

MICROVISION INC
Form 10-K
March 06, 2014

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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the fiscal year ended December 31, 2013

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 001-34170

MicroVision, Inc.

(Exact name of Registrant as Specified in its Charter)

Delaware

(State or Other Jurisdiction of Incorporation or Organization)

91-1600822

(I.R.S. Employer Identification Number)

6244 185th Ave NE, Suite 100
Redmond, Washington 98052

(Address of Principal Executive Offices including Zip Code)

(425) 936-6847

(Registrant's Telephone Number, Including Area Code)

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

| <u>Title of each class</u> | <u>Name of each exchange on which registered</u> |
|--|--|
| 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

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

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. Yes

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 | <input type="radio"/> | Non-accelerated filer | <input type="radio"/> | Smaller reporting company |
| <input type="radio"/> | <input type="radio"/> | <input type="radio"/> | <input checked="" type="radio"/> | <input type="radio"/> | <input type="radio"/> |

(Do not check if a 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, 2013 was approximately \$70.4 million (based on the closing price for the registrant's Common Stock on the NASDAQ Global Market of \$2.52 per share).

The number of shares of the registrant's common stock outstanding as of March 3, 2014 was 35,801,000.

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 2014 Annual Meeting of Shareholders are incorporated herein by reference into Part III of this report.

MicroVision, Inc.
2013 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, technology development by third parties, future operations, financing needs or plans of MicroVision, as well as assumptions relating to the foregoing. The words "anticipate," "could," "would," "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 risk factors identified below in Item 1A.

ITEM 1. BUSINESS

Overview

We are developing our proprietary PicoP® display technology which can be used by our customers to create high-resolution miniature laser display and imaging engines. Our PicoP display technology uses our widely patented expertise in two dimensional Micro-Electrical Mechanical Systems (MEMS), lasers, optics, and electronics to create a high quality video or still image from a small form factor device with lower power needs than conventional display technologies. Our strategy is to develop and supply PicoP display technology directly or through licensing arrangements to original device manufacturers (ODMs) and original equipment manufacturers (OEMs) in various market segments, including consumer electronics and automotive, for integration into their products.

During 2012, we aligned our operations to our ingredient brand strategy, simplifying our operations and resulting in a significant reduction to our 2013 cash usage relative to 2012. Our strategy is to focus our efforts on licensing our technology and selling display engine components to partners who will produce display engines based on PicoP display technology and either sell those display engines to OEMs, or incorporate the engines into their own products.

Our development efforts are focused on improving the performance of display engines through the improvement of both engine system, hardware and software design, and the performance of various components of the display engine. We also provide engineering support to our customers as they prepare to manufacture display engines and we provide support to ODMs and OEMs during the integration and optimization of PicoP display technology for specific products.

The primary objective for consumer applications is to provide users of mobile devices such as smartphones, tablets and other consumer electronics products with a large screen viewing experience produced by a small projector either embedded in the device or via a companion product. These potential products would allow users to watch movies and videos, play games, and display images and other data onto a variety of surfaces, freeing users from the limitations of a small screen.

PicoP display technology could also be combined with other components and systems to be embedded into a vehicle or integrated into a portable standalone head-up display (HUD). HUD technology allows for important information, such as safety warnings or navigation instructions, to be projected so that it appears in front of vehicle operators where the information can be accessed without taking their eyes off the road.

We also see potential for PicoP display technology in other areas, although we are not currently working with customers. PicoP display technology could be combined with other components and systems to be incorporated 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.

Devices enabled by PicoP display technology could be used in field-based professions such as service repair or sales to view and share information such as schematics for equipment repair, sales data, orders or contact information on a larger, more user-friendly display. We also see potential for embedding PicoP display technology in industrial products where our displays could be used for 3D measuring and digital signage, enhancing the overall user experience of these applications.

We develop and procure intellectual property rights relating to our technology as a key aspect of our business strategy. We generate intellectual property from our internal research and development activities and our ongoing performance on development contracts. We also have acquired exclusive rights to various technologies under licensing and acquisition agreements.

Technology

Our patented PicoP

® display technology includes a single-mirror MEMS scanner, laser light sources, electronics, and optics combined using our proprietary system control expertise, gained through years of internal research and development. Our bi-directional MEMS scanning mirror is a key component of our technology platform and is one of our core competencies. Our MEMS design is a silicon device with a tiny mirror at the center. This mirror is connected to small flexures which allow it to oscillate vertically and horizontally to capture (imaging) or reproduce (display) an image pixel-by-pixel. PicoP display technology creates 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 PicoP display technology offers significant advantages over traditional display and imaging systems. Depending on the specific product application, these advantages may include:

- Focus free operation
- HD resolution
- Low power requirements to enable battery operated devices and applications
- Large screen size up to 200 inches from short distances
- Small and thin package size
- High brightness, contrast and brightness uniformity
- Rich, saturated color reproduction
- Small text readability

PicoP display technology currently uses red, blue and green laser diodes as the light source for the projector. Historically, the availability of green lasers has been constrained due to their complexity and a limited number of manufacturers. While the manufacturing complexity of the green laser has improved, there continues to be a limited number of suppliers.

Business Strategy

Our business model is to commercialize our technology by providing a reference design and display engine components to display engine manufacturers, and by licensing our technology to OEMS and ODMs for them to integrate and embed PicoP display technology across a broad range of display and imaging product applications. The key elements of our business strategy include the following:

- Continue to improve the performance of our PicoP display technology platform by advancing the system design, hardware and software.
- Partner with leading consumer and automotive OEMs to integrate our PicoP display technology into their products or to help them to develop their engines based on our technology.
- Partner with ODMs to ensure broader availability of high quality pico display engines in quantities to support the consumer electronics market.
- Supply key components for the display engine being developed by OEMs and ODMs who license PicoP display technology.
- Maintain a position of leadership with our intellectual property around PicoP display technology.

Marketing Focus:
Mobile Device Displays

The use of mobile devices worldwide has grown significantly and consumers' awareness and willingness to use mobile devices for data services has increased dramatically over the last few years. Applications such as email, texting, web-browsing, downloading and playing of videos, social networking and mobile gaming are driving the demand for more capable smartphones and other mobile devices such as tablets. Typically, these devices have small screens which limit the utility and enjoyment of the content, especially in small group settings. We believe that pico projectors can free mobile device users from the limitations of a palm-sized or tablet-sized screen and provide a large screen viewing experience to increase the usefulness and enjoyment of watching movies and videos, playing games, and displaying and sharing images and many other applications.

Vehicle Displays

We believe an automotive head-up display (HUD) improves driver safety by eliminating the driver's need to look away from the road to read information such as GPS mapping images, audio controls and other automobile instrumentation. Working independently and with Tier 1 automotive suppliers, we have produced prototypes that demonstrate the ability of PicoP display technology to project high-resolution images onto the windshield of an automobile, providing the driver with a variety of information related to the car's operation. We believe that an automotive HUD based on our PicoP display technology 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 day or night, 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 are working independently and with a Tier 1 supplier to market PicoP display technology to automotive sector OEM customers. Our PicoP display technology 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 for use in automobiles, specialty vehicles, trucks, buses and motor coaches.

Go-To-Market Strategy

We are currently marketing our PicoP

® display technology to leading OEMs and ODMs. We expect our vertically integrated customers may act as OEMs and may integrate our PicoP display technology into their end products. We expect other customers may act as ODMs and develop display engines for sale to OEMs.

Certain applications using PicoP display technology, such as an automotive HUD or pico projection for tablets and mobile phones, will require integration of an engine based on our technology into the products. Also, in cases where a customer requires such assistance, we plan on providing designs for components, subsystems and systems 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 our customer's engineering, manufacturing and marketing teams would work with our technical staff to customize the PicoP display technology for their targeted market and application. We may charge fees to our customers to fund the costs of the engineering effort incurred on such

development projects. The nature of these relationships may vary from partner to partner depending on the proposed specifications for the display engine, the product to be developed, and the customers' design, manufacturing and distribution capabilities. We believe this strategy allows us to limit our own direct manufacturing investment for components, reducing our capital requirements and the risks inherent in taking PicoP display technology to market.

To date, the majority of our revenue from pico projection products has been generated primarily through sales of PicoP display engine components, development revenue and sales of our SHOWWX line of accessory projectors through distributors and OEM customers, and to a lesser extent directly to end users through our online store. If we are successful in getting ODMs and OEMs to launch products enabled by PicoP display technology into markets, our revenue may come from the sales of components, licensing fees, and/or royalties, depending on the needs of each ODM or OEM.

Human Factors, Ergonomics and Safety

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, we work with and commission third party 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. Potential display products incorporating our technology 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, Micron Technology, ST Micro, and Syndiant, 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 use either liquid crystal on silicon (LCOS) panel solutions or Texas Instruments' DLP™ display technology, using primarily light emitting diode light sources. 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.

Intellectual Property and Proprietary Rights

We generate intellectual property from our ongoing performance on development contracts, our internal research and development activities and technology acquisitions. 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. Protecting these key enabling technologies and components is 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.

We believe our extensive and highly-rated patent portfolio is the largest, broadest and earliest filed laser pico projection and display portfolio and includes applications such as automotive head-up display, range finding, portable media devices, image capture and laptop applications. MicroVision has over 500 issued patents, pending patents and licensed patents worldwide.

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 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.

Our ability to compete effectively in the display and image capture market may depend, in part, on our ability and the ability of our 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 "PicoP," "MicroHud" and the "tri-curve" logo with the United States Patent and Trademark Office. We have filed for registration of various other marks 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 PicoP® display technology that will be required for specific applications. Research and development expense for the fiscal years ended December 31, 2013 and 2012 was \$10.3 million and \$12.9 million, respectively. In 2013, 50% of our revenue was generated from performance on collaborative research and development agreements, 40% of our revenue was generated from product sales, and 9% and 1% of revenue was derived from performance on development contracts with commercial customers and the U.S government, respectively. Two commercial customers accounted for 86% of our revenue in 2013. In 2012, 81% of our revenue was generated from product sales, and 17% and 2% of revenue was derived from performance on development contracts with commercial customers and the U.S government, respectively. One commercial customer accounted for 61% of our revenue in 2012. Prior to 2012, most of our revenue was generated from development contracts to develop our technology to meet customer specifications for both the U.S. government and commercial enterprises and, to a lesser extent, product sales. See Management's Discussion and Analysis of Financial Condition and Results of Operations.

We had a backlog of \$2.1 million at December 31, 2013 compared to a backlog of \$1.8 million at December 31, 2012. The backlog at December 31, 2013 is composed of \$1.7 million in collaborative research and development agreements, \$285,000 in development contracts and orders for prototype units and evaluation kits, and \$147,000 in orders for components and accessory pico projectors. We plan to complete all of the backlog within one year.

Employees

As of March 3, 2014, we had approximately 64 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 6244 185th Avenue NE, Suite 100, 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, 2013, we had an accumulated deficit of \$450.7 million.
- We incurred consolidated net losses of \$414.8 million from inception through 2011, \$22.7 million in 2012, and \$13.2 million in 2013.

The likelihood of our success must be considered in light of the expenses, difficulties and delays frequently encountered by companies formed to develop and commercialize 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 revenue or commercializing our technology or products. In light of these factors, we expect to continue to incur substantial losses and negative cash flow at least through 2014 and likely thereafter. We cannot be certain that we will achieve positive cash flow at any time in the future.

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

Based on our current operating plan, we anticipate that we have sufficient cash and cash equivalents to fund our operations through March 2014. We will require additional cash to fund our operating plan past that time. We plan to obtain additional cash through the issuance of equity or debt securities.

We are introducing new technology into an emerging market which creates significant uncertainty about our ability to accurately project revenue, costs and cash flows. Our capital requirements will depend on many factors, including, but not limited to, the rate at which original equipment manufacturers and original device manufacturers introduce products incorporating PicoP display technology and the market acceptance and competitive position of such products. If revenues are less than we anticipate, if the mix of revenues varies from anticipated amounts or if expenses exceed the amounts budgeted, we may require additional capital earlier than expected to fund our operations. In addition, our operating plan provides for the development of strategic relationships with suppliers of components, our products and systems and equipment manufacturers that may require additional investments by us.

Additional capital may not be available to us, or if available, on terms acceptable to us or on a timely basis. Raising additional capital may involve issuing securities with rights and preferences that are senior to our common stock and may dilute the value of current shareholders' shares. If adequate funds are not available on a timely basis we may consider limiting our operations substantially to extend out funds as we pursue other financing opportunities and business relationships. This limitation of operations could include delaying development projects and reductions in staff, operating costs, including research and development, and capital expenditures. Reducing operations may jeopardize our ability to achieve our business goals or satisfy our customers.

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 PicoP® display technology includes entering into 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 PicoP display technology 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 development, manufacturing, 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.

