

MICROVISION, INC.
Form 10-K
March 06, 2019

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

FORM 10-K

(Mark one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2018

OR

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 Avenue NE, Suite 100
Redmond, Washington 98052

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(Address of Principal Executive Offices, including Zip Code)

(425) 936-6847

(Registrant's Telephone Number, including Area Code)

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

| <u>Title of class</u> | <u>Name of exchange on which registered</u> |
|---|---|
| Common Stock, \$0.001 par value per share | The Nasdaq Stock Market LLC |

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

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities 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 every Interactive Data File required to be submitted 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 such files. Yes

x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) 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.

x

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

| | | | | | | | | |
|-------------------------|-------------------|------------------------------------|-----------------------|--------------------------|---------------------------|------------------------------------|-------------------------|--------------------------|
| Large accelerated filer | Accelerated filer | <input checked="" type="radio"/> x | Non-accelerated filer | <input type="radio"/> .. | Smaller reporting company | <input checked="" type="radio"/> x | Emerging growth company | <input type="radio"/> .. |
|-------------------------|-------------------|------------------------------------|-----------------------|--------------------------|---------------------------|------------------------------------|-------------------------|--------------------------|

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act. "

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

No x

The aggregate market value of common stock held by non-affiliates of the registrant as of June 29, 2018 was approximately \$104.2 million (based upon the closing price of \$1.12 per share for the registrant's common stock as reported by the Nasdaq Global Market on that date).

The number of shares of the registrant's common stock outstanding as of March 1, 2019 was 102,105,000.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A in connection with the registrant's 2019 Annual Meeting of Shareholders (the "2019 Proxy Statement") are incorporated herein by reference in Part III of this Annual Report on Form 10-K to the extent stated herein.

MICROVISION, INC.
ANNUAL REPORT ON FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2018

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PART I.

Preliminary Note Regarding Forward-Looking Statements

This Annual 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, Inc. ("we," "our," or "us"), 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

MicroVision, Inc. is a pioneer in laser beam scanning (LBS) technology that we market under our brand name PicoP®. We have developed our proprietary scanning technology that can be used in products for interactive projection, consumer LiDAR, automotive LiDAR, and augmented and mixed reality. Our PicoP® scanning technology is based on our patented expertise in systems that include micro-electrical mechanical systems (MEMS), laser diodes, opto-mechanics, and electronics and how those elements are packaged into a small form factor, low power scanning engine that can display, interact and sense, depending on the needs of the application. These systems utilize edge computing and machine intelligence as part of the solutions.

Our strategy includes selling LBS engines to original equipment manufacturers (OEMs) and original design manufacturers (ODMs). We plan to offer scanning engines to support a wide array of applications: an interactive scanning engine for smart home speakers and other Internet of Things (IoT) products, a light detection and ranging (LiDAR) engine for consumer electronic applications, and solutions for augmented and mixed reality devices. We also are developing LiDAR for automotive collision avoidance systems.

In addition to selling engines, we have licensed our patented PicoP® scanning technology to other companies for incorporation into their scanning engines for projection. We sell our customers key components needed to produce their laser scanning engines and/or license our technology in exchange for a royalty fee or margin for each scanning engine they sell. Companies to whom we license our PicoP® scanning technology are typically OEMs or ODMs who are in the business of making components or products ready for sale to end users. To date, we have primarily focused on the consumer electronics market, however, we believe that our LBS technology could support multiple applications and markets including automotive, medical, and industrial.

While we are optimistic about our technology and the potential for future revenues, we have incurred substantial losses since inception and we expect to incur a significant loss during the fiscal year ending December 31, 2019.

MicroVision, Inc. was founded in 1993 as a Washington corporation and reincorporated in 2003 under the laws of the State of Delaware. Our headquarters is located at 6244 185th Avenue NE, Suite 100, Redmond, Washington 98052, and our telephone number is (425) 936-6847.

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports are available free-of-charge from the investor page of our website, accessible at www.microvision.com, as soon as reasonably practicable after such material is electronically filed with the Securities and Exchange Commission (SEC). Copies of these filings may also be obtained by visiting the SEC's website,

www.sec.gov, which contains current, quarterly and annual reports, proxy and information statements and other information regarding issuers that file electronically.

