF reached a final consensus on EITF Issue No. 07-1, *Accounting for Collaborative Arrangements* ("EITF 07-1"). EITF 07-1 discusses how to determine whether an arrangement constitutes a collaborative arrangement, how costs incurred and revenue generated on sales to third parties should be reported by the participants, how an entity should characterize payments made between participants and what participants should disclose in the notes to the financial statements about a collaborative arrangement. EITF 07-1 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. The Company is currently assessing the financial impact of EITF 07-1 on its financial statements.

3. Long-term contracts

Cost and estimated earnings in excess of billings on uncompleted contracts comprises amounts of revenue recognized on contracts that the Company has not yet billed to customers because the amounts were not contractually billable at December 31, 2008 and 2007. The following table summarizes when the Company will be contractually able to bill the balance as of December 31, 2008 and 2007.

| | Year Ended December 31, | |
|---|---|---|
| | 2008 | 2007 |
| Billable within 30 days | $ 688,000 | $ 434,000 |
| Billable between 31 and 90 days | -- | -- |
| Billable after 90 days | 7,000 | 9,000 |
| | $ 695,000 | $ 443,000 |

The Company's current contracts with the U.S. government are primarily cost plus fixed fee type contracts. Under the terms of a cost plus fixed fee contract, the U.S. government reimburses the Company for negotiated actual direct and indirect cost incurred in performing the contracted services. The Company is under no obligation to spend more than the contract value to complete the contracted services. The period of performance is generally one year. Each of the Company's contracts with the United States government can be terminated for convenience by the government at any time. To date, the U.S. government has not terminated a contract with the Company.

In December 2007, we entered into a $1 million contract with a commercial customer to develop prototype units based on our PicoP technology, for evaluation of future consumer electronics product applications. The development work under this contract was initiated and fully completed in 2008.

In May 2007, the Company announced that it had entered into a $3,181,000 contract with the U.S. Air Force to provide a lightweight, see-through, full-color eyewear display prototype to the government. The contract, which continues a development effort with the Air Force, specifies the development, design, verification, testing, and delivery of a lightweight, see-through full-color wearable display for evaluation by several DOD project offices. As of December 31, 2008 this contract had been completed.

In September 2006, the Company entered into a 12 month development agreement with Visteon, a major global Tier 1 automotive supplier, to develop a commercial scanned-beam head-up display (HUD) product for automotive applications. Under the agreement, Visteon and Microvision will design and produce a series of advanced HUD samples, including devices specifically designed to be compatible with automotive environmental requirements. As of December 31, 2007 this contract had been completed.

In September 2006, the Company entered into an 18 month, $5,945,000 contract with General Dynamics C4 Systems to supply full-color, daylight readable, see-through helmet-mounted displays as part of the U.S. Army's Mounted Warrior HMD Improvement Program. General Dynamics holds prime contracts with the U.S. Army for other Warrior programs including Land Warrior, Air Warrior and Future Force Warrior Advanced Technology Demonstration. The contract specifies the development and delivery of ten full-color display units for evaluation. As of December 31, 2008 this contract had been completed.

The following table summarizes the costs incurred on the Company's revenue contracts:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Costs and estimated earnings incurred on uncompleted contracts | $ 14,166,000 | $ 9,357,000 |
| Billings on uncompleted contracts | (13,533,000) | (9,884,000) |
| | $ 633,000 | $ (527,000) |
| **Included in accompanying balance sheets under the following captions:** | | |
| Costs and estimated earnings in excess of billings on uncompleted contracts | $ 695,000 | $ 443,000 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | (62,000) | (970,000) |
| | $ 633,000 | $ (527,000) |

4. Cash equivalents, investment securities, available-for-sale, and fair value measurements

The Company accounts for investment securities in accordance with the provisions of FAS 115 and FAS 157. General descriptions of each are included in Note 2.

FAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability in its principal or most advantageous market in an orderly transaction between market participants on the measurement date. FAS 157 establishes a three level fair value inputs hierarchy, and requires an entity to maximize the use of observable valuation inputs and minimize the use of unobservable inputs. A company is to utilize market data, assumptions and risks it believes market participants would use in measuring the fair value of the asset or liability, including the risks inherent in the inputs and the valuation techniques. The hierarchy is summarized below.

Level 1 - Observable inputs such as quoted prices in active markets for identical assets or liabilities.

Level 2 - Observable inputs such as quoted prices for similar assets or liabilities in markets that are not sufficiently active to qualify as level 1 or, other observable inputs.

Level 3 - Unobservable inputs for which there is little or no market data, which requires a company to develop its own assumptions, which are significant to the measurement of the fair values.

The Company's investment securities are comprised of debt securities. Generally, they are issued by the U.S. government, its agencies, corporations, and currently, student loan financial aid organizations. Accounting for these investments is discussed in Note 2.

The principal markets for the debt securities are dealer markets which have a high level of price transparency. The market participants for debt securities are typically large money center banks and regional banks, brokers, dealers, pension funds, and other entities with debt investment portfolios.

As of December 31, 2007, the Company held $8.8 million aggregate par value of ARS, $5.8 million in municipal ARS and $3.0 million in SLARS. The municipal ARS were sold at par value during the period from February through May 2008.

At December 31, 2008, the Company continued to hold $3.0 million par value SLARS. The SLARS owned by the Company are highly rated long-term bonds, structured with variable interest rate resets, purchases and sales to be determined via a Dutch Auction process every 28 days. They were issued to fund US government guaranteed student loans. However, beginning in February 2008 as global credit markets significantly deteriorated, insufficient clearing bids have been submitted for the SLARS. The auctions have thus failed, the interest rates have been reset to "maximum rates" instead of "auction rates" and the SLARS have been temporarily illiquid through the auction process and secondary ARS markets.

At the time of the Company's initial investment, and through the filing date of this report, the SLARS held by the Company have maintained the following credit factors:

- guaranteed by the Federal Family Education Loan Program ("FFELP") and other federal and state student loan guarantee programs,
- collateralized by the student loans funded with the SLARS proceeds and collections thereon,
- no declines in the credit ratings of the issuers; and,
- no material changes in loan collection rates.

At the time of the Company's initial investment, the SLARS and AMBAC, the insurer of half of the SLARS, held AAA ratings. As of December 31, 2008 one of the SLARS was downgraded to A by only one of its rating services. AMBAC has since been down-graded to A by Standard & Poor's and to Baa1 by Moody's rating services. Based on its revised lower rating of AMBAC, Moody's reduced its rating on the insured SLARS to that of AMBAC, Baa1. AMBAC is continuing actions to manage its credit rating. The U.S. government guarantee on the student loan collateral reduces the impact of the ratings changes on the SLARS.