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

Our success will depend in part on customer acceptance of PicoP display technology. PicoP display technology 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, PicoP display technology must meet the expectations of our potential customers in the consumer, automotive, and other markets. If our technology fails to achieve market acceptance, we may not be able to continue to develop our technology platform.

Future products based on our PicoP® display technology are dependent on advances in technology by other companies.

Our PicoP display technology 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 future products based on our technology 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 or our customers' specific uses. There are no guarantees that such activities will result in useful technologies or components for us.

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.

Since 2010, most of our revenues have been generated from product sales to a limited number of customers and distribution partners. In 2012, one commercial customer accounted for 61% of our revenue. In 2013, 86% of our revenue was generated from sales to two commercial companies. Our quarterly operating results may vary significantly based on:

- commercial acceptance of products based on PicoP display technology;
- 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.

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

Our backlog of open orders totaled \$2.1 million as of December 31, 2013. We may be unable to meet the performance requirements, including performance specifications or delivery dates, required by such purchase orders. Further, our customers may be unable or unwilling to perform their obligations thereunder on a timely basis or at all if, among other reasons, our products and technologies do not achieve market acceptance, our customers' products and technologies do not achieve market acceptance or our customers otherwise fail to achieve their operating goals. To the extent we are unable to perform under such purchase orders or to the extent customers are unable or unwilling to perform, our operating results and cash flows could be adversely affected.

It may become more difficult to sell our stock in the public market or maintain our listing on the NASDAQ Global Market.

Our common stock is listed for quotation on The NASDAQ Global Market. On December 17, 2013, we received a deficiency notice from NASDAQ advising us that for 30 consecutive trading days preceding the date of the notice we were not in compliance with the \$50,000,000 minimum market value of listed securities required for continued listing on The NASDAQ Global Market pursuant to NASDAQ's listing requirements. Market value of listed securities is calculated by multiplying our daily closing bid price by our total outstanding shares of common stock. In accordance with NASDAQ's listing rules, we have 180 calendar days, or until June 16, 2014, to regain compliance with this requirement. During this initial 180-day compliance period, we can regain compliance if the market value of our listed securities closes at \$50,000,000 or more for a minimum of 10 consecutive business days. As of the date of filing of this Annual Report on Form 10-K, we believe that the market value of our listed securities closed at \$50,000,000 or more for 10 consecutive business days, though we do not yet have confirmation from NASDAQ as to whether we have regained compliance with its continued listing requirements.

If we are unable to meet NASDAQ'S listing maintenance standards for any reason, our common stock could be delisted from The NASDAQ Global Market. If our common stock were delisted, we likely would seek to list the common stock on the NASDAQ Capital Market, the American Stock Exchange or on a regional stock exchange. Listing on such other market or exchange could reduce the liquidity of our common stock. If our common stock were not listed on the NASDAQ Capital Market or an exchange, trading of our common stock would be conducted in the over-the-counter market on an electronic bulletin board established for unlisted securities or directly through market makers in our common stock. If our common stock were to trade in the over-the-counter market, an investor would find it more difficult to dispose of, or to obtain accurate quotations for the price of, the common stock. A delisting from The NASDAQ Global Market and failure to obtain listing on such other market or exchange would subject our securities to so-called penny stock rules that impose additional sales practice and market-making requirements on broker-dealers who sell or make a market in such securities. Consequently, removal from The NASDAQ Global Market and failure to obtain listing on another market or exchange could affect the ability or willingness of broker-dealers to sell or make a market in our common stock and the ability of purchasers of our common stock to sell their securities in the secondary market. In addition, when the market price of our common stock is less than \$5.00 per share, we become subject to penny stock rules even if our common stock is still listed on The NASDAQ Global Market. While the penny stock rules should not affect the quotation of our common stock on The NASDAQ Global Market, these rules may further limit the market liquidity of our common stock and the ability of investors to sell our common stock in the secondary market. The market price of our stock has mostly traded below \$5.00 per share during 2013 and 2012. On March 3, 2014, the closing price of our stock was \$2.30.

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

Our current products and potential future products will compete with established manufacturers of existing products and companies developing new technologies. Many of our competitors have substantially greater financial, technical

and other resources than we have. Because of their greater resources, our competitors may develop products or technologies that are superior to our own. The introduction of superior competing products or technologies could result in reduced revenues, lower margins or loss of market share, any of which could reduce the value of our business.

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

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

We may not succeed in these efforts because of:

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

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

We could face lawsuits related to our use of PicoP® display technology 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 or display engines enabled by PicoP display technology and, consequently, materially reduce our revenues. Moreover, we cannot be certain that patent holders or other third parties will not claim infringement by us with respect to current and future technology. Because U.S. patent applications are held and examined in secrecy, it is also possible that presently pending U.S. applications will eventually be issued with claims that will be infringed by our products or our technology. The defense and prosecution of a patent suit would be costly and time consuming, even if the outcome were ultimately favorable to us. An adverse outcome in the defense of a patent suit could subject us to significant costs, to require others and us to cease selling products that incorporate PicoP display technology, 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.

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.

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

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

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

In the recent past, general worldwide economic conditions have experienced a downturn due to slower economic activity, concerns about inflation, increased energy costs, decreased consumer confidence, reduced corporate profits and capital spending, and adverse business conditions. Any continuation or worsening of the current global economic and financial conditions could materially adversely affect (i) our ability to raise, or the cost of, needed capital, (ii)

demand for our current and future products and (iii) our ability to commercialize products. We cannot predict the timing, strength, or duration of any economic slowdown or subsequent economic recovery, worldwide, or in the display industry.

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

We currently use foreign manufacturers and plan to continue 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.

Qualifying a new contract manufacturer or foundry for our products could cause us to experience delays that result in lost revenues and damaged customer relationships.

We rely on single suppliers to manufacture our products, including 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. Changing our source of supply and manufacture could cause significant delays in shipping products which may result in lost revenues and damaged customer relationships.

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

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 needed manufacturing resources. Future manufacturing limitations of our suppliers could result in a limitation on the number of products incorporating our technology that we are able to produce.

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

Intellectual property protection for our products is important and uncertain. If we do not obtain effective intellectual property protection for our products, processes and technology, we may be subject to increased competition. Our commercial success will depend in part on our ability and the ability of our licensors to maintain the proprietary nature of the PicoP display and other key technologies by securing valid and enforceable patents and effectively maintaining unpatented technology as trade secrets. We try to protect our proprietary technology by seeking to obtain United States and foreign patents in our name, or licenses to third-party patents, related to proprietary technology, inventions, and improvements that may be important to the development of our business. However, our patent position and the patent position of our licensors involve complex legal and factual questions. The standards that the United States Patent and Trademark Office and its foreign counterparts use to grant patents are not always applied predictably or uniformly and can change. Additionally, the scope of patents are subject to interpretation by courts and their validity can be subject to challenges and defenses, including challenges and defenses based on the existence of prior art. Consequently, we cannot be certain as to the extent to which we will be able to obtain patents for our new products and technology or the extent to which the patents that we already own or license from others protect our products and technology. Reduction in scope of protection or invalidation of our licensed or owned patents, or our inability to obtain new patents, may enable other companies to develop products that compete with ours on the basis of the same or similar technology.

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

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

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

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

Our contracts and collaborative research and 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 contracts and collaborative research and development agreements could cause significant variability in our revenues and operating results for any particular quarterly period.

Our contracts and collaborative research and development agreements may not lead to any products or products that will be profitable.

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

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

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

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.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. PROPERTIES

We currently lease approximately 23,900 square feet of combined use office, laboratory and manufacturing space at our headquarters facility in Redmond, Washington. The 65 month lease expires in January 2019.

ITEM 3. LEGAL PROCEEDINGS

We are subject to various 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 are reasonably possible to have a material adverse effect on our financial position, results of operations or cash flows.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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 52, 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 new technologies programs lead and a head of I&RD office 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.

Michael Franzi, age 58, joined MicroVision in December 2012 as Vice President, Marketing and Business Development. Prior to MicroVision, from August 2009 to December 2012, he served as the principal of MJF Group, a consulting firm that assists companies in monetizing technology assets, including licensing of intellectual property and the development of strategic and tactical sales and marketing plans. From September 2010 to July 2011, he was Vice President and General Manager of Synopsis, Inc., a supplier of electronic design automation solutions, systems and intellectual property to global semiconductor and electronic OEM companies. He served as Vice President Global Marketing of ARC International from June 2008 until its acquisition by Synopsis in September 2010. From August 2005 to April 2008, Mr. Franzi served as Vice President Global Licensing and Business Development of SRS Labs, Inc. an audio technology engineering company that specialized in licensing of audio enhancement technology solutions for global electronic companies. Mr. Franzi received a B.S. degree in electrical engineering from the Swanson School of Engineering, University of Pittsburgh.

Stephen Holt, age 51, joined MicroVision in April 2013 as Chief Financial Officer. Prior to MicroVision, from May 2007 to May 2012, he served as Chief Financial Officer of PixelOptics, where he played a lead role in bringing the company's first electronic focusing eyewear product to market. At this venture capital-backed start-up, Mr. Holt raised capital and negotiated strategic partner agreements to license technology in addition to implementing policies and procedures to create an infrastructure capable of supporting rapid growth while maintaining a strong internal control environment. From March 2006 to April 2007, he was the Chief Financial Officer of Interstate Distributors, a trucking and transportation services company. From December 2003 to March 2006, he was the Chief Financial Officer of a group of companies consisting of Activelight, Boxlight, Cinelight and Projector Wholesale Supply. These companies were value added resellers and distributors of audio-visual and projection equipment. Mr. Holt, a Certified

Management Accountant, holds a Bachelor of Science from California State University, Chico and an M.B.A. from Santa Clara University.

David Westgor, age 60, was appointed Vice President, General Counsel and Secretary in November 2013 after serving as General Counsel since December 2012 and Deputy General Counsel since June 2007. In his current role, Mr. Westgor oversees the legal department, advises the Board of Directors and executive team on corporate governance matters and provides support for the company's business activities. Before joining MicroVision, Mr. Westgor was Senior Counsel at Medtronic Physio-Control where he had primary responsibility for the legal affairs of its medical and informatics business units. Mr. Westgor graduated from Loyola Law School and practiced in the Los Angeles office of Pillsbury Winthrop. He moved to the Seattle area to become in-house counsel at a broadband telecommunications company. Mr. Westgor also has a Master of Fine Arts degree from the Art Institute of Chicago and a B.A. from St. Olaf College.

Dale Zimmerman, age 54, has served as Vice President of Research and Development since June 2012 and Director of Systems Engineering of MicroVision from June 2011 to May 2012. Prior to MicroVision, from February 2006 to December 2008 he served as Vice President of Product Strategy of Silicon Image, a company specializing in high speed serial interface solutions for HDTV, PC and storage products. From 1996 to 2006 he served as General Manager of DLP TV for Texas Instruments where he played an important role in launching the first conference room projectors, home theater projectors, and HDTVs. His teams received many awards including 3 Emmys and CES Innovation Best of Show. He received B.S. and M.S. degrees in electrical and electronics engineering from Massachusetts Institute of Technology (MIT) and a second M.S. in electrical engineering in 2011 from Stanford University.

PART II

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

Our common stock began trading publicly on August 27, 1996. Our common stock trades on The NASDAQ Global Market under the symbol "MVIS." 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.

A 1:8 reverse stock split became effective on February 17, 2012. All of the per share prices shown in the table below have been adjusted to reflect the effect of this reverse split.

As of March 3, 2014, there were approximately 75 holders of record of 35,801,000 shares of common stock outstanding. As many of our shares of common stock are held by brokers and other institutions on behalf of shareholders, we are unable to estimate the total number of beneficial holders of our common stock represented by these record holders.