Technology

Our patented PicoP® scanning technology combines a MEMS scanning mirror, laser diode light sources, electronics, and optics that are controlled using our proprietary system control algorithms along with edge computing and machine learning in some systems. The bi-directional MEMS scanning mirror is a key component of our technology system and is one of our core competencies. Our MEMS design is a silicon device with a one-millimeter mirror at the center. This mirror is connected to small flexures that allow it to oscillate vertically and horizontally to generate an image pixel-by-pixel for use in sensing and display. Scanning engines with our technology can operate in three modes: display only, display and sensing combined, and sensing only. For applications that include a projected display, our PicoP® scanning technology creates a brilliant, full color, high-contrast, uniform image over the entire field-of-view from a small and thin engine with low power consumption. For 3D LiDAR scanning applications, our engine is small with high resolution, low power and low latency which are features that are important for such applications. We believe that our proprietary technology offers significant advantages over traditional display and 3D LiDAR sensing systems. Depending on the specific product application, these advantages may include:

- Ability to perform projection and three-dimensional sensing and image capture from a single device;
- Leveraging our custom MEMS and application-specific integrated circuits (ASICs) components across multiple engine types for economies of scale;
- Focus-free operation;
- HD resolution;
- Low power requirements to enable battery operated devices and applications;
- Small and thin engine size;
- High-brightness, high-dynamic range, and brightness uniformity;
- Rich, saturated color reproduction;
- Short throw projection with multi-mode operation for table top and wall mode;
- 3D LiDAR sensing as a touch interface or point cloud;
- Dynamic, programmable resolution and frame rate 3D scanning; and
- Efficiency of edge computing and machine learning integrated within our solution.

Business Strategy

Our business strategy is to commercialize our PicoP® scanning technology by enabling OEMs and ODMs to produce end-user products via three go-to-market paths:

- Design and sell LBS engines directly to OEMs and ODMs to incorporate inside their products;
- License our LBS technology and sell key components to OEMs and ODMs to create their own scanning engines; and
- License LBS technology to OEMs and ODMs who developed their own key components or subsystems.

By providing these options, we permit OEMs and ODMs to integrate and embed our technology across a broad range of interactive and non-interactive display and 3D LiDAR sensing product applications in the way that best matches their technical capabilities and timelines for bringing their products to market.

The key elements of our business strategy include the following:

- Develop LBS modules that enable our customers to make products that end users find indispensable;
- Continue to improve the performance of our PicoP® scanning technology system by advancing the key application attributes such as higher brightness for displays, lower power, smaller size, and greater accuracy and longer distances for 3D sensing;
- Develop machine learning algorithms that allow our 3D LiDAR sensing products to respond faster and more accurately to users and/or objects in the environment;
- Sell LBS engines to OEMs and ODMs;
- Provide engineering services to develop LBS engines for OEMs and ODMs who need custom engines;
- Develop a supply chain able to supply customers with high quality LBS engines in quantities to support the consumer electronics market;

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- Supply key scanning engine components for products being developed by OEMs and ODMs who license our PicoP® scanning technology and/or license rights to OEMs and ODMs to produce such components;
- Partner with other companies that are interested in growing the LBS market to cooperatively promote our solutions and develop solutions for future products and capabilities where appropriate; and
- Maintain a position of LBS leadership with our intellectual property around our PicoP® scanning technology.

Markets for Our Technology

Our PicoP® scanning technology system strategy is focused on addressing the following market segments:

- Interactive and non-interactive pico projection;
- 3D LiDAR sensing for consumer electronics, automotive collision avoidance; and
- Augmented/Virtual Reality (AR/VR).

We see interactive and non-interactive pico projection, 3D LiDAR sensing, and AR/VR as the most promising applications for our technology in the near to mid-term. We have concentrated on pico projection over the past several years and we announced plans for other engine solutions for interactive pico projection and 3D LiDAR sensing. We also believe AR and VR eyewear displays can also benefit from our technology, and we are actively exploring these opportunities.

In interactive projection, our goal is to enable an interactive screen experience produced on demand by a small system for AI connected devices such as smart speakers. The solution would allow users to perform micro transactions by augmenting the capabilities of these voice controlled devices, making transactions more intuitive and easier to perform. By working on a variety of surfaces in conjunction with smart devices, these solutions provide the functionality of display screens while reducing the size requirements of display screens in the home.

We have developed 3D LiDAR sensing capabilities in our LBS engine. This allows the LBS engine to sense what is in front of it and where that object is in space. If we project an image on a surface and use our 3D LiDAR sensing capability concurrently, we are able to create an LBS engine where a user can touch the projected image or interact with the image using gestures and it will react much like a touchscreen. We call this interactive display. We believe that interactive display can enable a whole new category of smart IoT products.