Prior to June 30, 2008, the Company used the market approach to measure fair values of its investments in all debt and equity securities and the income approach for derivatives. Under the market approach, prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities are used to estimate values. Under the income approach, valuation techniques to convert future amounts to a single present amount are used. During the quarter ended June 30, 2008, the Company determined the market did not have sufficient liquidity and market participant activity to continue supporting the market approach to value its SLARS, and changed to the income approach.

As of September 30, 2008, based on continuing low market liquidity and auction failures with significant uncertainty as to when such conditions would improve, the Company determined that the estimated fair value of the SLARS no longer approximated par value, and the impairments were other-than-temporary. The Company used a discounted cash

flow model, with rates adjusted for liquidity, to determine the estimated fair values of the SLARS as of September 30, 2008 and recorded an "impairment of investment securities, available-for-sale" of $300,000 on the consolidated statement of operations. The Company also reclassified the SLARS from Level 2 to Level 3 of the fair value hierarchy because of the significance of sufficiently unobservable assumptions and inputs developed by the Company and used in the valuations. As of December 31, 2008, the Company derived the same conclusions regarding the valuation approach, inputs hierarchy and fair values for the SLARS.

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

| | |
|---|---|
| Balance, December 31, 2007 | $ -- |
| Transfer into Level 3, September 30, 2008 | 3,000,000 |
| Recognized loss included in earnings | (300,000) |
| Balance, December 31, 2008 | $ 2,700,000 |

The valuation inputs hierarchy classification for assets and liabilities measured at fair value on a recurring basis in accordance with FAS 157 are summarized below as of December 31, 2008:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Assets | | | | |
| Corporate debt securities | $ -- | $4,984,000 | $ -- | $ 4,984,000 |
| Auction rate securities | -- | -- | 2,700,000 | 2,700,000 |
| | $ -- | $4,984,000 | $2,700,000 | $ 7,684,000 |
| Liabilities | | | | |
| Liability associated with common stock warrants | | $ 331,000 | | $ 331,000 |

The corporate debt securities are classified within Level 2 of the fair value hierarchy because they are valued using actual and quoted pricing sources with sufficient levels of price transparency using the market approach. The liability associated with common stock warrants is classified within Level 2 because it is valued using the Black-Scholes option valuation method using inputs with sufficient levels of observability using the income approach. Financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

The Company's investments and liability associated with common stock warrants are summarized below as of December 31, 2008 and December 31, 2007.

| | Cost/ Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Class |
|---|---|---|---|---|---|
| | | | | | Ca Equiv |
| As of December 31, 2008: | | | | | |

| | Cost/ Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | |
|---|---|---|---|---|---|
| Assets | | | | | |
| Corporate debt securities | $ 5,022,000 | $ -- | $ (38,000) | $ 4,984,000 | $ 4,97 |
| Auction-rate securities | 2,700,000 | -- | -- | 2,700,000 | |
| | $ 7,722,000 | $ -- | $ (38,000) | $ 7,684,000 | $ 4,97 |
| Liabilities | | | | | |
| Liability associated with common stock warrants | | | | $ 331,000 | |

| | | | | | Class |
|---|---|---|---|---|---|
| | Cost/ Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value | Ca Equiv |
| As of December 31, 2007: | | | | | |
| Assets | | | | | |
| Corporate debt securities | $ 9,074,000 | $ 54,000 | $ (5,000) | $ 9,123,000 | $ |
| U.S. government and agency securities | 4,486,000 | 3,000 | (1,000) | 4,488,000 | |
| Auction-rate securities | 8,800,000 | -- | -- | 8,800,000 | |
| Warrants | -- | -- | -- | 130,000 | |
| | $22,360,000 | $ 57,000 | $ (6,000) | $22,541,000 | $ |
| Liabilities | | | | | |
| Liability associated with common stock warrants | | | | $ 2,657,000 | |

As of December 31, 2008, the unrealized losses on the Company's investments in debt securities were due primarily to changes in interest rates and credit market conditions.

The realized gains and losses associated with the liability attributed to common stock warrants were primarily due to changes in the Microvision stock price and decreasing terms to expiration.

The maturities of the investment securities available-for-sale as of December 31, 2008 are shown below:

| | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| Maturity date: | | | | |
| Less than one year | $ 5,022,000 | -- | (38,000) | $ 4,984,000 |
| Due in 1-3 years | -- | | | -- |
| Greater than five years | 2,700,000 | | | 2,700,000 |
| | $ 7,722,000 | | | $ 7,684,000 |

5. Inventory

Inventory consists of the following:

| | December 31, 2008 | December 31, 2007 |
|---|---|---|
| Raw materials | $ 45,000 | $ 122,000 |
| Work in process | -- | 10,000 |
| Finished goods | 1,480,000 | 629,000 |
| | $ 1,525,000 | $ 761,000 |

The inventory at December 31, 2008 and 2007 consisted of raw materials, work in process and finished goods for ROV and the discontinued Flic bar code product. Inventory is stated at the lower of cost or market, with cost determined on a weighted average basis. Management periodically assesses the need to provide for obsolescence of inventory and adjusts the carrying value of inventory to its net realizable value when required. In addition, Microvision reduces the value of its inventory to its estimated scrap value when management determines that it is not probable that the inventory will be consumed through the normal course of business during the next twelve months. In 2008, 2007, and 2006, Microvision recorded inventory write-downs of $475,000, $84,000, and $1,181,000, respectively. During the second quarter of 2006, the Company determined that it would no longer promote the Nomad product and recorded an expense of $210,000 to reduce the value of Nomad inventory to zero. In addition, the Company recorded $100,000 as additional accelerated depreciation expense related to fixed assets used in Nomad production. Both inventory and fixed asset balances related to Nomad production were zero at December 31, 2008 and December 31, 2007.