The high and low sales prices of our 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, as adjusted for the reverse stock split, are as follows:

| Quarter Ended | Common Stock | |
|--------------------|--------------|---------|
| | HIGH | LOW |
| 2012 | | |
| March 31, 2012 | \$ 5.36 | \$ 2.28 |
| June 30, 2012 | 3.63 | 1.11 |
| September 30, 2012 | 2.94 | 1.46 |
| December 31, 2012 | 2.72 | 1.84 |
| 2013 | | |
| March 31, 2013 | \$ 2.28 | \$ 1.52 |
| June 30, 2013 | 3.49 | 1.58 |
| September 30, 2013 | 2.71 | 1.70 |
| December 31, 2013 | 1.84 | 1.03 |

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2014

January 1, 2014 to March 3, 2014

| | | | |
|----|------|----|------|
| \$ | 3.38 | \$ | 1.12 |
|----|------|----|------|

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ITEM 6. SELECTED FINANCIAL DATA

A summary of selected financial data as of and for the five years ended December 31, 2013 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. A 1:8 reverse stock split of MicroVision's common stock became effective on February 17, 2012. All of the share and per share amounts discussed and shown in the statements and tables below have been adjusted to reflect the effect of this reverse split.

| | 2013 | YEARS ENDED DECEMBER 31, | | | 2009 |
|---|----------|--|-----------|-----------|-----------|
| | | 2012 | 2011 | 2010 | |
| | | <i>(in thousands, except per share data)</i> | | | |
| Statement of Operations Data: | | | | | |
| Revenue | \$ 5,852 | \$ 8,365 | \$ 5,617 | \$ 4,740 | \$ 3,833 |
| Net loss available for common shareholders | (13,178) | (22,693) | (35,808) | (47,460) | (39,529) |
| Basic and diluted net loss per share | (0.47) | (1.05) | (2.57) | (4.17) | (4.29) |
| Weighted average shares outstanding basic and diluted | 28,025 | 21,595 | 13,919 | 11,379 | 9,220 |
| Balance Sheet Data: | | | | | |
| Cash and cash equivalents | \$ 5,375 | \$ 6,850 | \$ 13,075 | \$ 19,413 | \$ 43,025 |
| Investments available-for-sale | - | - | - | 13 | 2,710 |
| Working capital (deficit) | (3,878) | 1,831 | 5,913 | 15,618 | 38,221 |
| Total assets | 8,447 | 12,938 | 23,870 | 35,233 | 53,536 |
| Long-term liabilities | 481 | 20 | 326 | 1,394 | 1,471 |
| Total shareholders' equity (deficit) | (1,696) | 5,054 | 10,802 | 21,833 | 41,891 |

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

Overview

We are developing our proprietary PicoP® display technology which can be used by our customers to create high-resolution miniature laser display and imaging engines. Our PicoP display technology uses our widely patented expertise in two dimensional Micro-Electrical Mechanical Systems (MEMS), lasers, optics, and electronics to create a high quality video or still image from a small form factor device with lower power needs than conventional display technologies. Our strategy is to develop and supply PicoP display technology directly or through licensing arrangements to original device manufacturers (ODMs) and original equipment manufacturers (OEMs) in various market segments, including consumer electronics and automotive, for integration into their products.

During 2012, we aligned our operations to our ingredient brand strategy, simplifying our operations and resulting in a significant reduction to our 2013 cash usage relative to 2012. Our strategy is to focus our efforts on licensing our technology and selling display engine components to partners who will produce display engines based on PicoP display technology and either sell those display engines to OEMs, or incorporate the engines into their own products.

Our development efforts are focused on improving the performance of display engines through the improvement of both engine system, hardware and software design, and the performance of various components of the display engine. We also provide engineering support to our customers as they prepare to manufacture display engines as well as providing support to ODMs and OEMs during the integration and optimization of PicoP display technology for specific products.

The primary objective for consumer applications is to provide users of mobile devices such as smartphones, tablets and other consumer electronics products with a large screen viewing experience produced by a small projector either embedded in the device or via a companion product. These potential products would allow users to watch movies and videos, play games, and display images and other data onto a variety of surfaces, freeing users from the limitations of a small screen.

PicoP display technology could also be combined with other components and systems to be embedded into a vehicle or integrated into a portable standalone head-up display (HUD). HUD technology allows for important information, such as safety warnings or navigation instructions, to be projected so that it appears in front of vehicle operators where the information can be accessed without taking their eyes off the road.

We also see potential for PicoP display technology in other areas, although we are not currently working with customers. PicoP display technology could be combined with other components and systems to be incorporated 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.

Devices enabled by PicoP display technology could be used in field-based professions such as service repair or sales to view and share information such as schematics for equipment repair, sales data, orders or contact information on a larger, more user-friendly display. We also see potential for embedding PicoP display technology in industrial products where our displays could be used for 3D measuring and digital signage, enhancing the overall user experience of these applications.

We develop and procure intellectual property rights relating to our technology as a key aspect of our business strategy. We generate intellectual property from our internal research and development activities and our ongoing performance on development contracts. We also have acquired exclusive rights to various technologies under licensing and acquisition agreements.

We have incurred substantial losses since inception and expect to incur a substantial loss during the fiscal year ending December 31, 2014.

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. We evaluate our estimates on an on-going basis. 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 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 our consolidated financial statements:

Revenue Recognition.

We evaluate the performance criteria and terms of our collaborative research and development agreements to determine whether revenue should be recognized under a performance-based method or milestone method. Significant items included in our evaluation are the following:

- the nature of our obligation under the agreement,
- whether provisions leading to variable revenues exist
- whether any payments are refundable,
- whether the deliverables should be treated as one unit of accounting or separated into multiple units,
- whether substantive milestones exist,
- whether milestone payments are commensurate with either our level of effort or the increase in value of the customer's rights, and
- whether a licensing agreement exists.

We recognize development revenue as work progresses on the agreement and as our customer accepts the deliverables using a proportional method based on the lesser of the cumulative proportion of total planned costs to be incurred under the agreement or the cash payments received plus outstanding billings for work accepted by the customer. Since our collaborative agreements generally require some level of technology development, the actual costs required to complete a contract can vary from our estimates. The proportional revenue recognition method we use for collaborative research and development agreements includes adjustments for revisions to estimated total agreement costs. Each period, we evaluate total estimated costs for each agreement. Any adjustments that result from revisions to the estimated costs are recognized in the period we become aware of changes. The costs for work performed under collaborative research and development agreements are expensed in the periods incurred and included in the Statement of Operations in research and development expense.

Our product sales generally include acceptance provisions. We recognize product revenue upon acceptance of the product by the customer or expiration of the contractual acceptance period, after which there are no rights of return. We have entered into agreements with resellers and distributors, as well as selling directly to the public. Sales made to resellers and distributors are recognized using either the sell-through method or upon expiration of the contractually agreed-upon acceptance period, depending on our ability to reasonably estimate returns. Some of the agreements with resellers and distributors contain price-protection clauses, and revenue is recognized net of these amounts. Sales made directly to the public are recognized either upon expiration of the contractual acceptance period after which there are no rights of return, or net of estimated returns and allowances. Provisions are made for warranties at the time revenue is recorded. Our quarterly revenue may vary substantially due to the timing of product orders from customers, production constraints and availability of components and raw materials.

We recognize contract revenue as work progresses on long-term, cost plus fixed fee, and fixed price contracts using the percentage-of-completion method, which relies on estimates of total expected contract revenue and costs. We have developed processes that allow us to make reasonable estimates of the cost to complete a contract. When we begin work on the contract, and at the end of each accounting period, we estimate the labor, material and other costs required to complete the contract using information provided by our technical team, project managers, vendors, outside consultants and others and compare these to costs incurred to date. Recognized revenues are subject to revisions as actual cost becomes certain. Revisions in revenue estimates are reflected in the period in which the facts that give rise to the revision become known. Historically, we have made only immaterial revisions in the estimates to complete the contract at each reporting period. In the future, revisions in these estimates could significantly impact recognized revenue in any one reporting period. We recognize contract revenue on the sale of prototype units and evaluation kits upon acceptance of the deliverables by the customer or expiration of the contractual acceptance period, after which there are no rights of return.

We establish an allowance for estimated losses if the estimated cost to complete a contract exceeds 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.

Cost of Revenue.

Cost of product revenue includes 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.

Cost of contract revenue includes both the direct and allocated indirect costs of performing on development contracts and producing prototype units and evaluation kits. Direct costs include labor, materials and other costs incurred

directly in performing on a contract or producing prototype units and evaluation kits. Indirect costs include labor and other costs associated with operating our research and development department and building our technical capabilities and capacity. Cost of contract revenue is determined by the level of direct and indirect costs incurred, which can fluctuate substantially from period to period.

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

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.

Intangible Assets.

Our intangible assets consist entirely of purchased patents. The patents are amortized using the straight-line method over their estimated period of benefit, ranging from one to 17 years. We evaluate the recoverability of intangible assets periodically by taking into account events or circumstances that may warrant revised estimates of useful lives or that indicate the asset may be impaired. We compare the projected undiscounted net cash flows associated with the related intangible assets or group of assets over their remaining lives against their respective carrying amounts. Measurement of an impairment loss for our intangible assets is based on the difference between the fair value of the asset and its carrying value.

Inventory.

We value inventory at the lower of cost or market with cost determined on a net-realizable value basis. We make significant judgments and estimates to value our inventory and make adjustments to its carrying value. We review several factors in determining the market value of our inventory including evaluating the replacement cost of the raw materials, the net realizable value of the finished goods, and the likelihood of obsolescence. 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.

Warrant liability.

In combination with our registered direct offerings of common stock in May and September 2013, we issued warrants to purchase common stock. Based on the terms of the warrants we issued, we have determined that they should be classified as a liability given that the warrants could result in the issuance of a variable number of shares of common stock based on a conditional exchange provision that is outside of our control at any point when the share price of our common stock is equal to or less than the warrant exercise prices. At the dates of issuance, and as of December 31, 2013, our common stock was trading at a value less than the exercise prices. As such, the holders may elect to exchange the warrants for a variable number of shares of common stock as determined by a formula included in the warrants. However, the warrants limit the number of shares that may be issued under this exchange provision to one share of common stock for each warrant exchanged. Changes in the market value of our common stock may increase or decrease the number of shares to be issued under this exchange feature.

At each balance sheet date, we evaluate the fair value of the warrants and any change in value is recorded as a non-operating gain or loss on the statement of operations. Due to the features of the warrants, the determination of the fair value of the warrant liability may vary depending on our common stock price. If the price of our common stock is less than the exercise price of the warrant, we will calculate the fair value of the warrant liability as the fair value of the common stock that would be required to be issued to settle the exchange feature of the warrant. If the price of our common stock is greater than the exercise price of the warrant, we will use a binomial option pricing model to estimate the fair value of the warrant as the exchange feature provided per the agreement will no longer be available to the holder. If and when the exchange feature is exercised by the holder, we will recognize a gain or loss on the exchange based on the fair market value of the common stock issued by us to the holder to satisfy the exchange provision.

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 equity instruments issued to employees using the straight-line attribution method of allocating the fair value of share-based compensation expense over the requisite service period of the related award. The value of restricted or unrestricted 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. 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, 2013 COMPARED TO YEAR ENDED DECEMBER 31, 2012

Product Revenue.

| | 2013 | % of product revenue | 2012 | % of product revenue | \$ change | % change |
|-----------------|----------|----------------------|----------|----------------------|------------|----------|
| (in thousands) | | | | | | |
| Product revenue | \$ 2,341 | 100.0 | \$ 6,782 | 100.0 | \$ (4,441) | (65.5) |

Product revenue during 2013 primarily included sales of components to Pioneer under our "Image by PicoP" ingredient brand business model. Product revenue during 2012 included sales of components to Pioneer, sales of our SHOWWX™ line of accessory pico projectors and sales of our PicoP display engines.

Our quarterly and annual revenue may vary substantially due to the timing of orders from customers, production constraints and availability of components and raw materials. In 2012, we reduced our sales and marketing effort on our sales of our SHOWWX™ line of accessory pico projectors.

Product revenue was lower during the year ended December 31, 2013 than the same period in 2012, due to lower sales of components to Pioneer and decreased sales of our PicoP display engines and finished units. We have fulfilled all open orders from Pioneer, and do not expect to receive additional follow-on orders. The backlog of product orders at December 31, 2013 was approximately \$147,000, compared to \$1.7 million at December 31, 2012. The product backlog is scheduled for delivery within one year.

Contract Revenue.

| | 2013 | % of contract revenue | 2012 | % of contract revenue | \$ change | % change |
|------------------------|--------|-----------------------|----------|-----------------------|-----------|----------|
| (in thousands) | | | | | | |
| Government revenue | \$ 80 | 13.3 | \$ 156 | 9.9 | \$ (76) | (48.7) |
| Commercial revenue | 522 | 86.7 | 1,427 | 90.1 | (905) | (63.4) |
| Total contract revenue | \$ 602 | | \$ 1,583 | | \$ (981) | (62.0) |

We earn contract revenue from performance on development contracts with commercial customers and the U.S. government and from the sale of prototype units and evaluation kits and sales of test equipment built specifically for use in display engine production. Our contract revenue from development contracts in a particular period is dependent upon when we enter into a contract, the value of the contracts we have entered into, and the availability of technical resources to perform work on the contracts. Our contract revenue from sales of prototype units and evaluation kits may vary substantially due to the timing of orders from customers and potential constraints on resources.

Contract revenue was lower during the year ended December 31, 2013 than the same period in 2012 primarily due to lower sales of test equipment and reduced activity on government contracts in 2013 compared to the prior year.

Our backlog of development contracts, including orders for prototype units and evaluation kits, at December 31, 2013 was \$285,000 compared to \$100,000 at December 31, 2012, all of which is scheduled for completion during the next twelve months.