Additionally, we are working to bring to market 3D LiDAR sensors. The consumer 3D LiDAR sensor we are developing is a small sensor able to capture information about what is in front of the sensor with high accuracy and high fidelity. We see applications for this sensor in smart home and smart home security products and in commercial space management. We are also working on LiDAR modules for automotive collision avoidance systems.

Another application area for our PicoP® scanning technology that we are focused on is eyewear displays, also known as AR and VR. We have a long history with this application, and we believe the eyewear ecosystem has progressed to a point where we see future growth opportunities in this market.

Products and Services

In 2018, our revenue was derived from development contracts and from license and royalty fees for PicoP® scanning technology.

In May 2018, we signed a five-year license agreement with a customer granting them an exclusive license to our LBS technology for display-only applications. The license represents functional intellectual property which derives a substantial portion of its utility from its significant standalone functionality. The intellectual property is not expected to substantially change during the license period, nor are we contractually or practically required to use updated intellectual property during the license life. During the year ended December 31, 2018 we completed the performance obligations required by the contract. As a result, we recognized \$10.0 million in license revenue for the year ended

December 31, 2018.

In April 2017, we signed a contract with a major technology company to develop an LBS display system. Under this agreement, we would develop a new generation of MEMS, ASIC and related firmware for a high resolution, LBS-based product that the technology company is planning to produce. We would receive up to \$24.6 million, including \$14.6 million in fees for development contingent on completion of milestones and an upfront payment of \$10.0 million, which payment has been received. The original contract was for \$14.0 million in fees for development, but the customer added \$632,000 in additional work to total \$14.6 million. As of December 31, 2018, we have received \$10.7 million of the fees for development work. The remaining development fees would be paid contingent on completion of

milestones through the second quarter of 2019. Upon successful completion of the development program, if the company decides to manufacture the product with the MicroVision display components, the \$10.0 million upfront payment would be applied as a discount to future component purchases from us. If the contract is terminated by the technology company for our failure to meet milestones, the \$10.0 million upfront payment is subject to repayment. As the contract is expected to be completed in Q2 2019, we believe the risk of repayment is low.

In 2017, we introduced a small form factor, high definition display engine for applications where form factor and flexibility of product design are required. In March 2017, we received a \$6.7 million order for our small form factor display engine from Ragentek Communication Technology Co., Limited (Ragentek), an Asian electronics device manufacturer. Initial shipments of engines to Ragentek began at the end of June 2017 to embed in its smartphone product. Ragentek launched their smartphone during the third quarter of 2017. We had planned to recognize \$4.3 million of product revenue during the fourth quarter of 2017 by completing the remainder of the order. The customer, however, requested a deferment in taking receipt of the remainder of the engines until 2018. In 2018 the customer did not take delivery of the remaining engines. We are pursuing our legal rights to enforce the contract.

We also plan to introduce an interactive display engine that integrates display and 3D LiDAR sensing to allow the user to interact with projected images and a consumer grade LiDAR engine for consumer electronics (smart home and smart home security) applications.

The key components and technology we offer for inclusion in an LBS engine are our MEMS, ASICs, and software. Our licensees can purchase none, some, or all of the key components and license the technology we offer depending on their capability and desire to manufacture them and the terms of the licensing agreement.

Research and Development

We believe our research and development efforts have earned us a leadership position in the field of LBS technology and applications as applied to consumer electronics, automotive and other markets. Our ability to attract customers and grow revenue will depend on our ability to maintain our LBS technology leadership, to continually improve performance, reduce costs, reduce the size of component parts and scanning engines, and to increase the number of applications and products enabled by our PicoP® scanning technology.

Our research and development team is located in Redmond, Washington and as of December 31, 2018, was comprised of 85 engineering and technical staff in optics, software engineering, electrical engineering, product engineering, and MEMS design.

Sales and Marketing

Our sales and marketing approach is account based, business-to-business targeting of OEMs and ODMs. We license our PicoP® scanning technology and sell components used in the production of scanning engines to our licensees and sell scanning engines to our customers. We also engage end product manufacturers and retailers in our target markets to educate them about product opportunities based on our PicoP® scanning technology.

We currently have sales and business development representatives based in the United States and Asia, focused on business development in the Americas, Europe and Asia. Our sales and business development representatives are supported by a technical sales engineering team that assists customers during the "design win" and "design in" cycles. The technical sales engineering team operates from Redmond, Washington, and Japan. Our marketing team is located in Redmond, Washington. We engage potential customers directly, participate in trade shows, maintain a website, and cooperate on co-marketing activities with key partners.