6. Accrued liabilities

Accrued liabilities consist of the following:

| | December 31, | |
|---|---|---|
| | 2008 | 2007 |
| Bonuses | $ 500,000 | $ 1,500,000 |
| Payroll and payroll taxes | 809,000 | 656,000 |
| Compensated absences | 623,000 | 458,000 |
| Deferred rent credit | 311,000 | 306,000 |
| Adverse purchase commitments | 119,000 | -- |
| Professional fees | 343,000 | 447,000 |
| Other | 840,000 | 787,000 |
| | $ 3,545,000 | $ 4,154,000 |

7. Property and equipment, net

Property and equipment consists of the following:

| | December 31, | |
|---|---|---|
| | 2008 | 2007 |

| | | |
|---|---|---|
| Production equipment | $ 3,124,000 | $ 2,815,000 |
| Leasehold improvements | 3,310,000 | 3,304,000 |
| Computer hardware and software/lab equipment | 7,192,000 | 6,879,000 |
| Office furniture and equipment | 1,496,000 | 1,490,000 |
| | 15,122,000 | 14,488,000 |
| Less: Accumulated depreciation | (11,421,000) | (10,441,000) |
| | $ 3,701,000 | $ 4,047,000 |

Depreciation expense was $989,000, $953,000, and $1,218,000 in 2008, 2007, and 2006, respectively.

8. Receivables from related parties

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

In January 2006, two officers with outstanding loans left the Company and their loans became due in January 2007. In May 2007, the Company foreclosed on 50,000 shares of Lumera common stock pledged as collateral for one of the officer's loans and sold the shares for net proceeds of $227,000. A third officer with outstanding loans left the Company in August 2007 and his loans became due in August 2008.

Under the terms of a settlement agreement with one of the former officers who left in January 2006, the Company received payments of $241,000 in 2008. The Company is pursuing collection of the remaining outstanding balances from the other former officers.

As of December 31, 2008 and December 31, 2007, the total amount outstanding under the lines of credit was $1,851,000 and $2,496,000, respectively. As of December 31, 2008 and December 31, 2007, the allowance for receivables from related parties was $1,851,000 and $2,496,000, respectively.

The interest on the lines of credit is forgiven if the executive is an employee of the Company at December 31 of the respective year. Compensation expense of $22,000 was recognized in 2006, for interest forgiven.

9. Common stock

In July 2008, the Company raised approximately $26.0 million, before issuance costs of approximately $2.0 million, through a registered direct public offering of 11,172,000 shares of common stock and warrants to purchase 6,703,000 shares of its common stock. Details of the warrants are described below in Note 10.

On June 21, 2007, the Company exercised its right to call its publicly traded warrants issued in 2006. The Company received $34.1 million from the exercise of 12,855,000 publicly traded warrants.

In November 2006, the Company raised $7.9 million, before issuance costs of $779,000, through an underwritten public offering of 3,318,000 shares of its common stock.

In June and July 2006, the Company raised an aggregate of $27.1 million, before issuance costs of $2.2 million, through an underwritten public offering of 11.6 million shares of its common stock and warrants to purchase 12.4 million shares of its common stock. The warrants had an exercise price of $2.65 per share, a five year term, and were not exercisable for one year from the date of issuance. The Company could call the warrants after one year from the

date of issuance if the average closing bid price of its stock exceeded $5.30 for any 20 consecutive trading days. In connection with the offering, the Company issued the underwriter a warrant to purchase 537,500 shares of Microvision common stock at an exercise price of $2.76 per share. The Company also issued the underwriter a warrant to acquire 537,500 warrants, identical to those sold in the offering, at an exercise price of $0.16 per warrant. Both underwriter warrants were issued with a 4 year term. In June 2007, the Company called the public warrants as described above and the underwriter exercised the warrants for warrants in connection with the call.

10. Warrants

In July 2008, the Company raised approximately $26.0 million, before issuance costs of approximately $2.0 million, through a registered direct public offering of 11,172,000 shares of our common stock and warrants to purchase 6,703,000 million shares of our common stock. The warrants have an exercise price of $3.60 per share, a five year term, and are not exercisable for one year from the date of issuance. The Company can call the warrants after one year from the date of issuance if the average closing bid price of its stock is over $7.20 (200% of exercise price) for any 20 consecutive trading days. The warrants are listed on the NASDAQ Global Market under the ticker "MVISW".

On June 21, 2007, the Company exercised its right to call its publicly traded warrants issued in its June and July 2006 financing transactions. The Company received $34.1 million from the exercise of 12,855,000 publicly traded warrants.

A total of 45,000 warrants expired unexercised.

The following summarizes activity with respect to Microvision common stock warrants during the three years ended December 31, 2008:

| | Warrants to purchase common Shares | Weighted-average excercise price |
|---|---|---|
| Outstanding at December 31, 2005 | 4,120,000 | $ 6.99 |
| Granted: | | |
| Exercise price greater than intrinsic value | 12,900,000 | 2.66 |
| Exercise price equal to intrinsic value | 537,000 | 2.81 |
| Exercised | -- | -- |
| Canceled/expired | -- | -- |
| Outstanding at December 31, 2006 | 17,557,000 | 3.50 |
| Granted: | | |
| Exercise price greater than intrinsic value | 537,000 | 2.65 |
| Exercise price equal to intrinsic value | 25,000 | 3.42 |
| Exercised | (13,803,000) | 2.59 |
| Canceled/expired | (252,000) | 6.30 |
| Outstanding at December 31, 2007 | 4,064,000 | 6.19 |
| Granted: | | |
| Exercise price greater than intrinsic value | 6,703,000 | 3.60 |
| Exercise price equal to intrinsic value | -- | -- |
| Exercised | -- | -- |
| Canceled/expired | (1,257,000) | 6.11 |
| Outstanding at December 31, 2008 | 9,510,000 | $ 4.32 |
| Exercisable at December 31, 2008 | 2,807,000 | $ 6.04 |

The following table summarizes information about the weighted-average fair value of Microvision common stock warrants granted for the periods shown:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2006 |
| Exercise price greater than fair value | $ 1.59 | $ -- | $ 1.81 |
| Exercise price equal to fair value | -- | 2.08 | -- |
| Exercise price less than fair value | -- | 0.47 | 2.00 |

The fair values of the Microvision common stock warrants granted were estimated on the respective grant dates using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2008, 2007, and 2006, respectively: dividend yield of zero percent for all years; expected volatility of 65%, 47%, and 65%; risk-free interest rates of 3.2%, 4.9%, and 5.0% and expected lives of 5, 0.3, and 5 years, respectively.