Development Revenue.

| (in thousands) | 2013 | % of development revenue | 2012 | % of development revenue | \$ change | % change |
|---------------------|----------|--------------------------------|------|--------------------------------|-----------|----------|
| Development revenue | \$ 2,909 | 100.0 | \$ - | - | \$ 2,909 | - |

We earn development revenue from performance on collaborative research and development agreements with commercial customers researching and developing commercial applications for our technology. Our contributions under the collaborative agreements generally include research services, components, and prototype devices and fixtures. Our development revenue from such agreements in a particular period is dependent upon the values and timing of agreements, the availability of technical resources to perform the work, and achievement of mutually agreed upon contractual milestones. We evaluate the performance criteria and terms of our collaborative research and development agreements to determine whether revenue should be recognized under a performance-based method or milestone method.

In March 2013, we entered into a \$4.6 million collaborative research and development agreement with a prominent electronics company to incorporate our PicoP® display technology into a display engine that could enable a variety of new products. During the twelve months ended December 31, 2013, \$2.9 million of revenue was recognized on this agreement.

Based on the terms of this agreement, we recognize development revenue as work progresses on the agreement and as our customer accepts the deliverables using a proportional method based on the lesser of the cumulative proportion of total planned costs to be incurred under the agreement versus the cash payments received plus outstanding billings for work accepted by the customer. Since our collaborative agreements generally require some level of technology development, the actual costs required to complete a contract can vary from our estimates. The proportional revenue recognition method we use for collaborative research and development agreements includes adjustments for revisions to estimated total agreement costs. Each period, we evaluate the total estimated costs for each agreement. Any adjustments that result from revisions to the estimated costs are recognized in the period we become aware of changes. In the future, revisions in these estimates could significantly impact recognized revenue in any one reporting period.

Our backlog of collaborative research and development agreements at December 31, 2013 was \$1.7 million compared to zero at December 31, 2012. The backlog is scheduled for completion during the next twelve months and subject to the successful achievement of contractual milestones and customer acceptance.

Cost of Product Revenue.

| (in thousands) | 2013 | % of product revenue | 2012 | % of product revenue | \$ change | % change |
|-------------------------|----------|----------------------------|----------|----------------------------|------------|----------|
| Cost of product revenue | \$ 1,518 | 64.8 | \$ 6,085 | 89.7 | \$ (4,567) | (75.1) |

Cost of product revenue includes the direct and allocated indirect cost of manufacturing products sold to customers. Direct costs include labor, materials and other costs incurred directly in the manufacture of these products. Indirect costs include labor and other costs associated with operating our manufacturing capabilities and capacity. In the event that we maintain production capacity in excess of production requirements, cost of product revenue may also include manufacturing overhead associated with the excess capacity.

Cost of product revenue was lower during 2013 compared to 2012 primarily because of the change in product mix from lower margin SHOWWX™ products to sales of higher margin components, decreased inventory write downs and lower manufacturing overhead associated with excess production capacity compared to the prior year. During 2013 and 2012, cost of product revenue included inventory write downs of \$303,000 and \$1.1 million, respectively. During 2013, cost of product revenue did not include any manufacturing overhead associated with production capacity in

excess of production requirements, compared to \$523,000 in 2012.

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The cost of product revenue as a percentage of product revenue can fluctuate significantly from period to period, depending on the product mix and volume, the level of overhead expense and the volume of direct material purchased. The decrease in the percentage during 2013 compared to 2012 was due to costs incurred in 2012 associated with aligning our operations to our ingredient brand strategy per above.

Cost of Contract Revenue.

| | 2013 | % of contract revenue | 2012 | % of contract revenue | \$ change | % change |
|--------------------------|--------|-----------------------------|--------|-----------------------------|-----------|----------|
| (in thousands) | | | | | | |
| Cost of contract revenue | \$ 283 | 47.0 | \$ 839 | 53.0 | \$ (556) | (66.3) |

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

The cost of contract revenue was lower in 2013 than in 2012 as a result of the decreased sales of test equipment and reduced activity on government contracts.

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.

Research and Development Expense.

| | 2013 | 2012 | \$ change | % change |
|--------------------------|-----------|-----------|------------|----------|
| (in thousands) | | | | |
| Research and development | \$ 10,267 | \$ 12,851 | \$ (2,584) | (20.1) |

Research and development expense consists of compensation related costs of employees and contractors engaged in internal research and product development activities, direct material to support development programs, laboratory operations, outsourced development and processing work, and other operating expenses. Research and development expense includes costs associated with our work under collaborative research and development arrangements. We allocate our research and development resources based on the business opportunity of the available projects, the skill mix of the resources available and the contractual commitments we have made to customers.

The decrease in research and development expense during 2013, compared to 2012, is primarily attributable to decreased payroll costs associated with reductions in staffing levels, lower subcontracted services and lower non-cash compensation expense.

We believe that a substantial level of continuing research and development expense will be required to further develop our technology and to support our customers to integrate our technology into their products under the ingredient brand business model. Accordingly, we anticipate our level of research and development spending will continue to be substantial.

Sales, Marketing, General and Administrative Expense

| | 2013 | 2012 | \$ change | % change |
|--|----------|-----------|------------|----------|
| (in thousands) | | | | |
| Sales, marketing, general and administrative | \$ 8,792 | \$ 11,252 | \$ (2,460) | (21.9) |

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.

The decrease in sales, marketing, general and administrative expense during 2013, compared to 2012, is primarily due to decreased payroll costs associated with reductions in staffing levels compared to the prior year and lower non-cash compensation expense.

Impairment of intangible assets

| | 2013 | 2012 | \$ change | % change |
|---------------------------------|--------|--------|-----------|----------|
| (in thousands) | | | | |
| Impairment of intangible assets | \$ 277 | \$ 284 | \$ (7) | (2.5) |

Impairment of intangible assets includes losses recognized when the carrying value of the assets exceeds their fair value. In 2013, we recorded an impairment amounting to \$277,000 on 42 patents that were abandoned in prosecution. In 2012, we recorded an impairment amounting to \$284,000 on 35 patents that were abandoned in prosecution.

Gain on sale of previously reserved inventory

| | 2013 | 2012 | \$ change | % change |
|---|----------|----------|-----------|----------|
| (in thousands) | | | | |
| Gain on sale of previously reserved inventory | \$ (156) | \$ (212) | \$ 56 | (26.4) |

Gain on sale of previously reserved inventory includes the sales of excess component inventory for discontinued products and was fully reserved in prior periods. The decrease during 2013, compared to 2012, is due to decreased sales volume.

Change in warrant liability

| | 2013 | 2012 | \$ change | % change |
|-----------------------------|----------|------|-----------|----------|
| (in thousands) | | | | |
| Change in warrant liability | \$ 1,801 | \$ - | \$ 1,801 | - |

Based on the terms of the warrants we issued in May and September, 2013, we have determined that they should be classified as a liability given that the warrants could result in the issuance of a variable number of shares of common stock based on a conditional exchange provision that is outside of our control at any point when the share price of our common stock is equal to or less than the stated exercise prices of \$2.886 and \$2.444 per share. At the dates of issuance, and as of December 31, 2013, our common stock was trading at a value less than the stated exercise price. As such, the holders may elect to exchange the warrants for a variable number of shares of common stock as determined by a formula included in the warrants. However, the warrants limit the number of shares that may be issued under this exchange provision to one share of common stock for each warrant exchanged. The maximum number of shares that we could be required to issue under the terms of the warrants is 4,071,552. As of December 31, 2013, 358,243 shares of common stock have been issued on a one-for-one basis under the warrant exchange provisions of the May and September agreements. As of December 31, 2013, based upon the terms of the then outstanding warrants and the quoted market price of our common stock, if the exchange feature had been exercised, we would have been required to issue 3,713,309 shares of common stock to satisfy the obligation without receiving any additional cash consideration, equal to an estimated fair market value of \$4,902,000, which we believe is the best indication of the fair value of the warrant obligation as of December 31, 2013. Changes in the market value of our common stock may decrease the number of shares to be issued under this exchange feature.

At each balance sheet date, we evaluate the fair value of the warrants and any change in value will be recorded as a non-operating gain or loss on the statement of operations. During 2013, we recorded gains of \$1.8 million related to the change in value of the warrants. If and when the exchange feature is exercised by the holder, we will recognize a gain or loss on the exchange based on the fair market value of the common stock issued by us to the holder to satisfy

the exchange provision.

Other Income and Expense.

| | 2013 | 2012 | \$ change | % change |
|--------------------------|--------|---------|-----------|----------|
| (in thousands) | | | | |
| Other income and expense | \$ 115 | \$ (38) | \$ 153 | (402.6) |
| | | | 21 | |

The increase in other income and expense in 2013 from 2012 results primarily from realized gains recorded upon issuance of common stock under the warrant exchange provisions of the May and September agreements.

Income Taxes.

No provision for income taxes has been recorded because we have experienced net losses from inception through December 31, 2013. At December 31, 2013, we had net operating loss carry-forwards of approximately \$326.0 million for federal income tax reporting purposes. In addition, we have research and development tax credits of \$6.3 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 2017 to 2033 if not previously used. The research and development tax credits and the remaining net operating losses are scheduled to expire between 2018 and 2033. 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 use a portion of our net operating loss carry-forwards.

We recognize interest accrued and penalties related to unrecognized tax benefits in tax expense. We did not have any unrecognized tax benefits at December 31, 2013 or at December 31, 2012.

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. At December 31, 2013, we had \$5.4 million in cash and cash equivalents and a working capital deficit of \$3.9 million. Included in the working capital deficit is a \$4.9 million non-cash liability associated with our warrants as described above.

Based on our current operating plan, we anticipate that we have sufficient cash and cash equivalents to fund our operations through March 2014. We will require additional cash to fund our operating plan past that time. We plan to obtain additional cash through the issuance of equity or debt securities. There can be no assurance that additional cash will be available or that, if available, it will be available on terms acceptable to us on a timely basis. If adequate funds are not available on a timely basis, we intend to consider limiting our operations substantially. This limitation of operations could include reducing our planned investment in development projects resulting in reductions in staff, operating costs, capital expenditures and investment in research and development.

We have received a report from our independent registered public accounting firm regarding the consolidated financial statements for the year ended December 31, 2013 that includes an explanatory paragraph expressing substantial doubt about our ability to continue as a going concern. These financial statements are prepared assuming we will continue as a going concern.

Cash used in operating activities totaled \$12.7 million during 2013, compared to \$20.6 million during 2012. During 2013, the decrease in net cash used in operating activities was primarily driven by lower personnel costs and increased margins on product sales, as well as savings resulting from steps taken to lower our cash usage.

Investing Activities

Cash used in investing activities totaled \$340,000 in 2013 compared to \$92,000 in 2012. Purchases of property and equipment during 2013 totaled \$376,000 compared to \$533,000 during 2012. Prior year activity also included a \$350,000 decrease of our restricted cash.

Financing Activities

Cash provided by financing activities totaled \$11.5 million in 2013, compared to \$14.5 million in 2012. The following is a list of our financing activities during 2013 and 2012. All share amounts have been adjusted for the 1:8 reverse stock split discussed in this annual report.

- In September 2013, we raised \$6.6 million before issuance costs of approximately \$452,000 from the sale of 3.5 million shares of common stock and warrants to purchase up to an aggregate of 2.1 million shares of our common stock in a registered direct offering. The warrants have an exercise price of \$2.444 per share, a five year term, and are exercisable beginning on the date of issuance. Each warrant to purchase a share of common stock may also be exchanged during its term for a number of shares of common stock (but not more than one

share of common stock for each warrant so exchanged) with a value determined by a formula if, among other things, our common stock is then trading at a price at or lower than the warrant exercise price per share. Subject to limitations in the warrants, we may require the warrants be exercised for cash if the closing bid price of our stock is over \$3.055 for 20 consecutive trading days and the average daily dollar volume over that period is equal to or exceeds \$300,000.

- In May 2013, we raised \$5.85 million before issuance costs of approximately \$362,000 from the sale of 2.6 million shares of common stock and warrants to purchase up to an aggregate of 2.0 million shares of our common stock in a registered direct offering. The warrants have an exercise price of \$2.886 per share, a five year term, and are exercisable beginning on the date of issuance. Each warrant to purchase a share of common stock may also be exchanged during its term for a number of shares of common stock (but not more than one share of common stock for each warrant so exchanged) with a value determined by a formula if, among other things, our common stock is then trading at a price at or lower than the warrant exercise price per share. Subject to limitations in the warrants, we may require the warrants be exercised for cash if the closing bid price of our stock is over \$3.61 for 20 consecutive trading days and the average daily dollar volume over that period is equal to or exceeds \$300,000.
- In June 2012, we raised \$10.5 million before issuance costs of approximately \$823,000 through an underwritten public offering of 4.2 million shares of our common stock and warrants to purchase 2.1 million shares of our common stock. The warrants have an exercise price of \$2.65 per share, a five year term, and are exercisable beginning one year from the date of issuance.
- In May 2012, we raised approximately \$5.0 million before issuance costs of approximately \$71,000 from the sale of 3.3 million shares of common stock and warrants to purchase 1.0 million shares of our common stock to private investors. The warrants have an exercise price of \$2.12 per share, a three year term, and are exercisable beginning on the date of issuance.