Manufacturing

Our products include scanning engines as well as components that are integral to a scanning engine. Our scanning engine products are manufactured by a contract manufacturer based on our proprietary design and incorporate our PicoP® scanning technology and include MEMS and ASICs that are produced to order by semiconductor foundries.

Our manufacturing is not currently subject to seasonal variations as our shipments have been relatively small and are in the early stages of product introduction. In the future, depending on our customers' product mix, we may be affected by seasonal fluctuations which could affect working capital demands.

We provide forecasts that allow our contract manufacturers to stock component parts and other materials and plan capacity. Our contract manufacturers procure raw materials in volumes consistent with our forecasts, manufacture and/or assemble the products and perform tests according to our specifications. Products are shipped to our customers or shipped to our Redmond, Washington headquarters to be inventoried as finished goods. We procure some specific components and either sell them or consign them to our contract manufacturers. We hold some inventories of these components. Our contract manufacturers procure additional raw materials we do not own until the finished goods are completed by our contract manufacturer. Title to the products transfers from our contract manufacturers to us and then to our customers upon shipment from the manufacturer. If raw materials are unused, or the products are not sold within specified periods of time, we may incur carrying charges or obsolete material charges for component parts that our contract manufacturers purchased to build products to meet our forecasts or customer orders.

Many of the raw materials used in our components are standard to the consumer electronics industry. Our MEMS, MEMS die, and ASICs are currently manufactured to our specifications by separate single-source suppliers.

Human Factors, Ergonomics and Safety

We work with third party independent experts in the field of laser safety to assist in meeting safety specifications. In addition, we monitor developments in the area of permissible laser exposure limits as established by International Electrotechnical Commission (IEC) and others. Independent experts have concluded that laser exposure to the eye resulting from use of LBS devices under normal operating conditions would be below the calculated maximum permissible exposure level set by the IEC.

Competitive Conditions

The consumer display and 3D sensing industries are highly competitive. Potential products incorporating our PicoP® scanning technology, including any LBS engines we develop, will compete with manufacturers of established technologies, such as flat panel display devices, as well as companies developing new display and 3D LiDAR sensing technologies. Our competitors include companies such as Texas Instruments, Intel, Syndiant, Velodyne, Bosch, Quanergy, Innoluce, Opus, Mirrorcle, Maradin, Himax, Pioneer, Sony (LCOS) and others, some of which have much greater financial, technical and other resources than us. Many of our competitors are currently developing alternative miniature display and 3D LiDAR sensing technologies. Our competitors may succeed in developing innovative technologies and products that could render our technology or our proposed products commercially infeasible or technologically obsolete.

The consumer display and 3D sensing industries have been characterized by rapid and significant technological advances. Our PicoP® scanning technology system and potential products may not be competitive with such advances, and we may not have sufficient funds to invest in new technologies, products or processes. Although we believe our technology system and proposed products could deliver images of a substantially higher performance from a smaller form factor device than those of commercially available LCOS and DLP based display products, LCD and LCOS interactive panels or solid state LiDAR and CMOS sensing solutions, manufacturers of competing technologies may develop improvements to their technology that could reduce or eliminate the anticipated advantages of our proposed products.

3D sensing is a new market and we believe we are developing products that will have cost and performance benefits over what competitors may offer. However, manufacturers of competing technologies may develop improvements to the size, performance, and cost of their modules, that could reduce or eliminate the anticipated advantages of our proposed products.

Intellectual Property and Proprietary Rights

We create intellectual property from three sources: internal research and development activities, technology acquisitions, and performance on development contracts. The inventions covered by our patent applications generally relate to systems controls in our PicoP® scanning technology, component miniaturization, power reduction, feature enhancements, 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 LBS technologies at the system, component, and process levels.

We believe our extensive patent portfolio is the largest, broadest, and earliest filed LBS technology portfolio and includes applications such as augmented reality, range finding, portable media devices, image capture, and projection applications. We have over 500 issued patents, pending patents and licensed patents worldwide.

Since our inception in 1993, we have acquired, either under license agreements or portfolio purchases, patents that grant us exclusive rights to various LBS technologies. From time to time some of these patents may expire, or we may decide to terminate a license agreement for a variety of reasons to better utilize resources expended to maintain intellectual property.

Our ability to compete effectively in the consumer display and 3D sensing markets 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.

We have registered the name "PicoP®" and "MicroVision®" with the United States Patent and Trademark Office.

Employees

As of March 1, 2019, we had 107 full-time employees. None of our employees are represented by a labor union.

ITEM 1A. RISK FACTORS

You should carefully consider the risks described below together with the other information set forth in this report, which could materially affect our business, financial condition and future results. The risks described below are not the only risks facing our company. Risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and operating results.