The following table summarizes information about Microvision common stock warrants outstanding and exercisable at December 31, 2008:

| | Warrants outstanding | | | Warrants exercisable | |
|---|---|---|---|---|---|
| Range of exercise prices | Number outstanding at December 31, 2008 | Weighted average remaining contractual life (years) | Weighted average excercise price | Number exercisable at December 31, 2008 | Weighted average excercise price |
| $2.76-$3.51 | 472,000 | 2.24 | $ 2.93 | 472,000 | $ 2.93 |
| $3.60-$3.61 | 7,065,000 | 4.36 | 3.60 | 362,000 | 3.61 |
| $3.77-$3.94 | 1,304,000 | 1.87 | 3.91 | 1,304,000 | 3.91 |
| $5.03-$5.32 | 469,000 | 1.19 | 5.03 | 469,000 | 5.03 |
| $34.00 | 200,000 | 1.61 | 34.00 | 200,000 | 34.00 |
| $2.76-$34.00 | 9,510,000 | | | 2,807,000 | |

11. Share-Based Compensation

The Company accounts for equity instruments issued to employees in accordance with the provisions of FAS123(R). FAS 123(R) requires all employee share-based awards to be valued at fair value and expensed over the applicable service period. The valuation of and accounting for share-based awards includes a number of complex and subjective estimates. These estimates include, but are not limited to, the future volatility of the Company's stock price, future employee stock option exercise behaviors and future employee terminations. The Company uses the estimated forfeiture and straight-line expense attribution methods.

As a result of adopting FAS 123(R), the Company's net loss for each of the years ended December 31, 2008, 2007 and 2006 included $2.8 million, $1.8 million, and $1.8 million of share-based employee compensation expense. In addition, basic and diluted net loss per share was greater by $0.05, $0.04 and $0.05 per share, respectively.

The share-based employee compensation expense charged against loss was as shown below (in thousands):

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2 |
| Share-based employee compensation expense charged against loss | $ 2,807 | $ 1,797 | $ |

The Company accounts for equity instruments issued to non-employees in accordance with the provisions of FAS 123 and EITF 96-18.

Stock Option Exchange

Subject to the terms of its tender offer filed in April 2006, on May 17, 2006, the Company exchanged 2.2 million existing options for 2.2 million new options affecting 105 employees. The new options have an exercise price of $2.77. The new options vested 25% on the grant date and will vest 25% on each subsequent annual anniversary. The tender offer did not result in the acceleration of vesting of any options. The new options have the same expiration dates as the options exchanged. The Company also adjusted the exercise price of 386,000 options not subject to the tender offer to $2.77 on the same date affecting 19 employees.

The tender offer was accounted for in accordance with FAS 123(R). The Company will recognize $496,000 incremental fair value as additional non-cash compensation. The incremental expense is recognized ratably over the vesting periods of the options, 25% on the grant date with the remaining 75% straight-line over the remaining vesting period. The incremental fair value of the modified options was estimated using the Black-Scholes option pricing model with the following assumptions.

| | Pre-modification | Post-modification |
|---|---|---|
| Weighted average: | | |
| Exercise price | $ 8.84 | $ 2.77 |
| Volatility | 73% | 65% |
| Expected term (years) | 6.9 | 4.2 |
| Risk free rate | 5.0% | 5.0% |
| Pre-vest forfeiture rate | 5.0% | 5.0% |

Description of Incentive Plans

The Company currently has two share-based incentive plans. The 2006 Incentive Plan described below is administered by the Board of Directors, or its designated committee ("Plan Administrator"), and provides for various awards as determined by the Plan Administrator. The Company terminated using a second share-based incentive plan, the Independent Director Stock Option Plan described below, in June 2008.

In July 2006, the 1996 Stock Option Plan (the "1996 Plan") expired. In September 2006, Company shareholders approved the 2006 Microvision, Inc. Incentive Plan which amends, restates and renames the 1996 Plan ("2006 Incentive Plan"). All awards outstanding under the 1996 Plan remain outstanding under the 2006 Incentive Plan. The 2006 Incentive Plan retained the 8.0 million share authorization of the 1996 Plan and permits granting non-qualified stock options ("NSOs"), incentive stock options ("ISOs"), stock appreciation rights, restricted or unrestricted stock, deferred stock, other share-based awards, or cash awards to employees, officers and certain non-employees of the Company. Any award may be a performance-based award. Awards granted under the 2006 Incentive Plan have generally been to employees under non-qualified stock option agreements with the following provisions: exercise prices greater than or equal to the Company's closing stock price on the date of grant; vesting periods ranging from three years to four years; expiration 10 years from the date of grant; and optionees who terminate their service after

vesting have a limited time to exercise their options (typically three to twelve months). In June 2008, the Company shareholders approved an amendment to the 2006 Incentive Plan to increase the common stock reserved for issuance under the plan to 11.4 million shares and allow non- employee directors to participate in the plan.

The Independent Director Stock Option Plan ("IDSOP") has 900,000 shares authorized and permits granting NSOs to independent directors of the Company. In June 2005, shareholders approved an amendment to the Director Option Plan, increasing the number of shares reserved for the plan by 400,000 to 900,000 shares. Under the IDSOP, upon initial election or appointment to the Board of Directors, Directors received a fully vested option to purchase 15,000 shares of common stock and a second option to purchase 15,000 shares of common stock. Upon reelection to the Board, Directors received a subsequent option to purchase 15,000 shares of common stock. The second initial option grant and any reelection grant vested the earlier of one year from date of grant or the day before the next regularly scheduled annual shareholder meeting. Grants awarded under the IDSOP generally, had the following terms: exercise price equal to the Company's closing stock price on the date of grant, expiration 10 years from the date of grant, and vested grants remain exercisable until their expiration dates if a director leaves the Board. In June 2008, the Company shareholders approved an amendment to the 2006 Incentive Plan described above to allow non-employee directors to participate in the plan. Annual grants were made to independent directors from the IDSOP concurrent with each director's annual reelection in June 2008. The Company does not intend to issue additional options from the IDSOP.

Options Valuation Methodology and Assumptions

The Company uses the Black-Scholes option valuation model to determine the fair value of options granted and uses the closing price of its common stock as the fair market value of its stock on that date.

The Company considers historical stock price volatilities, volatilities of similar companies and other factors in determining its estimates of future volatilities.

The Company uses historical lives, including post-termination exercise behavior, publications, comparable company estimates, and other factors as the basis for estimating expected lives.

Risk free rates are based on the U.S. Treasury Yield Curve as published by the U.S. Treasury.