Our cash requirements will depend on many factors, including, but not limited to, the rate at which OEMs and ODMs 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:

- commercial acceptance of products based on PicoP display technology;
- 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;
- the cost of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights;
- our ability to establish cooperative development, joint venture and licensing arrangements; or
- other factors unrelated to our company or industry.

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.

New accounting pronouncements

See Note 2, "Summary of significant accounting policies," in the Notes to the consolidated financial statements found in part II, Item 8 of this Form 10-K.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate and Market Liquidity Risks

As of December 31, 2013, all of our total cash and cash equivalents have variable interest rates. Therefore, we believe our exposure to market and interest rate risks is not material.

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, 2013, our cash and cash equivalents are comprised of short-term highly rated money market savings accounts.

The values of cash equivalents and investment securities, available-for-sale by maturity date as of December 31, 2013, are as follows:

| | Amount | Percent |
|---------------------------|--------------|---------|
| Cash and cash equivalents | \$ 5,375,000 | 100.0 % |
| Less than one year | - | - |
| | \$ 5,375,000 | 100.0 % |

Foreign Exchange Rate Risk

All of our contract and collaborative research and development agreements payments are currently made in U.S. dollars. However, in the future we may enter into contracts or collaborative research and development agreements in foreign currencies that may subject us to foreign exchange rate risk. We have purchase orders and supply agreements in foreign currencies and may enter into such arrangements from time to time in the future. We believe our exposure to currency fluctuations related to these arrangements is not material. We may enter into foreign currency hedges to offset material exposure to currency fluctuations when we can adequately determine the timing and amounts of the 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
MicroVision, Inc.

We have audited the accompanying consolidated balance sheets of MicroVision, Inc. (the "Company") as of December 31, 2013 and 2012, and the related consolidated statements of operations, comprehensive loss, shareholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of MicroVision, Inc. as of December 31, 2013 and 2012, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 1 to the consolidated financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 1. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Moss Adams LLP
Seattle, Washington
March 6, 2014

MicroVision, Inc.

Consolidated Balance Sheets (in thousands, except per share information)

| | December 31, | |
|--|--------------|-----------|
| | 2013 | 2012 |
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 5,375 | \$ 6,850 |
| Accounts receivable, net of allowances of \$373 and \$332 | 24 | 1,115 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | - | 12 |
| Inventory | 49 | 497 |
| Other current assets | 336 | 1,221 |
| Total current assets | 5,784 | 9,695 |
| Property and equipment, net | 1,065 | 1,205 |
| Restricted cash | 435 | 436 |
| Intangible assets | 1,145 | 1,580 |
| Other assets | 18 | 22 |
| Total assets | \$ 8,447 | \$ 12,938 |
| Liabilities and Shareholders' Equity | | |
| Current liabilities | | |
| Accounts payable | \$ 1,610 | \$ 3,035 |
| Accrued liabilities | 2,455 | 4,007 |
| Deferred revenue | - | 609 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 680 | 98 |
| Warrant liability | 4,902 | - |
| Current portion of capital lease obligations | 15 | 48 |
| Current portion of long-term debt | - | 67 |
| Total current liabilities | 9,662 | 7,864 |
| Capital lease obligations, net of current portion | - | 20 |
| Deferred rent, net of current portion | 481 | - |
| Total liabilities | 10,143 | 7,884 |
| Commitments and contingencies (Note 11) | | |
| Shareholders' (Deficit) Equity | | |
| Preferred stock, par value \$.001; 25,000 shares authorized; 0 and 0 shares issued and outstanding | - | - |
| Common stock, par value \$.001; 100,000 shares authorized; 32,069 and 25,237 shares issued and outstanding at December 31, 2013 and 2012, respectively | 32 | 25 |
| Additional paid-in capital | 448,981 | 442,560 |
| Accumulated deficit | (450,709) | (437,531) |
| Total shareholders' (deficit) equity | (1,696) | 5,054 |
| Total liabilities and shareholders' (deficit) equity | \$ 8,447 | \$ 12,938 |

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

MicroVision, Inc.

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

| | Years Ended December 31, | |
|---|---------------------------------|-------------|
| | 2013 | 2012 |
| Product revenue | \$ 2,341 | \$ 6,782 |
| Contract revenue | 602 | 1,583 |
| Development revenue | 2,909 | - |
| Total revenue | 5,852 | 8,365 |
| Cost of product revenue | 1,518 | 6,085 |
| Cost of contract revenue | 283 | 839 |
| Total cost of revenue | 1,801 | 6,924 |
| Gross margin | 4,051 | 1,441 |
| Research and development expense | 10,267 | 12,851 |
| Sales, marketing, general and administrative expense | 8,792 | 11,252 |
| Impairment of intangible assets | 277 | 284 |
| Gain on disposal of fixed assets | (35) | (79) |
| Gain on sale of previously reserved inventory | (156) | (212) |
| Total operating expenses | 19,145 | 24,096 |
| Loss from operations | (15,094) | (22,655) |
| Change in warrant liability | 1,801 | - |
| Other income, net | 115 | (38) |
| Net loss | \$ (13,178) | \$ (22,693) |
| Net loss per share basic and diluted | \$ (0.47) | \$ (1.05) |
| Weighted-average shares outstanding basic and diluted | 28,025 | 21,595 |

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

MicroVision, Inc.

Consolidated Statements of Comprehensive Loss (in thousands)

| | Years Ended December 31, | |
|--|--------------------------|-------------|
| | 2013 | 2012 |
| Net loss | \$ (13,178) | \$ (22,693) |
| Other comprehensive gain (loss) | | |
| Unrealized gain (loss) on investment securities, available-for-sale: | | |
| Unrealized holding gain (loss) arising during period | - | 3 |
| Less: reclassification adjustment for losses realized in net income | - | 32 |
| Comprehensive loss | \$ (13,178) | \$ (22,658) |

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

MicroVision, Inc.

Consolidated Statements of Shareholders' Equity (in thousands)

| | Shareholders' Equity (Deficit) | | | | | Total Shareholders' equity (deficit) |
|-------------------------------------|--------------------------------|--------------|----------------------------------|---|------------------------|--|
| | Common Stock Shares | Par value | Additional paid-in capital | Accumulated other comprehensive loss | Accumulated deficit | |
| Balance at December 31, 2011 | 17,019 | \$ 17 | \$ 425,658 | \$ (35) | \$ (414,838) | \$ 10,802 |
| Share-based compensation expense | 648 | - | 2,286 | - | - | 2,286 |
| Exercise of warrants and options | 16 | - | 23 | - | - | 23 |
| Sales of common stock and warrants | 7,554 | 8 | 14,593 | - | - | 14,601 |
| Other comprehensive gain | - | - | - | 35 | - | 35 |
| Net loss | - | - | - | - | (22,693) | (22,693) |
| Balance at December 31, 2012 | 25,237 | 25 | 442,560 | - | (437,531) | 5,054 |
| Share-based compensation expense | 323 | - | 1,589 | - | - | 1,589 |
| Exercise of options | 23 | - | 41 | - | - | 41 |
| Sales of common stock and warrants | 6,128 | 7 | 4,255 | - | - | 4,262 |
| Exchange of warrants | 358 | - | 536 | - | - | 536 |
| Net loss | - | - | - | - | (13,178) | (13,178) |
| Balance at December 31, 2013 | 32,069 | \$ 32 | \$ 448,981 | \$ - | \$ (450,709) | \$ (1,696) |

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

MicroVision, Inc.

Consolidated Statements of Cash Flows (in thousands)

| | Years Ended December 31, | |
|---|---------------------------------|-------------|
| | 2013 | 2012 |
| Cash flows from operating activities | | |
| Net loss | \$ (13,178) | \$ (22,693) |
| Adjustments to reconcile net loss to net cash used in operations: | | |
| Depreciation | 923 | 1,445 |
| Amortization of intangible assets | 158 | 184 |
| Impairment of intangible assets | 277 | 284 |
| Gain on disposal of property and equipment | (35) | (79) |
| Realized loss on sale of short-term investments | - | 32 |
| Non-cash share-based compensation | 1,606 | 2,269 |
| Change in warrant liability | (1,801) | - |
| Realized gain on warrant exchange | (99) | - |
| Inventory write-downs | 303 | 1,094 |
| Non-cash deferred rent | (31) | (118) |
| Change in: | | |
| Accounts receivable | 1,091 | (652) |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 12 | 58 |
| Inventory | 145 | 2,663 |
| Other current assets | 868 | (419) |
| Other assets | 4 | 12 |
| Accounts payable | (1,486) | (4,077) |
| Accrued liabilities | (1,387) | (1,175) |
| Deferred revenue | (609) | 609 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | 582 | (58) |
| Net cash used in operating activities | (12,657) | (20,621) |
| Cash flows from investing activities | | |
| Sales of investment securities | - | 11 |
| Decrease in restricted investment | 1 | 350 |
| Proceeds on sale of property and equipment | 35 | 80 |
| Purchases of property and equipment and intangible assets | (376) | (533) |
| Net cash used in investing activities | (340) | (92) |
| Cash flows from financing activities | | |
| Principal payments under capital leases and long-term debt | (120) | (136) |
| Net proceeds from issuance of common stock and warrants | 11,642 | 14,624 |
| Net cash provided by financing activities | 11,522 | 14,488 |
| Net decrease in cash and cash equivalents | (1,475) | (6,225) |
| Cash and cash equivalents at beginning of period | 6,850 | 13,075 |
| Cash and cash equivalents at end of period | \$ 5,375 | \$ 6,850 |
| Supplemental disclosure of cash flow information | | |
| Cash paid for interest | \$ 12 | \$ 30 |
| Supplemental schedule of non-cash investing and financing activities | | |
| Other non-cash additions to property and equipment | \$ 407 | \$ - |
| Issuance of common stock for exchange of warrants | \$ 536 | \$ - |

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

MicroVision, Inc.
Notes to Consolidated Financial Statements

1. The Company and liquidity

MicroVision, Inc. (the "Company") is developing its proprietary PicoP® display technology which can be used by our customers to create high-resolution miniature laser display and imaging engines. Our PicoP display technology uses our widely patented expertise in two dimensional Micro-Electrical Mechanical Systems (MEMS), lasers, optics, and electronics to create a high quality video or still image from a small form factor device with lower power needs than conventional display technologies. Our strategy is to develop and supply PicoP display technology directly or through licensing arrangements to original device manufacturers (ODMs) and original equipment manufacturers (OEMs) in various market segments, including consumer electronics and automotive, for integration into their products.

During 2012, we aligned our operations to our ingredient brand strategy, simplifying our operations and resulting in a significant reduction to our 2013 cash usage relative to 2012. Our strategy is to focus our efforts on licensing our technology and selling display engine components to partners who will produce display engines based on PicoP display technology and either sell those display engines to OEMs, or incorporate the engines into their own products.

Our development efforts are focused on improving the performance of display engines through the improvement of both engine system, hardware and software design, and the performance of various components of the display engine. We also provide engineering support to our customers as they prepare to manufacture display engines as well as providing support to ODMs and OEMs during the integration and optimization of PicoP display technology for specific products.

The primary objective for consumer applications is to provide users of mobile devices such as smartphones, tablets and other consumer electronics products with a large screen viewing experience produced by a small projector either embedded in the device or via a companion product. These potential products would allow users to watch movies and videos, play games, and display images and other data onto a variety of surfaces, freeing users from the limitations of a small screen.

PicoP display technology could also be combined with other components and systems to be embedded into a vehicle or integrated into a portable standalone head-up display (HUD). HUD technology allows for important information, such as safety warnings or navigation instructions, to be projected so that it appears in front of vehicle operators where the information can be accessed without taking their eyes off the road.

We also see potential for PicoP display technology in other areas, although we are not currently working with customers. PicoP display technology could be combined with other components and systems to be incorporated 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.

Devices enabled by PicoP display technology could be used in field-based professions such as service repair or sales to view and share information such as schematics for equipment repair, sales data, orders or contact information on a larger, more user-friendly display. We also see potential for embedding PicoP display technology in industrial products where our displays could be used for 3D measuring and digital signage, enhancing the overall user experience of these applications.

We develop and procure intellectual property rights relating to our technology as a key aspect of our business strategy. We generate intellectual property from our internal research and development activities and our ongoing performance on development contracts. We also have acquired exclusive rights to various

technologies under licensing and acquisition agreements.