Risk Factors Related to Our Business and Industry

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, 2018, we had an accumulated deficit of \$546.1 million.
- We incurred consolidated net losses of \$493.4 million from inception through 2016, \$25.5 million in 2017, and \$27.3 million in 2018.

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 PicoP® scanning technology system 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 significant losses and negative cash flow at least through 2019 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 that includes expected proceeds from a development contract signed in April 2017 with a major technology company, we anticipate that we have sufficient cash and cash equivalents to fund our operations through June 2019. Our receipt of proceeds under our April 2017 development contract is subject to our completion of certain milestones, and we can provide no assurance that such milestones will be completed. We will require additional capital to fund our operating plan past that time. We plan to obtain additional capital through the issuance of equity or debt securities, product sales and/or licensing activities.

We are introducing new technology and products 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 commercial success of our LBS engines, the rate at which OEMs and ODMs introduce products incorporating our PicoP® scanning technology and the market acceptance and competitive position of such products. If revenues are less than we anticipate, if we fail to meet milestones for future payments or have to repay amounts already received under our April 2017 development contract, if the mix of revenues and the associated margins 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, products and systems, and equipment manufacturers that may require additional investments by us.

Additional capital may not be available to us or, if available, may not be 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 our current shareholders' shares. If adequate capital resources are not available on a timely basis, we may consider limiting our operations substantially and we may be unable to continue as a going concern. This limitation of operations could include reducing investments in our production capacities or research and development projects, staff, operating costs, and capital expenditures which could jeopardize our ability to achieve our business goals or satisfy our customer requirements.

Qualifying a new or alternative 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 or limited-source suppliers to manufacture our products. Establishing a relationship with a new or alternative contract manufacturer(s) or foundry is a time-consuming process, as our unique technology may require significant manufacturing process adaptation to achieve full manufacturing capacity. Accordingly, we may be unable to establish a relationship with new or alternative contract manufacturers in the short-term, or at all, at prices or on other terms that are acceptable to us.

Changes in our supply chain may result in increased cost and delay and may subject us to risks and uncertainties regarding, but not limited to, product warranty, product liability and quality control standards. The loss of any single or limited-source supplier, the failure of any of these suppliers to perform as expected or the disruption in the supply chain of components from these suppliers could cause significant delays in product deliveries, which may result in lost revenues and damaged customer relationships. To the extent that we are not able to establish a relationship with a new or alternative contract manufacturer(s) or foundry in a timely manner, we may be unable to meet contract or production milestones, which could have a material adverse effect on our financial condition, results of operations and cash flows.

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

Our success will depend, in part, on our ability to provide our components and future products in commercial quantities at competitive prices and on schedule. 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.

Our foreign contract manufacturers could experience severe financial difficulties or other disruptions in their business, and such continued supply could be significantly reduced or terminated. In addition, we cannot be certain that we will successfully obtain access to needed manufacturing resources concurrent with a significant increase in our planned production levels. Future manufacturing limitations of our suppliers could constrain the number of products that we are able to develop and produce.

We are dependent on third parties in order to develop, manufacture, sell and market products incorporating our PicoP® scanning technology, scanning engines, and the scanning engine components.

Our business strategy for commercializing our technology in products incorporating PicoP® scanning technology includes entering into development, manufacturing, licensing, sales and marketing arrangements with OEMs, ODMs and other third parties. These arrangements reduce our level of control over production and distribution and may subject us to risks and uncertainties regarding, but not limited to, product warranty, product liability and quality control standards.

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 our PicoP® scanning technology or find that the development, manufacture or sale of products incorporating our technology would not be feasible. To the extent that we enter into development, manufacturing, licensing, sales and marketing or other 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 system or products incorporating our PicoP® scanning technology will achieve market acceptance. If our technology system or products incorporating our technology do not achieve market acceptance, our revenues may not grow.

Our success will depend in part on customer acceptance of our PicoP® scanning technology. Our technology may not be accepted by manufacturers who use display and 3D sensing technologies in their products, by systems integrators, OEMs, and ODMs who incorporate the scanning engine components into their products or by end users of these products. To be accepted, our PicoP® scanning technology must meet the expectations of our current and potential customers in the consumer electronics, automotive, and other markets. If our technology system or products incorporating our PicoP® scanning technology do not achieve market acceptance, we may not be able to continue to develop our technology.

Future products incorporating our PicoP® scanning technology and scanning engines are dependent on advances in technology by other companies.