The following table summarizes the weighted-average valuation assumptions and weighted-average grant date fair value of options granted, excluding grants issued under the Company's tender offer which require an incremental valuation methodology and are disclosed above, during the periods shown below:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2008 | 2007 | 2 |
| Assumptions (weighted average) | | | |
| Volatility | 65% | 68% | |
| Expected term (in years) | 5.1 | 6.2 | |
| Risk-free rate | 3.0% | 5.0% | |
| Expected dividends | -- | -- | |
| Pre-vest forfeiture rate | 5.0% | 5.0% | |
| Grant date fair value of options granted | $ 1.32 | $ 2.67 | $ |

Options Activity and Positions

The following table summarizes activity and positions with respect to options for the year ended December 31, 2008:

| Options | Shares | Weighted Average Exercise Price | Wei Ave Rema Cont T (ye |
|---|---|---|---|
| Outstanding at December 31, 2005 | 5,320,000 | $ 11.09 | |
| Granted * | 4,280,000 | 2.99 | |
| Exercised | (16,000) | 2.77 | |
| Forfeited or expired * | (3,873,000) | 9.62 | |
| Outstanding as of December 31, 2006 | 5,711,000 | 6.04 | |
| Granted | 1,617,000 | 4.08 | |
| Exercised | (84,000) | 2.78 | |
| Forfeited or expired | (1,790,000) | 9.05 | |
| Outstanding as of December 31, 2007 | 5,454,000 | 4.52 | |
| Granted | 2,276,000 | 2.33 | |
| Exercised | (143,000) | 2.72 | |
| Forfeited or expired | (590,000) | 2.93 | |
| Outstanding as of December 31, 2008 | 6,997,000 | $ 3.98 | |
| Vested and expected to vest as of December 31, 2008 | 6,745,000 | $ 4.02 | |
| Exercisable as of December 31, 2008 | 3,163,000 | $ 5.12 | |

* Includes 2.2 million shares exchanged pursuant to stock option exchange disclosed above

The total intrinsic value of options exercised during the years ended December 31, 2008, 2007, and 2006 were $87,000, $163,000, and $5,000, respectively.

As of December 31, 2008, the Company's unamortized share-based compensation was $4.7 million. The Company plans to amortize this share-based compensation cost over the next 2.4 years.

In October 2008, the Company's Board of Directors approved the payment of one half of each independent director's annual retainer fee to be paid in the Company's common stock. The common stock was valued at intrinsic value on the date of grant. A total of $50,000 was expensed on the grant date. Each independent director received 7,092 shares of common stock.

In March 2008, the Company's Board of Directors approved the issuance of 125,000 nonvested equity shares of the Company's common stock to the executive employees under the terms and conditions of the 2006 Incentive Plan. The shares vest over a three year period from the date of grant. The nonvested equity shares were valued at intrinsic value on the date of grant and the share-based compensation expense will be amortized over the three year service period.

As of December 31, 2008, the Company's unamortized nonvested equity share-based compensation was $177,000. The Company plans to amortize this nonvested equity share-based compensation over the next 2.2 years.

12. Commitments and contingencies

Agreements with the University of Washington ("UW")

In October 1993, the Company entered into a Research Agreement and an exclusive license agreement ("License Agreement") with the UW. The License Agreement grants the Company the rights to certain intellectual property, including the technology being subsequently developed under the Microvision research agreement ("Research Agreement"), whereby the Company has an exclusive, royalty-bearing license to make, use and sell or sublicense the licensed technology. In consideration for the license, the Company agreed to pay a one-time nonrefundable license issue fee of $5,134,000. Payments under the Research Agreement were credited to the license fee. In addition to the nonrefundable fee, which has been paid in full, the Company is required to pay certain ongoing royalties. Beginning in 2001, the Company is required to pay the UW a nonrefundable license maintenance fee of $10,000 per quarter, to be credited against royalties due.

Litigation

The Company has sued its former CEO and President Richard Rutkowski and his spouse to collect $1,733,000 in outstanding loans from the Company that were due in January 2007 and remain unpaid. Counterclaims were filed by Mr. Rutkowski and his spouse, seeking to recover damages in an amount in excess of $15,000,000. The Company believes these claims are without merit and intends to defend them vigorously. However, an adverse outcome could have a material adverse affect on its financial condition.

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

Lease commitments

The Company leases its office space and certain equipment under noncancelable capital and operating leases with initial or remaining terms in excess of one year.

The Company entered into a 90 month facility lease that commenced in February 2006. The lease includes extension and rent escalation provisions over the 90 month term of the lease. Rent expense will be recognized on a straight-line basis over the lease term.

Future minimum rental commitments under capital and operating leases for years ending December 31 are as follows:

| | Capital leases | Operating leases |
|---|---|---|
| 2009 | $ 47,000 | $ 844,000 |
| 2010 | 40,000 | 870,000 |
| 2011 | 8,000 | 904,000 |
| 2012 | -- | 938,000 |
| 2013 | -- | 564,000 |
| Thereafter | -- | -- |
| Total minimum lease payments | 95,000 | $ 4,120,000 |
| Less: Amount representing interest | (9,000) | |
| Present value of capital lease obligations | 86,000 | |
| Less: Current portion | (41,000) | |
| Long-term obligation at December 31, 2008 | $ 45,000 | |

The capital leases are collateralized by the related assets financed and by security deposits held by the lessors under the lease agreements. The cost and accumulated depreciation of equipment under capital leases was $1,017,000 and $932,000, respectively, at December 31, 2008 and $1,017,000 and $886,000, respectively, at December 31, 2007.

Net rent expense was $861,000, $830,000, and $1,082,000 for 2008, 2007, and 2006, respectively. Sub-lease income of $0, $0, and $125,000 for 2008, 2007, and 2006, respectively, was included as a reduction in rent expense.

Long-term debt

During 2006, the Company entered into a loan agreement with the lessor of the Company's corporate headquarters in Redmond to finance $536,000 in tenant improvements. The loan carries a fixed interest rate of 9% per annum, is repayable over the initial term of the lease, which expires in 2013, and is secured by a letter of credit. The balance of the loan was $393,000 at December 31, 2008.

Adverse purchase commitments

The Company has periodically entered into noncancelable purchase contracts in order to ensure the availability of materials to support bar code scanner production. Management periodically assesses the need to provide for impairment on these purchase contracts and records a loss on purchase commitments when required. In December 2008, the Company recorded a loss of $119,000 to cost of product revenue as a result of commitments to purchase materials for the ROV scanner that were in excess of its estimated future proceeds from the sale of the ROV scanners. In December 2006, the Company recorded a loss of $310,000 to cost of product revenue as a result of commitments to purchase materials for the Flic scanner that are were excess of its estimated future proceeds from the sale of the Flic scanners.