Based on our current operating plan, we anticipate that we have sufficient cash and cash equivalents to fund our operations through March 2014. We will require additional cash to fund our operating plan past that time. We plan to obtain additional cash through the issuance of equity or debt securities. There can be no assurance that additional cash will be available or that, if available, it will be available on terms acceptable to us on a timely basis. If adequate funds are not available on a timely basis, we intend to consider limiting our operations substantially. This limitation of operations could include reducing our planned investment in development projects resulting in reductions in staff, operating costs, capital expenditures and investment in research and development.

Our capital requirements will depend on many factors, including, but not limited to, the rate at which OEMs or ODMs introduce products incorporating the PicoP display and image capture technologies and the market acceptance and competitive position of such products. If revenues are less than anticipated, if the mix of revenues vary from anticipated amounts 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.

We have received a report from our independent registered public accounting firm regarding the consolidated financial statements for the year ended December 31, 2013 that includes an explanatory paragraph expressing substantial doubt about our ability to continue as a going concern. These consolidated financial statements are prepared assuming the Company will continue as a going concern.

A 1:8 reverse stock split of MicroVision's common stock became effective on February 17, 2012. All of the share and per share amounts discussed and shown in the consolidated financial statements and notes have been adjusted to reflect the effect of this reverse split.

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 us 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. We have identified the following areas where significant estimates and assumptions have been made in preparing the financial statements: revenue recognition, valuation of share-based compensation, allowance for uncollectible receivables and inventory valuation.

Principles of consolidation

Our consolidated financial statements include the accounts of MicroVision, Inc. and MicroVision Innovations Singapore Pte. Ltd. ("MicroVision Singapore"), a wholly owned foreign subsidiary. MicroVision Singapore was incorporated in April 2011 and was engaged in advanced research and development activities and operation support functions for MicroVision, Inc. There were no material intercompany accounts and transactions during the years ended December 31, 2013 and 2012.

Cash and cash equivalents and fair value of financial instruments

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in an orderly transaction between market participants. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. As a basis for considering such assumptions, the authoritative guidance 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 use 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 inputs that are observable by market data.

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.

Our financial instruments include cash and cash equivalents, accounts receivable, accounts payable, accrued liabilities, long-term debt and warrant liabilities. Excluding the long term debt and warrant liabilities, the carrying value of our financial instruments approximates fair value due to their short maturities. The carrying amount of long-term debt at December 31, 2013 and 2012 was not materially different from the fair value based on rates available for similar types of arrangements. At each balance sheet date, we evaluate the warrant liability and any change in value is recorded as a non-operating gain or loss on the statement of operations. Due to the features of the warrants, the determination of the fair value of the warrant liability may vary depending on our common stock price. If the price of our common stock is less than the exercise price of the warrant, we will calculate the fair value of the warrant liability as the fair value of the common stock that would be required to be issued to settle the exchange feature of the warrant. If the price of our common stock is greater than the exercise price of the warrant, we will use a binomial option pricing model to estimate the fair value of the warrant as the exchange feature provided per the agreement will no longer be available to the holder.

The valuation inputs hierarchy classification for the warrant liability measured at fair value on a recurring basis is summarized below as of December 31, 2013.

| As of December 31, 2013: | Level 1 | Level 2 | Level 3 | Total |
|--------------------------|---------|--------------|---------|--------------|
| Liabilities | | | | |
| Warrant liability | \$ - | \$ 4,902,000 | \$ - | \$ 4,902,000 |
| | \$ - | \$ 4,902,000 | \$ - | \$ 4,902,000 |

Our cash equivalents are comprised of money market savings accounts and equity securities. We classify investment securities available-for-sale purchased with 90 days or less remaining until contractual maturities as cash equivalents.

Intangible assets

Our intangible assets consist entirely of purchased patents. The patents are amortized using the straight-line method over their estimated period of benefit, ranging from one to 17 years. We evaluate the recoverability of intangible assets periodically by taking into account events or circumstances that may warrant revised estimates of useful lives or that indicate the asset may be impaired. We compare the projected undiscounted net cash flows associated with the related intangible assets or group of assets over their remaining lives against their respective carrying amounts. Measurement of an impairment loss for our intangible assets is based on the difference between the fair value of the asset and its carrying value.

Inventory

Inventory consists of components, raw materials and finished goods for our pico projectors. Inventory is recorded at the lower of cost or market with cost determined on a net realizable value basis. We periodically assess the need to provide for obsolescence of inventory and adjust the carrying value of inventory to its net realizable value when required. In addition, we reduce the value of our inventory to its estimated scrap value when we determine that it is not probable that the inventory will be consumed through normal production during the next twelve months.

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. Costs for repairs and maintenance are charged to expense as incurred and expenditures for major improvements are capitalized at cost. Gains or losses on the disposition of assets are reflected in the income statements at the time of disposal.

Restricted investments

As of December 31, 2013, restricted investments were in money market savings accounts and serve as collateral for \$435,000 in irrevocable letters of credit. The restricted investments balance includes two letters of credit which are outstanding in connection with a lease agreement for our corporate headquarters building in Redmond, WA. The balance is required over the term of the lease, which expires in January 2019. In January 2012, a \$350,000 letter of credit which was outstanding under the terms of a supplier agreement expired.

Revenue recognition

We evaluate the performance criteria and terms of our collaborative research and development agreements to determine whether revenue should be recognized under a performance-based method or milestone method. Significant items included in our evaluation are the following:

- the nature of our obligation under the agreement,
- whether provisions leading to variable revenues exist
- whether any payments are required to be repaid,
- whether the deliverables should be treated as one unit of accounting or separated into multiple units,
- whether substantive milestones exist,
- whether milestone payments are commensurate with either our level of effort or the increase in value of the customer's rights, and
- whether a licensing agreement exists.

We recognize development revenue as work progresses on the agreement and as our customer accepts the deliverables using a proportional method based on the lesser of the cumulative proportion of total planned costs to be incurred under the agreement or the cash payments received plus outstanding billings for work accepted by the customer. Since our collaborative agreements generally require some level of technology development, the actual costs required to complete a contract can vary from our estimates. The proportional revenue recognition method we use for collaborative research and development agreements includes adjustments for revisions to estimated total agreement costs. Each period, we evaluate total estimated costs for each agreement. Any adjustments that result from revisions to the estimated costs are recognized in the period we become aware of changes. The costs for work performed under collaborative research and development agreements are expensed in the periods incurred and included in the Statement of Operations in research and development expense.

Product revenue is recognized when there is sufficient evidence of an arrangement, delivery has occurred, the fee is fixed or determinable, and collection is reasonably assured. We have entered into agreements with resellers and distributors, as well as selling directly to the public. Sales made to resellers and distributors are recognized using either the sell-through method or upon expiration of the contractually agreed-upon acceptance period, depending on the volume of the sale. Some of the agreements with resellers and distributors contain price-protection clauses, and revenue is recognized net of these amounts. Sales made directly to the public are recognized either upon expiration of the contractual acceptance period after which there are no rights of return, or net of estimated returns and allowances. Provisions are made for warranties at the time revenue is recorded.

Contract revenue has primarily been generated from contracts to develop 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 estimate the labor, material, and other cost required to complete the statement of work compared to cost incurred to date. We use information provided by our technical team, project managers, vendors, outside consultants and others 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

estimates. We have developed processes that allow us to reasonably estimate 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.

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

We recognize contract revenue for prototype units and evaluation kits for development work upon acceptance or the expiration of the acceptance period, when there is sufficient evidence of an arrangement, the selling price is fixed or determinable and collection is reasonably assured.

Cost of revenue

Cost of product revenue includes 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.

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

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

Concentration of credit risk and sales to major customers

Concentration of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk are primarily cash equivalents and accounts receivable. We typically do not require collateral from our customers. As of December 31, 2013, our cash and cash equivalents are comprised of short-term highly rated money market savings accounts.

Concentration of Sales to Major Customers

During 2013, two commercial customers accounted for 86% of our total revenue. During 2012, one commercial customer accounted for 61% of our total revenue and 96% of our accounts receivable balance at December 31, 2012.

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 using the weighted-average number of common shares outstanding during the periods. Net loss per share assuming dilution is calculated using 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.

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As of December 31, 2013 and 2012, we 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 in the respective years.

| | December 31, | |
|------------------------------|--------------|-----------|
| | 2013 | 2012 |
| Publicly traded warrants | - | 753,000 |
| Options and private warrants | 9,996,000 | 5,696,000 |
| Nonvested equity shares | 108,000 | 207,000 |
| | 10,104,000 | 6,656,000 |

Research and development

Research and development expenses consist of costs incurred for internally funded research and product development activities as well as collaborative research and development activities that are funded by customers. These costs include compensation related costs of employees, share-based compensation, materials, subcontracted services, facility costs, and depreciation of facilities and lab equipment. Research and development costs are expensed as incurred.

Long-lived assets

We evaluate the recoverability of our long-lived assets when an impairment is indicated based on expected undiscounted cash flows. We recognize impairment of the carrying value of long-lived assets, if any, based on the fair value of such assets.

Share-based compensation

Our share-based incentive compensation plans are described in Note 10.

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

| | Year Ended December 31, | |
|--|-------------------------|--------------|
| | 2013 | 2012 |
| Cost of contract revenue | \$ 19,000 | \$ 34,000 |
| Cost of product revenue | 1,000 | 54,000 |
| Research and development expense | 466,000 | 825,000 |
| Sales, marketing, general and administrative expense | 1,120,000 | 1,356,000 |
| | \$ 1,606,000 | \$ 2,269,000 |

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 February 2013, the Financial Accounting Standards Board ("FASB") issued guidance that requires disclosure of amounts reclassified out of accumulated other comprehensive income in its entirety, by component, on the face of the statement of operations or in the notes thereto. Amounts that are not required to be reclassified in their entirety to net income must be cross-referenced to other disclosures that provide additional detail. This standard is effective prospectively for annual and interim reporting periods beginning after December 15, 2012. We adopted this guidance on January 1, 2013. The adoption did not have a material impact on our financial position, results of operations or cash flows.

3. Long-term contracts

In March 2013, we entered into a \$4.6 million collaborative research and development agreement with a prominent electronics company to incorporate our PicoP® display technology into a display engine that could enable a variety of new products. Based on the terms of this agreement, we recognize development revenue as work progresses on the agreement and as our customer accepts the deliverables using a proportional method based on the lesser of the cumulative proportion of total planned costs to be incurred under the agreement versus the cash payments received plus outstanding billings for work accepted by the customer. During the twelve months ended December 31, 2013, \$2.9 million of revenue was recognized on this agreement.

Historically, our contracts with the U.S. government were primarily cost-plus-fixed-fee type contracts. Under the terms of a cost-plus-fixed-fee contract, the U.S. government reimbursed us for negotiated actual direct and indirect cost incurred in performing the contracted services. We were not obligated to spend more than the contract value to complete the contracted services. The period of performance was generally one year. As of December 31, 2013, we were not performing services on any U.S. government contracts.

The following table summarizes the costs incurred on our collaborative research and development agreements and revenue contracts (in thousands):

| | December 31, | |
|--|--------------|----------|
| | 2013 | 2012 |
| Costs and estimated earnings incurred on uncompleted contracts | \$ 2,909 | \$ 1,977 |
| Billings on uncompleted contracts | (3,589) | (2,063) |
| | \$ (680) | \$ (86) |

Included in accompanying consolidated balance sheets under the following captions:

| | | |
|---|----------|---------|
| Costs and estimated earnings in excess of billings on uncompleted contracts | \$ - | \$ 12 |
| Billings in excess of costs and estimated earnings on uncompleted contracts | (680) | (98) |
| | \$ (680) | \$ (86) |

4. Inventory

Inventory consists of the following:

| | December 31, | |
|----------------|--------------|------------|
| | 2013 | 2012 |
| Raw materials | \$ 23,000 | \$ 361,000 |
| Finished goods | 26,000 | 136,000 |
| | \$ 49,000 | \$ 497,000 |

The inventory at December 31, 2013 and 2012 consisted of components and finished goods primarily composed of our accessory pico projectors. Inventory is stated at the lower of cost or market. Management periodically assesses the need to provide for obsolescence of inventory and adjusts the carrying value of inventory to its net realizable value when required. In addition, we reduce the value of our inventory to 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 2013 and 2012, we recorded inventory write-downs of \$303,000 and \$1,094,000, respectively. At December 31, 2013 and 2012, we have aggregate write-downs recorded of \$7,964,000 and \$9,916,000, respectively, offsetting inventory on hand deemed to be obsolete or scrap inventory.