Our PicoP® scanning technology will continue to rely on technologies, such as laser diode light sources and other components that are developed and produced by other companies. The commercial success of certain future products incorporating our PicoP® scanning 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 products that will be profitable.

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.

In 2018, one customer accounted for \$10.0 million in revenue, representing 57% of our total revenue. A second customer accounted for \$7.4 million in revenue, representing 42% of our total revenue. In 2017, one customer accounted for \$5.8 million in revenue, representing 60% of our total revenue, and a second customer accounted for \$2.3 million in revenue, representing 24% of our total revenue. Our customers take time to obtain, and the loss of a significant customer could negatively affect our revenue. Our quarterly operating results may vary significantly based upon:

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- Market acceptance of products incorporating our PicoP® scanning 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;

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- 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 or agreements, which could adversely affect our operating results and cash flows.

Our backlog under open orders and agreements totaled \$2.5 million as of December 31, 2018. We or our customers may be unable to meet the performance requirements and obligations under open orders or agreements, including performance specifications, milestones or delivery dates, required by such purchase orders or agreements. Furthermore, 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 agreements or to the extent customers are unable or unwilling to perform, our operating results and cash flows could be adversely affected.

We may not be able to maintain our listing on The Nasdaq Global Market and it may become more difficult to sell our stock in the public market.

Our common stock is listed on The Nasdaq Global Market. To maintain our listing on this market, we must meet Nasdaq's listing maintenance standards. If we are unable to continue to meet Nasdaq's listing maintenance standards 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 our 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 another exchange, trading of our common stock would be conducted in the Over-the-Counter (OTC) 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 OTC 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 another market or exchange would subject our common stock 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.

On March 1, 2019, the closing price of our common stock was \$1.17 per share.

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

Our products and potential products incorporating our PicoP® scanning technology 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 may be 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 consumer display and 3D sensing industries have been characterized by rapidly changing technology, accelerated product obsolescence and continuously evolving industry standards.

Our success will depend upon our ability to further develop our PicoP® scanning technology system 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 due to:

- Delays in product development;
- Lack of market acceptance for our technology or products incorporating our PicoP® scanning technology; or
- Lack of funds to invest in product research, development and marketing.

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

We could face lawsuits related to our use of PicoP® scanning 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 or products incorporating our PicoP® scanning technology, 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 3D sensing 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 products incorporating our PicoP® scanning 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, require others and us to cease selling products incorporating our technology, require us to cease licensing our technology or 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 any 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 incorporating PicoP® scanning technology 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.

If we fail to adequately reduce and control our manufacturing, supply chain and operating costs, our business, financial condition, and operating results could be adversely affected.

We incur significant costs related to procuring components and increasing our production capabilities to manufacture our products. We may experience delays, cost overruns or other unexpected costs associated with an increase in production. If we are unsuccessful in our efforts to reduce and control our manufacturing, supply chain and operating costs and keep costs aligned with the levels of revenues we generate, our business and financial condition could suffer.

Our technology and products incorporating our PicoP® scanning technology may be subject to future environmental, health and safety regulations that could increase our development and production costs.

Our technology and products incorporating our PicoP® scanning technology could become subject to future environmental, health and safety regulations or amendments that could negatively impact our ability to commercialize our technology and products incorporating our PicoP® scanning technology. Compliance with any such new regulations would likely increase the cost to develop and produce products incorporating our PicoP® scanning technology, and violations may result in fines, penalties or suspension of production. If we become subject to any environmental, health, or safety laws or regulations that require us to cease or significantly change our operations to comply, our business, financial condition and operating results could be adversely affected.

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, regionally 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 contract manufacturers and plan to continue to use foreign contract manufacturers to manufacture current and future products, where appropriate. These international operations are subject to inherent risks, which may adversely affect us, including, but not limited to:

- 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, regulations and sanctions;
- Foreign taxes and duties;
- Changes in tariff rates or other trade, tax or monetary policies; and
- Changes or volatility in currency exchange rates and interest rates.

Our contract manufacturers' facilities could be damaged or disrupted by a natural disaster or labor strike, either of which would materially affect our financial position, results of operations and cash flows.

A major catastrophe, such as an earthquake, monsoon, flood or other natural disaster, labor strike, or work stoppage at our contract manufacturers' facilities, our suppliers, or our customers, could result in a prolonged interruption of our business. A disruption resulting from any one of these events could cause significant delays in product shipments and the loss of sales and customers, which could have a material adverse effect on our financial condition, results of operations, and cash flows.