13. Income taxes

A provision for income taxes has not been recorded for 2008, 2007, and 2006 due to the valuation allowances placed against the net operating losses and deferred tax assets arising during such periods. A valuation allowance has been recorded for all deferred tax assets because based on the Company's history of losses since inception, the available objective evidence creates sufficient uncertainty regarding the realizability of the deferred tax assets.

At December 31, 2008, Microvision has net operating loss carry forwards of approximately $217.6 million, for federal income tax reporting purposes. In addition, Microvision has research and development tax credits of $4.3 million. The net operating loss carry forwards and research and development credits available to offset future taxable income, if any, will expire in varying amounts from 2009 to 2027 if not previously utilized. In certain circumstances, as specified in the Internal Revenue Code, a 50% or more ownership change by certain combinations of the Company's stockholders during any three-year period would result in limitations on the Company's ability to utilize its net operating loss carry-forwards. The Company has determined that such a change occurred during 1995 and the annual utilization of loss carry-forwards generated through the period of that change will be limited to approximately $761,000. An additional change occurred in 1996; and the limitation for losses generated in 1996 is approximately $1,600,000.

Deferred tax assets are summarized as follows:

| | December 31, | |
|---|---|---|
| | 2008 | 2007 |
| Deferred tax assets, current | | |
| Reserves | $ 1,990,000 | $ 2,460,000 |

| | | |
|---|---|---|
| Other | 996,000 | 712,000 |
| Total gross deferred tax assets, current | 2,986,000 | 3,172,000 |
| Deferred tax assets, noncurrent | | |
| Net operating loss carryforwards | 74,605,000 | 68,658,000 |
| R&D credit carryforwards | 4,258,000 | 3,601,000 |
| Depreciation/amortization deferred | 15,665,000 | 10,848,000 |
| Other | 3,520,000 | 2,581,000 |
| Total gross deferred tax assets, noncurrent | 98,048,000 | 85,688,000 |
| Deferred tax liabilities, noncurrent | | |
| Convertible debt | (1,828,000) | (1,209,000) |
| Total gross deferred tax liabilities, noncurrent | (1,828,000) | (1,209,000) |
| Net deferred taxes before valuation allowance | 99,206,000 | 87,651,000 |
| Less: Valuation allowance | (99,206,000) | (87,651,000) |
| Deferred tax assets | $ -- | $ -- |

The valuation allowance and the research and development credit carry forwards account for substantially all of the difference between the Company's effective income tax rate and the Federal statutory tax rate of 34%.

Certain net operating losses arise from the deductibility for tax purposes of compensation under nonqualified stock options equal to the difference between the fair value of the stock on the date of exercise and the exercise price of the options. For financial reporting purposes, the tax effect of this deduction when recognized is accounted for as a credit to shareholders' equity.

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. The Company did not have any unrecognized tax benefits which would require an adjustment to the January 1, 2007 beginning balance of retained earnings. The Company did not have any unrecognized tax benefits at December 31, 2007 and at December 31, 2008.

The Company recognizes interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2008 and 2007 the Company recognized no interest or penalties.

The Company files income tax returns in the U.S. federal jurisdiction and various states. The tax years 2005-2007 generally remain open to examination by major taxing jurisdictions to which the Company is subject.

14. Retirement savings plan

The Company has a retirement savings plan ("the Plan") that qualifies under Internal Revenue Code Section 401(k). The Plan covers all qualified employees. Contributions to the Plan by the Company are made at the discretion of the Board of Directors.

Under the Plan, the Company matches 50% of employee contributions to the Plan up to 6% of the employee's per pay period compensation. During 2008, 2007, and 2006, the Company contributed $365,000, $295,000, and $308,000, respectively, to the Plan under the matching program.

15. Segment Information

Microvision operates as one segment. At January 31, 2006, Lumera was a significant unconsolidated equity investment of Microvision. For the one month period ended January 31, 2006, Lumera revenue was $168,000, gross profit was $82,000, loss from operations was $1,109,000 and net loss was $1,040,000.

16. Quarterly Financial Information (Unaudited)

The following table presents the Company's unaudited quarterly financial information for the years ending December 31, 2008 and 2007:

| | Year Ended December 31, 2008 | | | |
|---|---|---|---|---|
| | **December 31,** | **September 30,** | **June 30,** | **March 31,** |
| Revenue | $ 1,525,000 | $ 894,000 | $ 1,622,000 | $ 2,570,000 |
| Gross Margin | 287,000 | 285,000 | 719,000 | 1,469,000 |
| Net loss available for common shareholde | (9,873,000) | (8,443,000) | (9,266,000) | (5,038,000 |
| Net loss per share basic and diluted | (0.15) | (0.13) | (0.16) | (0.09 |

| | Year Ended December 31, 2007 | | | |
|---|---|---|---|---|
| | **December 31,** | **September 30,** | **June 30,** | **March 31,** |
| Revenue | $ 2,988,000 | $ 2,599,000 | $ 2,662,000 | $ 2,235,000 |
| Gross Margin | 1,092,000 | 846,000 | 999,000 | 941,000 |
| Net loss available for common shareholde | (6,022,000) | (4,718,000) | (2,155,000) | (6,892,000 |
| Net loss per share basic and diluted | (0.11) | (0.08) | (0.05) | (0.16 |

17. Subsequent Events

During January 2009, the Company terminated 9 employees or approximately 5% of its workforce. The Company expects to record expense of approximately $202,000 related to the severance agreements for these employees in the first quarter of 2009. The cost associated with the work force reduction will be accounted for in accordance with FAS 146-*Accounting for Costs Associated with Exit or Disposal Activities*, which requires that the liability for the costs associated with the exit or disposal activity be recognized and measured at fair value in the period in which the liability is incurred.

MICROVISION, INC.
VALUATION AND QUALIFYING ACCOUNTS AND RESERVES SCHEDULE
(in thousands)

| Description | Balance at beginning of fiscal period | Additions: Charges to costs and expenses | Additions: Charges to other accounts |
|---|---|---|---|
| Year Ended December 31, 2006 | | | |
| Allowance for receivables from related parties | 1,931 | 542 | -- |
| Tax valuation allowance | 71,028 | -- | 5,537 |
| Year Ended December 31, 2007 | | | |
| Allowance for receivables from related parties | 2,473 | 23 | -- |
| Tax valuation allowance | 76,565 | -- | 11,086 |
| Year Ended December 31, 2008 | | | |
| Allowance for receivables from related parties | 2,496 | -- | -- |
| Tax valuation allowance | 87,651 | -- | 11,555 |

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

There have been no changes in or disagreements with accountants in accounting or financial disclosure matters during the Company's fiscal years ended December 31, 2008 and 2007.