5. Accrued liabilities

Accrued liabilities consist of the following:

| | December 31, | |
|------------------------------|--------------|--------------|
| | 2013 | 2012 |
| Bonuses | \$ 725,000 | \$ 724,000 |
| Payroll and payroll taxes | 375,000 | 427,000 |
| Compensated absences | 315,000 | 384,000 |
| Deferred rent credit | 99,000 | 187,000 |
| Warranty | 32,000 | 206,000 |
| Adverse purchase commitments | 500,000 | 634,000 |
| Accelerated rent expense | - | 109,000 |
| Professional fees | 76,000 | 533,000 |
| Other | 333,000 | 803,000 |
| | \$ 2,455,000 | \$ 4,007,000 |

6. Property and equipment, net

Property and equipment consists of the following:

| | December 31, | |
|--|--------------|--------------|
| | 2013 | 2012 |
| Production equipment | \$ 2,943,000 | \$ 5,201,000 |
| Leasehold improvements | 502,000 | 3,344,000 |
| Computer hardware and software/lab equipment | 4,373,000 | 9,002,000 |
| Office furniture and equipment | 1,100,000 | 1,485,000 |
| | 8,918,000 | 19,032,000 |
| Less: Accumulated depreciation | (7,853,000) | (17,827,000) |
| | \$ 1,065,000 | \$ 1,205,000 |

Depreciation expense was \$923,000 and \$1,445,000 in 2013 and 2012, respectively.

7. Intangible assets

Our intangible assets consist entirely of technology-based purchased patents. The patents are amortized using the straight-line method over their estimated period of benefit, ranging from one to 17 years. The gross value of our intangible assets was \$1.7 million and \$2.3 million as of December 31, 2013 and 2012, respectively. Amortization expense was \$158,000 and \$184,000 in 2013 and 2012, respectively. In 2013, we recorded an impairment amounting to \$277,000 on 42 patents that were abandoned in prosecution. In 2012, we recorded an impairment amounting to \$284,000 on 35 patents that were abandoned in prosecution.

The following table outlines the estimated future amortization expense related to intangible assets held at December 31, 2013:

| Year ended December 31, | Amount |
|-------------------------|--------------|
| 2014 | \$ 132,000 |
| 2015 | 132,000 |
| 2016 | 131,000 |
| 2017 | 120,000 |
| 2018 | 119,000 |
| Thereafter | 511,000 |
| Total | \$ 1,145,000 |

8. Common stock

In September 2013, we raised \$6.6 million before issuance costs of approximately \$452,000 from the sale of 3.5 million shares of common stock and warrants to purchase up to an aggregate of 2.1 million shares of our common stock in a registered direct offering. Details of the warrants are described below in Note 9.

In May 2013, we raised \$5.85 million before issuance costs of approximately \$362,000 from the sale of 2.6 million shares of common stock and warrants to purchase up to an aggregate of 2.0 million shares of our common stock in a registered direct offering. Details of the warrants are described below in Note 9.

In June 2012, we raised \$10.5 million before issuance costs of approximately \$823,000 through an underwritten public offering of 4.2 million shares of our common stock and warrants to purchase 2.1 million shares of our common stock. Details of the warrants are described below in Note 9.

In May 2012, we raised approximately \$5.0 million before issuance costs of approximately \$71,000 from the sale of 3.3 million shares of common stock and warrants to purchase 1.0 million shares of our common stock to private investors. Details of the warrants are described below in Note 9.

9. Warrants

The warrants issued in September 2013 have an exercise price of \$2.444 per share, a five year term, and are exercisable beginning on the date of issuance. Each warrant to purchase a share of common stock may also be exchanged during its term for a number of shares of common stock (but not more than one share of common stock for each warrant so exchanged) with a value determined by a formula if, among other things, our common stock is then trading at a price at or lower than the warrant exercise price per share. Subject to limitations in the warrants, we may require the warrants be exercised for cash if the closing bid price of our stock is over \$3.055 for 20 consecutive trading days and the average daily dollar volume over that period is equal to or exceeds \$300,000.

The warrants issued in May 2013 have an exercise price of \$2.886 per share, a five year term, and are exercisable beginning on the date of issuance. Each warrant to purchase a share of common stock may also be exchanged during its term for a number of shares of common stock (but not more than one share of common stock for each warrant so exchanged) with a value determined by a formula if, among other things, our common stock is then trading at a price at or lower than the warrant exercise price per share. Subject to limitations in the warrants, we may require the warrants be exercised for cash if the closing bid price of our stock is over \$3.61 for 20 consecutive trading days and the average daily dollar volume over that period is equal to or exceeds \$300,000.

Based on the terms of the warrants we issued in May and September, 2013, we have determined that they should be classified as a liability given that the warrants could result in the issuance of a variable number of shares of common stock based on a conditional exchange provision that is outside of our control at any point when the share price of our common stock is equal to or less than the stated exercise prices of \$2.886 and \$2.444 per share. At the dates of issuance, and as of December 31, 2013, our common stock was trading at a value less than the stated exercise price. As such, the holders may elect to exchange the warrants for a variable number of shares of common stock as determined by a formula included in the warrants. However, the warrants limit the number of shares that may be issued under this exchange provision to one share of common stock for each warrant exchanged. The maximum number of shares that we could be required to issue is under the terms of the warrants is 4,071,552. As of December 31, 2013, 358,243 shares of common stock have been issued on a one-for-one basis under the warrant exchange provisions of the May and September agreements. As of December 31, 2013, based upon the terms of the then outstanding warrants and the quoted market price of our common stock, if the exchange feature had been exercised, we would have been required to issue 3,713,309 shares of common stock to satisfy the obligation without receiving any additional cash consideration, equal to an estimated fair market value of \$4,902,000, which we believe is the best indication of the fair value of the warrant obligation as of December 31, 2013. Changes in the market value of our

common stock may decrease the number of shares to be issued under this exchange feature.

At each balance sheet date, we evaluate the fair value of the warrants and any change in value will be recorded as a non-operating gain or loss on the statement of operations. During 2013, we recorded non-operating gains of \$1.8 million related to the change in value of the warrants. If and when the exchange feature is exercised by the holder, we will recognize a gain or loss on the exchange based on the fair market value of the common stock issued by us to the holder to satisfy the exchange provision.

Subsequent to year end, the holders of the warrants we issued in May and September 2013 elected to exchange all of such remaining outstanding warrants for common stock under the exchange provision, see Note 15.

The warrants issued in June 2012 were issued with an exercise price of \$2.65 per share, a five year term, and are exercisable beginning one year from the date of issuance. The exercise price of the warrants is subject to anti-dilution adjustments. As a result of subsequent financing activities, the exercise price has been reduced to \$2.29.

The warrants issued in May 2012 have an exercise price of \$2.125 per share, a three year term, and are exercisable 60 days from the date of issuance.

The following summarizes activity with respect to MicroVision common stock warrants during the two years ended December 31, 2013:

| | Warrants to purchase common shares | Weighted average exercise price |
|---|---|--|
| Outstanding at December 31, 2011 | 2,287,000 | \$ 14.96 |
| Granted: | | |
| Exercise price greater than intrinsic value | 3,100,000 | 2.48 |
| Exercised | - | - |
| Canceled/expired | (256,000) | 17.60 |
| Outstanding at December 31, 2012 | 5,131,000 | 7.28 |
| Granted: | | |
| Exercise price less than intrinsic value | 2,216,000 | 2.71 |
| Exercise price greater than intrinsic value | 1,855,000 | 2.44 |
| Exercised | (358,000) | 1.77 |
| Canceled/expired | (753,000) | 28.80 |
| Outstanding at December 31, 2013 | 8,091,000 | \$ 3.07 |
| Exercisable at December 31, 2013 | 8,091,000 | \$ 3.07 |

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, | |
|--|----------------------------|---------|
| | 2013 | 2012 |
| Exercise price greater than fair value | \$ - | \$ 0.97 |

With the exception of common stock warrants that include exchange provisions, we estimate the fair value of our common stock warrants using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2012: dividend yield of zero percent; expected volatility of 100%; risk-free interest rates of 0.52% and expected lives of 4 years.

The following table summarizes information about our common stock warrants outstanding and exercisable at December 31, 2013:

| Range of exercise prices | Warrants outstanding | | | Warrants exercisable | |
|--------------------------|---|---|---------------------------------|---|---------------------------------|
| | Number outstanding at December 31, 2013 | Weighted average remaining contractual life (years) | Weighted average exercise price | Number exercisable at December 31, 2013 | Weighted average exercise price |
| \$2.13 | 1,000,000 | 1.39 | \$ 2.13 | 1,000,000 | \$ 2.13 |
| \$2.29 | 2,100,000 | 3.47 | 2.29 | 2,100,000 | 2.29 |
| \$2.44 | 1,855,000 | 4.72 | 2.44 | 1,855,000 | 2.44 |
| \$2.89 | 1,858,000 | 4.38 | 2.89 | 1,858,000 | 2.89 |
| \$6.24 | 1,278,000 | 2.88 | 6.24 | 1,278,000 | 6.24 |
| \$2.13-\$6.24 | 8,091,000 | | | 8,091,000 | |

10. Share-based compensation

We use the straight-line attribution method to allocate the fair value of share-based compensation awards over the requisite service period for each award. The 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 our stock price, future stock option exercise behaviors, estimated employee turnover and award forfeiture rates.

As part of our plan to conserve cash used in operations, we have implemented share-based compensation programs under which we issued shares of our common stock as compensation instead of cash. We have allocated the expense related to these programs to various financial statement lines consistent with the method used for allocating all share-based compensation.

In August 2013, we issued 201,000 shares of our common stock to employees for payment of 2012 performance bonuses. These shares were valued using our closing stock price on the date of grant. These shares vested in November 2013 and expense was recognized over the vesting period. During 2013, we expensed \$457,000 of share-based employee compensation for these awards.

In August 2012, we issued 440,000 shares of our common stock to non-executive employees for retention purposes. These shares were valued using our closing stock price on the date of grant. These shares vest 40% in August 2012, 30% in December 2012, and 30% in August 2013 and expense is recognized over the vesting period. During 2013 and 2012, we expensed \$175,000 and \$562,000, respectively, of share-based employee compensation for these awards.

In May 2012, we issued 227,000 shares of our common stock to non-executive employees as the remaining payment of 2010 bonuses in lieu of cash. These shares were valued using our closing stock price on the date of grant. We expensed \$345,000 of share-based employee compensation for these awards at grant.

Description of Incentive Plans

The Company currently has two share-based incentive plans. The 2013 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. In June 2008, we determined not to issue additional options from a second share-based incentive plan, the Independent Director Stock Option Plan described below.

The 2013 Incentive Plan has 4.4 million shares authorized, of which 940,000 shares were available for awards as of December 31, 2013. The 2013 Incentive Plan 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, directors and certain non-employees of the Company. Any award may be a performance-based award. Awards granted under the 2013 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).

The Independent Director Stock Option Plan (IDSOP) has 113,000 shares authorized, of which 62,000 are issued and outstanding as of December 31, 2013. The IDSOP permits granting NSOs to independent directors of the Company. Grants awarded under the IDSOP generally have 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 2013 Incentive Plan described above to allow non-employee directors to participate in the plan.

Options Valuation Methodology and Assumptions

We use the Black-Scholes option valuation model to determine the fair value of options granted and use the closing price of our common stock as the fair market value of our stock on that date.

We consider historical stock price volatilities, volatilities of similar companies and other factors in determining estimates of future volatilities.

We use 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 during the periods shown below:

| | Year Ended December 31, | |
|--|--------------------------------|-------------|
| | 2013 | 2012 |
| Assumptions (weighted average) | | |
| Volatility | 96% | 98% |
| Expected term (in years) | 4.1 | 4.5 |
| Risk-free rate | 1.0% | 0.6% |
| Expected dividends | 0.0% | 0.0% |
| Pre-vest forfeiture rate | 8.5% | 8.5% |
| Grant date fair value of options granted | \$ 1.49 | \$ 1.39 |

Options Activity and Positions

The following table summarizes activity and positions with respect to options for the two years ended December 31, 2013:

| Options | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value |
|---|-----------|--|--|---------------------------------|
| Outstanding as of December 31, 2011 | 964,000 | \$ 24.00 | 5.8 | \$ - |
| Granted | 671,000 | 1.97 | | |
| Exercised | (16,000) | 1.80 | | |
| Forfeited or expired | (301,000) | 21.20 | | |
| Outstanding as of December 31, 2012 | 1,318,000 | 13.71 | 6.8 | - |
| Granted | 824,000 | 2.22 | | |
| Exercised | (23,000) | 1.80 | | |
| Forfeited or expired | (214,000) | 13.86 | | |
| Outstanding as of December 31, 2013 | 1,905,000 | \$ 8.86 | 7.4 | \$ 1,500 |
| Vested and expected to vest as of December 31, 2013 | 1,797,000 | \$ 9.26 | 7.3 | \$ 1,443 |
| Exercisable as of December 31, 2013 | 934,000 | \$ 15.41 | 5.6 | \$ 750 |

The total intrinsic value of options exercised during the years ended December 31, 2013 and 2012 were \$21,000 and \$13,000, respectively.