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

Intellectual property protection for our products, processes and technology 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, to maintain the proprietary nature of our PicoP® scanning technology and other key technologies by securing valid and enforceable patents and effectively maintaining unpatented technology as trade secrets.

We protect our proprietary PicoP® scanning 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 involves 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 is 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, 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 directly 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 negatively affected.

We could be subject 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 could be subject to product liability claims if any of the product applications are alleged to be defective or cause harmful effects. For example, because some of the scanning engines incorporating our PicoP® scanning technology could 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.

Additionally, any misuse of our technology or products incorporating our PicoP® scanning technology by end users or third parties that obtain access to our technology, could result in negative publicity and could harm our brand and reputation. Product liability claims or other claims related to our products or our technology, 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 and our PicoP® scanning technology.

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

Our contracts and collaborative research and development agreements have long sales cycles that involve numerous steps including determining the product application, exploring the technical feasibility of a proposed product, evaluating the costs of manufacturing a product or qualifying a new or alternative contract manufacturer for production. Our long sales cycle, which can last several years, makes it difficult to predict the quarter in which 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 period.

Our contracts and collaborative research and development agreements may not lead to any product or any 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. Our efforts may prove unsuccessful and these relationships may not result in the development of any product or any products that will be profitable.

Our operations could be adversely impacted by information technology system failures, network disruptions, or cyber security breaches.

We rely on information technology systems to process, transmit, store, and protect electronic data between our employees, our customers and our suppliers. Our systems are vulnerable to damage or interruptions due to events beyond our control, including, but are not limited to, natural disasters, power loss, telecommunications failures, computer viruses, hacking, or other cyber security issues. Our system redundancy may be inadequate and our disaster recovery planning may be ineffective or insufficient to account for all eventualities. Additionally, we maintain insurance coverage to address certain aspects of cyber risks. Such insurance coverage may be insufficient to cover all losses or all claims that may arise, should such an event occur.

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 hinder our ability to compete effectively in the LBS markets and adversely affect our business strategy execution and results of operations.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

In July 2017, we entered into a 65 month facility lease amendment on 31,142 square feet of combined use office, laboratory and manufacturing space at our headquarters facility in Redmond, Washington. The lease agreement includes extension and rent escalation provisions over the term of the lease.

ITEM 3. LEGAL PROCEEDINGS

During 2018, we settled all related claims with Asia Optical relating to its previously filed complaint for arbitration for less than related reserves.

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. The following persons serve as executive officers of MicroVision, Inc.:

Perry M. Mulligan, age 61, has served as a director of the Company since January 2010 and Chief Executive Officer of the Company since November 2017. Mr. Mulligan has over 30 years of experience in operations and supply chain management. Mr. Mulligan was formerly Senior Vice President of Operations for Emulex Corporation where he oversaw Emulex operations, including IT, facilities, supplier management, test engineering and logistics from July 2013 to June 2015. Mr. Mulligan served as Senior Vice President, Operations for QLogic from October 2007 to June 2013, where he was responsible for all aspects of the manufacturing and delivery of products to the customer in addition to overall supply chain design and manufacturing strategy. Prior to QLogic, Mr. Mulligan was at Solectron from May 2004 to September 2007, where he held the position of Senior Vice President Supply Chain Management and Chief Procurement Officer and was responsible for establishing the overall materials and supply chain strategy. Mr. Mulligan brings extensive experience and knowledge in developing and setting up worldwide manufacturing and sourcing operations and overall supply chain strategy. Mr. Mulligan has an MBA from the University of Western Ontario.

Stephen P. Holt, age 56, 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 B.S. from California State University, Chico and an M.B.A. from Santa Clara

University.

Sumit Sharma, age 45, was appointed Chief Operating Officer in June 2018, after serving as Vice President of Product Engineering and Operations since February 2017 and Vice President and Senior Director of Operations since September 2015. Prior to MicroVision, from April 2015 to September 2015, he was a Product Development and Operations consultant at BlueMadison Consulting. From November 2013 to March 2015, he was the Senior Director, Advanced Manufacturing Operations and Technology Development at Jawbone. From March 2011 to October 2013, he was the Head of Manufacturing Operations for project GLASS at Google. Mr. Sharma has extensive experience in optics, wearable technology, product development and qualification for automotive industry. Mr. Sharma also has deep experience in global operations and developing strategic partnerships. A patent holder, Mr. Sharma received his baccalaureate degree in engineering from New Jersey Institute of Technology.

David J. Westgor, age 65, 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. 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 Advanced Radio Telecom, a broadband telecommunications company. Mr. Westgor holds a B.A. from St. Olaf College and an M.F.A. degree from the Art Institute of Chicago.