## ITEM 9A. CONTROLS AND PROCEDURES

(a) *Evaluation of disclosure controls and procedures.* Our Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), prior to the filing of this Form 10-K. Based on that evaluation, our CEO and CFO concluded that, as of December 31, 2008, our disclosure controls and procedures were, in design and operation effective.

(b) *Management's Report on Internal Control Over Financial Reporting.* Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f) and 15d-15(f). Our management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its evaluation under the framework in *Internal Control - Integrated Framework,* our management concluded that our internal control over financial reporting was effective as of December 31, 2008.

The effectiveness of our internal control over financial reporting as of December 31, 2008 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their attestation report, which is included in Item 8 of this Annual Report on Form 10-K under the heading "Report of Independent Registered Public Accounting Firm."

(c) *Changes in internal controls over financial reporting.* There have not been any changes in the Company's internal control over financial reporting during the quarter ended December 31, 2008 which have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

Information regarding executive officers is included in Part I of this Annual Report on Form 10-K in Item 4A. The information required by this Item and not provided in Item 4A will appear under the caption "Discussion of Proposals Recommended by the Board" in the Proxy Statement, which section is incorporated in this Item by reference. The Proxy Statement will be filed prior to the Company's annual shareholders' meeting scheduled to be held on June 25, 2009.

ITEM 11. EXECUTIVE COMPENSATION.

The information required by this Item will appear under the captions "Executive Compensation," "Compensation Committee Interlocks and Insider Participation" and "Director Compensation for 2008" in the Proxy Statement, which sections are incorporated in this Item by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.

Information as of December 31, 2008 regarding equity compensation plans approved and not approved by stockholders is summarized in the following table:

| | Equity Compensatio | |
|---|---|---|
| **Plan Category** | **Number of securities to be issued upon excercise of outstanding options, warrants and rights (a)** | **Weighted-average excercise price of outstanding options, warrants and rights (b)** |
| Equity compensation plans approved by shareholders | 6,996,000 | $ 3.9 |
| Equity compensation plans not approved by shareholders | 233,000 | 29.7 |
| Total | 7,229,000 | $ 4.8 |

In August 2000, the Company issued two non-plan warrants to purchase an aggregate of 200,000 shares of Microvision common stock to two consultants in connection with entering into certain consulting agreements with the Company. Subsequently, one of the consultants was elected to the Board of Directors by shareholders. The warrants were fully exercisable as of December 31, 2007. The warrants have an exercise price of $34.00 per share and are exercisable prior to their expiration in August 2010. As of the date of grant, all but 25,000 of the underlying shares of

common stock issuable to each consultant upon exercise of the warrants were subject to lock-up restrictions that prevent the holder from transferring such shares. The number of shares subject to the lock-up restrictions is reduced by 25,000 for each consultant on each June 7 subsequent to the grant date. Rather than issue shares of common stock upon exercise of the warrants, the Company may elect to redeem the warrants if, in the opinion of the Board of Directors upon advice of counsel, it would be unlawful to issue the underlying securities. The warrants are transferable upon prior written approval of the Company. The Company cannot unreasonably withhold such approval with respect to transfers of warrants to purchase at least 10,000 shares that are not subject to the lock-up restrictions. If the Company terminates the consulting agreement due to the consultant's failure to provide consulting services during the first three years of the agreement, the consultant must return to the Company a pro-rata portion of the 75,000 warrants initially subject to the lock-up restrictions based on the number of calendar days remaining in the initial three year period. The number, class and price of securities for which the warrants may be exercised are subject to adjustment for certain changes in the Company's capital structure. The number of securities and exercise price per share will be proportionately adjusted if outstanding shares of the Company's common stock are divided into a greater number of shares or combined into a smaller number of shares, or a stock dividend is paid on the common stock. In the event of a change in the common stock from a merger, consolidation, reclassification, reorganization, partial or complete liquidation, or other change in the capital structure of the Company, the Company will, as a condition of the change in capital structure, make provision for the warrant holder to receive upon the exercise of the warrants the kind and amount of shares of stock, other securities or property to which the holder would have been entitled if, immediately prior to the change in capital structure, the warrant holder had held the number of shares of common stock obtainable upon the exercise of the warrants, and the exercise price will be proportionately adjusted.

In July 2005, Microvision issued a warrant to purchase 6,925 shares of common stock to a third party for services. The warrant was immediately exercisable, has an exercise price of $5.32 per share, and expires in July 2010. The number and price of securities for which the warrant may be exercised are subject to adjustment for certain changes in the Company's capital structure. Where the outstanding shares of common stock are divided into a greater number of shares, combined into a smaller number of shares, or a stock dividend is paid on the common stock, the exercise price per share shall be proportionately adjusted by the ratio of common shares outstanding immediately before and after the transaction. In the event of a change in the common stock from a reorganization, reclassification, consolidation, or merger, the holder will be entitled to receive, upon the exercise of the warrants, the same amount and kind of securities, cash or property to which the holder would have been entitled if, immediately prior to the change in capital structure, the warrant holder had held the number of shares of common stock obtainable upon the exercise of the warrants.

In February 2007, Microvision issued a warrant to purchase 25,000 shares of common stock to a third party for services. The warrant was immediately exercisable, has an exercise price of $3.42 per share, and expires in February 2012. The number and price of securities for which the warrant may be exercised are subject to adjustment for certain changes in the Company's capital structure. Where the outstanding shares of common stock are divided into a greater number of shares, combined into a smaller number of shares, or a stock dividend is paid on the common stock, the exercise price per share shall be proportionately adjusted by the ratio of common shares outstanding immediately before and after the transaction. In the event of a change in the common stock from a reorganization, reclassification, consolidation, or merger, the holder will be entitled to receive, upon the exercise of the warrants, the same amount and kind of securities, cash or property to which the holder would have been entitled if, immediately prior to the change in capital structure, the warrant holder had held the number of shares of common stock obtainable upon the exercise of the warrants.

The other information required by this Item will appear under the caption "Information About Microvision Common Stock Ownership" in the Proxy Statement, which section is incorporated in this Item by reference.

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.

The information required by this Item will appear under the captions "Certain Relationships and Related Transactions" and "Board Meetings and Committees" in the Proxy Statement, which sections are incorporated in this Item by reference.

## ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by this Item will appear under the caption "Independent Registered Public Accounting Firm" in the Proxy Statement, which section is incorporated in this Item by reference.