The total grant date fair value of options vested during the years ended December 31, 2013 and 2012 was \$1.7 million and \$2.5 million, respectively. As of December 31, 2013, our unamortized share-based compensation was \$1.2 million which we plan to amortize over the next 2.3 years.

In March 2011, we issued 85,000 restricted stock units of the Company's common stock to executive employees. These shares vest conditionally upon completion of certain service and performance objectives by June 30, 2014. The grant date fair value of the performance based restricted shares is recognized over the respective service periods based on an assessment of the probability that performance goals will be met.

As of December 31, 2013, our unamortized share-based compensation related to the restricted stock units was \$145,000 which we plan to amortize over the next six months.

11. Commitments and contingencies

Litigation

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

Lease commitments

We lease our office space and certain equipment under noncancelable capital and operating leases with initial or remaining terms in excess of one year.

We entered into a 65 month facility lease amendment that commenced in September 2013. The lease includes extension and rent escalation provisions over the 65 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 |
|--|---------------------------|-----------------------------|
| 2014 | \$ 15,000 | \$ 254,000 |
| 2015 | - | 430,000 |
| 2016 | - | 442,000 |
| 2017 | - | 434,000 |
| 2018 | - | 446,000 |
| Thereafter | - | 38,000 |
| Total minimum lease payments | 15,000 | \$ 2,044,000 |
| Less: Amount representing interest | - | |
| Present value of capital lease obligations | 15,000 | |
| Less: Current portion | (15,000) | |
| Long-term obligation at December 31, 2013 | \$ - | |

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 \$704,000 and \$704,000, respectively, at December 31, 2013 and \$987,000 and \$961,000, respectively, at December 31, 2012.

Net rent expense was \$636,000 and \$708,000 for 2013 and 2012, respectively.

Adverse purchase commitments

We have periodically entered into noncancelable purchase contracts in order to ensure the availability of materials to support production of our products and bar code scanners. We periodically assess the need to provide for impairment on these purchase contracts and record a loss on purchase commitments when required. During 2012, we recorded losses of \$500,000 to cost of product revenue as a result of commitments to purchase materials for the SHOWWX that were in excess of our estimated future proceeds from sale of the SHOWWX. During 2013, no losses on purchase commitments were recorded.

12. Income taxes

A provision for income taxes has not been recorded for 2013 and 2012 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. Based on our history of losses since inception, the available objective evidence creates sufficient uncertainty regarding the realizability of the deferred tax assets.

At December 31, 2013, we have net operating loss carry-forwards of approximately \$326.0 million, for federal income tax reporting purposes. In addition, we have research and development tax credits of \$6.3 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 2017 to 2033 if not previously utilized. The research and development tax credits and the remaining net operating losses are scheduled to expire between 2018 and 2033. In certain circumstances, as specified in the Internal Revenue Code, a 50% or more ownership change by certain combinations of our stockholders during any three-year period would result in limitations on our ability to utilize our net operating loss carry-forwards.

Deferred tax assets are summarized as follows:

| | December 31, | |
|---|---------------|---------------|
| | 2013 | 2012 |
| Deferred tax assets, current | | |
| Reserves | \$ 2,994,000 | \$ 3,804,000 |
| Other | 621,000 | 710,000 |
| Total gross deferred tax assets, current | 3,615,000 | 4,514,000 |
| Deferred tax assets, noncurrent | | |
| Net operating loss carryforwards | 111,339,000 | 104,893,000 |
| R&D credit carryforwards | 6,277,000 | 6,032,000 |
| Depreciation/amortization deferred | 24,526,000 | 26,594,000 |
| Other | 7,544,000 | 7,573,000 |
| Total gross deferred tax assets, noncurrent | 149,686,000 | 145,092,000 |
| Net deferred taxes before valuation allowance | 153,301,000 | 149,606,000 |
| Less: Valuation allowance | (153,301,000) | (149,606,000) |
| Deferred tax assets | \$ - | \$ - |

The valuation allowance and the research and development credit carry forwards account for substantially all of the difference between our 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.

We did not have any unrecognized tax benefits at December 31, 2013 and at December 31, 2012.

We recognize interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2013 and 2012, we recognized no interest or penalties.

We file income tax returns in the U.S. federal jurisdiction and various states. Due to our operating loss and credit carry-forwards, the U.S. federal statute of limitations remains open for 1997 and onward.

13. Retirement savings plan

We have a retirement savings 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. In March 2012, the Company discontinued matching contributions. Prior to March 2012, we matched 50% of employee contributions to the plan, up to 6% of the employee's per pay period compensation. During 2013 and 2012, we contributed \$0 and \$44,000, respectively, to the plan under the matching program.

14. Quarterly financial information (Unaudited)

The following table presents our unaudited quarterly financial information for the years ending December 31, 2013 and 2012 (in thousands, except per share data):

| | Fiscal Year 2013 | | | |
|--------------------------------------|-------------------------|----------------------|-----------------|------------------|
| | December 31, | September 30, | June 30, | March 31, |
| Revenue | \$ 1,217 | \$ 964 | \$ 1,870 | \$ 1,801 |
| Gross margin (loss) | 1,164 | 880 | 1,007 | 1,000 |
| Net loss | (2,421) | (3,667) | (3,436) | (3,654) |
| Net loss per share basic and diluted | (0.08) | (0.13) | (0.13) | (0.14) |
| | Fiscal Year 2012 | | | |
| | December 31, | September 30, | June 30, | March 31, |
| Revenue | \$ 2,727 | \$ 2,613 | \$ 1,295 | \$ 1,730 |
| Gross margin (loss) | 1,238 | 1,475 | 1,328 | (2,600) |
| Net loss | (4,074) | (3,845) | (4,971) | (9,803) |
| Net loss per share basic and diluted | (0.16) | (0.15) | (0.26) | (0.58) |

15. Subsequent Event

In February 2014, we issued 3,713,309 shares of our common stock under the warrant exchange provisions of our May and September 2013 registered direct offerings. Under the warrant exchange provisions, the holders could elect to exchange the warrants for a variable number of shares of common stock as determined by a formula included in the warrants. We did not receive additional cash consideration in the exchange transaction. We expect to record a loss of \$5.0 million during the first quarter of 2014 on the exchange, as the fair market value of the common stock issued was greater than the obligation recorded due to the increase in stock price subsequent to year end.

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, 2013 and 2012.

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, 2013, our disclosure controls and procedures were 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 (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its evaluation under the framework in *Internal Control - Integrated Framework (1992)*, our management concluded that our internal control over financial reporting was effective as of December 31, 2013.

(c) *Changes in internal controls over financial reporting.* There have not been any changes in our internal control over financial reporting during the quarter ended December 31, 2013 which have materially affected, or are reasonably likely to materially affect, our 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 our 2014 Annual Meeting of Shareholders.

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 2013" 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, 2013 regarding equity compensation plans approved and not approved by stockholders is summarized in the following table:

| Plan Category | Equity Compensation Plan Information | | |
|--|--|--|---|
| | Number of securities to be issued upon exercise of outstanding options, warrants and rights (a) | Weighted-average exercise price of outstanding options, warrants and rights (b) | Number of securities remaining available for further issuance under equity compensation plans (excluding securities reflected in column (a)) (c) |
| Equity compensation plans approved by shareholders | 1,905,000 | \$ 8.86 | 940,000 |
| Equity compensation plans not approved by shareholders | - | - | - |
| Total | 1,905,000 | \$ 8.86 | 940,000 |

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.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) Documents filed as part of the report:

Financial Statements

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2013 and 2012

Consolidated Statements of Operations for the years ended December 31, 2013 and 2012

Consolidated Statements of Comprehensive Loss for the years ended December 31, 2013 and 2012

Consolidated Statements of Shareholders' Equity for the years ended December 31, 2013 and 2012

Consolidated Statements of Cash Flows for the years ended December 31, 2013 and 2012

Notes to Consolidated Financial Statements

(b) Exhibits

The following exhibits are referenced or included in this report.

- 3.1 Amended and Restated Certificate of Incorporation of MicroVision, Inc., as amended ⁽⁸⁾
- 3.2 Certificate of Amendment to the Amended and Restated Certificate of Incorporation of MicroVision, Inc.⁽¹³⁾
- 3.3 Bylaws of MicroVision, Inc. ⁽²⁾
- 4.1 Form of Specimen Stock Certificate for Common Stock.⁽²⁾
- 4.2 Warrant Agreement dated November 16, 2011 by and between MicroVision, Inc. and American Stock Transfer and Trust Company, LLC.⁽¹²⁾
- 4.3 Form of Warrant issued under the Securities Purchase Agreement dated as of May 9, 2012 by and between MicroVision, Inc. and the investors named therein, as amended.
- 4.4 Warrant Agreement dated June 20, 2012 by and between MicroVision, Inc. and American Stock Transfer and Trust Company, LLC ⁽¹⁴⁾
- 4.5 Form of Warrant issued under the Securities Purchase Agreement dated as of May 17, 2013 by and between MicroVision, Inc. and the investors named therein ⁽¹⁷⁾
- 4.6 Form of Warrant issued under the Securities Purchase Agreement dated as of September 19, 2013 by and between MicroVision, Inc. and the investors 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.⁽⁴⁾
- 10.5 MicroVision, Inc. 2013 Incentive Plan, as amended. ^{(6)*}
- 10.6 Independent Director Stock Option Plan, as amended.^{(3)*}
- 10.7 Employment Agreement between MicroVision, Inc. and Alexander Y. Tokman dated April 7, 2009.⁽⁹⁾
- 10.8 Lease Agreement between CarrAmerica Reality Operating Partnership, L.P. and MicroVision, Inc., dated July 15, 2005.⁽⁵⁾
- 10.9 Change of Control Severance Plan
- 10.10 Jeff T. Wilson Severance and General Release Agreement.⁽¹⁵⁾
- 16.1 Letter from PricewaterhouseCoopers LLP to the Securities and Exchange Commission dated October 2, 2012.⁽¹⁶⁾
- 23.1 Consent of Independent Registered Public Accounting Firm - Moss Adams LLP.
- 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.

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- 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.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase
- 101.DEF XBRL Taxonomy Extension Definition Linkbase
- 101.LAB XBRL Taxonomy Extension Label Linkbase
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase

- (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 Form 10-Q for the quarterly period ended June 30, 2002.
- (4) Incorporated by reference to the Company's Current Report on Form 8-K filed on March 5, 2003.
- (5) Incorporated by reference to the Company's Form 10-Q for the quarterly period ended June 30, 2005.
- (6) Incorporated by reference to the Company's Form 10-Q for the quarterly period ended September 30, 2008.
- (7) Incorporated by reference to the Company's Form 10-Q for the quarterly period ended September 30, 2009.
- (8) Incorporated by reference to the Company's Form 10-Q for the quarterly period ended June 30, 2009.
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- (10) Incorporated by reference to the Company's Current Report on Form 8-K filed on May 6, 2011.
- (11) Incorporated by reference to the Company's Current Report on Form 8-K filed on September 13, 2011.
- (12) Incorporated by reference to the Company's Current Report on Form 8-K filed on November 15, 2011.
- (13) Incorporated by reference to the Company's Current Report on Form 8-K filed on February 17, 2012.
- (14) Incorporated by reference to the Company's Current Report on Form 8-K filed on June 16, 2012.
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- (17) Incorporated by reference to the Company's Current Report on Form 8-K filed on May 17, 2013.
- (18) Incorporated by reference to the Company's Current Report on Form 8-K filed on September 19, 2013.

+ 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.

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 6, 2014

By Alexander Tokman

/s/

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 6, 2014.

Signature

Title

/s/ Alexander Tokman

Alexander Tokman

Chief Executive Officer and Director
(Principal Executive Officer)

/s/ Stephen Holt

Stephen Holt

Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)

/s/ Richard A. Cowell

Richard A. Cowell

Director

/s/ Slade Gorton

Slade Gorton

Director

/s/ Jeanette Horan

Jeanette Horan

Director

/s/ Perry Mulligan

Perry Mulligan

Director

/s/ Brian Turner

Brian Turner

Director

/s/ Thomas Walker

Thomas Walker

Director

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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- (12) Incorporated by reference to the Company's Current Report on Form 8-K filed on November 15, 2011.
- (13) Incorporated by reference to the Company's Current Report on Form 8-K filed on February 17, 2012.
- (14) Incorporated by reference to the Company's Current Report on Form 8-K filed on June 16, 2012.
- (15) Incorporated by reference to the Company's Form 10-Q for the quarterly period ended September 30, 2012.
- (16) Incorporated by reference to the Company's Current Report on Form 8-K filed on October 3, 2012.
- (17) Incorporated by reference to the Company's Current Report on Form 8-K filed on May 17, 2013.
- (18) Incorporated by reference to the Company's Current Report on Form 8-K filed on September 19, 2013.

+ 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.