# PART IV

## ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of the report:

Financial Statements

Report of Independent Registered Public Accounting Firm

Balance Sheets as of December 31, 2008 and 2007

Statements of Operations for the years ended December 31, 2008, 2007 and 2006

Consolidated Statements of Mandatory Redeemable Convertible Preferred Stock and Shareholders' Equity (Deficit) for the years ended December 31, 2008, 2007 and 2006

Statements of Comprehensive Loss for the years ended December 31, 2008, 2007 and 2006

Statements of Cash Flows for the years ended December 31, 2008, 2007 and 2006

Notes to Consolidated Financial Statements

Valuation and Qualified Accounts and Reserves for the years ended December 31, 2008, 2007 and 2006

(b) Exhibits

The following exhibits are referenced or included in this report.

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| 3.1 | Certificate of Incorporation of Microvision, Inc., as amended [17] |
| 3.2 | Bylaws of Microvision, Inc. [2] |
| 4.1 | Form of Specimen Stock Certificate for Common Stock.[2] |
| 4.2 | Warrant No. 76 to Purchase Common Stock of Microvision, Inc. issued September 10, 2004 to Satellite Strategic Finance Associates, LLC. [6] |
| 4.3 | Form of Warrant issued under the Securities Purchase Agreement dated as of March 11, 2005 by and among Microvision, Inc. and the investors listed on the Schedule of Buyers thereto. [7] |
| 4.4 | |

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| | Form of Warrant issued as of July 25, 2005 under the Master Amendment Agreement dated as of July 25, 2005 by and among Microvision, Inc. and the investors listed on the Schedule of Buyers thereto. (10) |
| 4.5 | Warrant No. 1 to Purchase Common Stock of Microvision, Inc. issued August 9, 2005 to Satellite Strategic Finance Partners, Ltd. (12) |
| 4.6 | Warrant No. 2 to Purchase Common Stock of Microvision, Inc. issued August 9, 2005 to Satellite Strategic Finance Associates, LLC. (12) |
| 4.7 | Warrant No. 88 to Purchase Common Stock of Microvision, Inc. issued August 31, 2005 to Omicron Master Trust (13) |
| 4.8 | Form of Warrant issued under the Securities Purchase Agreement dated as of November 30, 2005 by and among Microvision, Inc. and the investors listed on the Schedule of Buyers thereto. (14) |
| 4.9 | Registration Rights Agreement dated as of May 3, 2006 by and between Microvision, Inc. and Satellite Strategic Finance Associates, LLC.(15) |
| 4.10 | Form of Underwriter's Warrant Agreement dated June 5, 2006 by and between Microvision, Inc. and MDB Capital Group, LLC.(16) |
| 4.11 | Form of Warrant issued under the Placement Agency Agreement dated as of July 18, 2008 by and between Microvision, Inc. and FTN Securities Corp., as representative of the several placement agents named therein. (18) |
| 10.1 | Assignment of License and Other Rights between The University of Washington and the Washington Technology Center and the H. Group, dated July 25, 1993.(1) |
| 10.2 | Project II Research Agreement between The University of Washington and the Washington Technology Center and Microvision, Inc., dated October 28, 1993.(1)+ |
| 10.3 | Exclusive License Agreement between The University of Washington and Microvision, Inc., dated October 28, 1993.(1)+ |
| 10.4 | Exclusive License Agreement between the University of Washington and Microvision, Inc. dated March 3, 1994.(5) |
| 10.5 | Microvision, Inc. 2006 Incentive Plan, as amended. (17)* |
| 10.6 | Independent Director Stock Option Plan, as amended.(4)* |
| 10.7 | Executive Loan Plan and Related Form of Note.(3)* |
| 10.8 | License and Development Agreement dated as of December 30, 2004 by and between Microvision, Inc. and Ethicon Endo-Surgery, Inc.(8)+ |
| 10.9 | Employment Agreement between Microvision, Inc. and Alexander Y. Tokman dated July 18, 2005.(9) |
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| | Lease Agreement between CarrAmerica Reality Operating Partnership, L.P. and Microvision, Inc., dated July 15, 2005.[11] |
| 23 | Consent of Independent Registered Public Accounting Firm. |
| 31.1 | Principal Executive Officer certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Principal Financial Officer certification pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Principal Executive Officer certification pursuant to Rule 13a- 14(b) or Rule 15d-14(b) and Section 1350, Chapter 63 of Title 18 United States Code (18 U.S.C. 1350), as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002. |
| 32.2 | Principal Financial Officer certification pursuant to Rule 13a- 14(b) or Rule 15d-14(b) and Section 1350, Chapter 63 of Title 18 United States Code (18 U.S.C. 1350), as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002. |

(1) Incorporated by reference to the Company's Form SB-2 Registration Statement, Registration No. 333-05276-LA.

(2) Incorporated by reference to the Company's Post-Effective Amendment to Form S-3 Registration Statement, Registration No. 333-102244.

(3) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2001.

(4) Incorporated by reference to the Company's Form 10-Q for the quarterly period ended June 30, 2002.

(5) Incorporated by reference to the Company's Current Report on Form 8-K filed on March 5, 2003.

(6) Incorporated by reference to the Company's Current Report on Form 8-K filed on September 10, 2004.

(7) Incorporated by reference to the Company's Current Report on Form 8-K filed on March 14, 2005.

(8) Incorporated by reference to the Company's Annual Report on Form 10-K for the year ended December 31, 2004.

(9) Incorporated by reference to the Company's Current Report on Form 8-K filed on July 7, 2005.

(10) Incorporated by reference to the Company's Current Report on Form 8-K filed on July 29, 2005.

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(14) Incorporated by reference to the Company's Current Report on Form 8-K filed on December 1, 2005.

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+ Subject to confidential treatment.

* Management contracts and compensatory plans and arrangements required to be filed as exhibits pursuant to Item 15(b) of this Report.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MICROVISION, INC.

Date: March 5, 2009 By Alexander Tokman

Alexander Tokman
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the following capacities on March 5, 2009.

Signature

Title

/s/ Alexander Tokman

Alexander Tokman

Chief Executive Officer and Director
(Principal Executive Officer)

/s/ Jeff Wilson

Jeff Wilson

Chief Financial Officer

/s/ Richard A. Cowell

Richard A. Cowell

Director

/s/ Slade Gorton

Slade Gorton

Director

/s/ Mark Onetto

Marc Onetto

Director

/s/ Jeanette Horan

Jeanette Horan

Director

/s/ Brian Turner

Brian Turner

Director

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EXHIBIT INDEX

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

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