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 ticker 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.

As of March 1, 2019, there were approximately 119 holders of record of 102,105,000 shares of common stock outstanding. As many of our shares of common stock are held by brokerages and 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.

ITEM 6. SELECTED FINANCIAL DATA

A summary of selected financial data as of and for the five years ended December 31, 2018 is set forth below. It should be read in conjunction with our consolidated financial statements and related notes appearing elsewhere in this Annual Report on Form 10-K. Years prior to 2016 do not reflect the effects from our January 1, 2018 adoption of ASC Topic 606.

(In thousands, except per share data)

| Statement of Operations Data | Year Ended December 31, | | | | |
|---|-------------------------|-----------|-----------|----------|----------|
| | 2018 | 2017 | 2016 | 2015 | 2014 |
| Revenue | \$ 17,607 | \$ 9,634 | \$ 12,527 | \$ 9,188 | \$ 3,485 |
| Net loss available for common shareholders | (27,250) | (25,486) | (17,981) | (14,542) | (18,120) |
| Basic and diluted net loss per share | (0.31) | (0.35) | (0.35) | (0.31) | (0.44) |
| Weighted-average shares outstanding basic and diluted | 86,983 | 72,786 | 51,958 | 46,540 | 41,599 |
| Balance Sheet Data | | | | | |
| Cash and cash equivalents | \$ 13,766 | \$ 16,966 | \$ 15,139 | \$ 7,888 | \$ 8,349 |
| Working capital (deficit) | (539) | 4,143 | 11,417 | 3,371 | 5,040 |
| Total assets | 23,033 | 29,767 | 20,395 | 14,042 | 11,945 |
| Long-term liabilities | 728 | 607 | 238 | 6,491 | 488 |
| Total shareholders' equity (deficit) | 4,117 | 10,086 | 13,937 | (153) | 6,872 |

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

Overview

Our business strategy is to commercialize our PicoP® scanning technology by enabling OEMs and ODMs to produce end-user products via three go-to-market paths:

1. Design and sell LBS engines directly to OEMs and ODMs to incorporate inside their products;
2. License our LBS technology and sell key components to OEMs and ODMs to create their own scanning engines; and
3. License LBS technology to OEMs and ODMs who developed their own key components.

In 2018, 57% of our revenue was generated from the five-year license agreement we signed in May 2018, 42% of our revenue was generated from development contracts, and 1% was generated from performance on contracts for prototype units. In 2018, one customer accounted for \$10.0 million in revenue, representing 57% of our total revenue and a second customer accounted for \$7.4 million in revenue, representing 42% of our total revenue.

In 2017, 67% of our revenue was generated from development contracts, 24% of our revenue was generated from product sales, 5% was generated from performance on contracts for prototype units, and 4% was generated from ongoing per unit royalties. In 2017, one customer accounted for \$5.8 million in revenue, representing 60% of our total revenue, and a second customer accounted for \$2.3 million in revenue, representing 24% of our total revenue.

We have incurred substantial losses since inception and expect to incur a significant loss during the fiscal year ending December 31, 2018. 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, product sales and licensing activities. There can be no assurance that additional capital will be available or that, if available, it will be available on terms acceptable to us on a timely basis. We cannot be certain that we will succeed in commercializing our technology or products. These factors raise substantial doubt regarding our ability to continue as a going concern. These financial statements were prepared assuming we will continue as a going concern and do not include any adjustments that might be necessary should we be unable to continue as a going concern.

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 materially affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent liabilities. We evaluate our estimates on a continuous basis. We base our estimates on historical data, terms of existing contracts, our evaluation of trends in the consumer display and 3D sensing 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 regarding 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 significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue recognition

Revenues are recognized when control of the promised goods or services are transferred to our customers, in an amount that reflects the consideration that we expect to receive in exchange for those goods or services. We generate all of our revenue from contracts with customers.

Our contract revenue in a particular period is dependent upon when we enter into a contract, the value of the contracts we have entered into, and the availability of technical resources to perform work on the contracts. We recognize contract revenue either at a point in time, or over time, depending upon the characteristics of the individual contract. If control of the deliverable(s) occur over time, the revenue is recognized in proportion to the transfer of control. If control passes to the customer only upon completion and transfer of the asset, revenue is recognized at the completion of the contract. In contracts that include significant customer acceptance provisions, we recognize revenue only upon acceptance of the deliverable(s).

We identify each performance obligation in our development contracts at contract inception. The contracts generally include product development and customization specified by the customer. In contracts with multiple performance obligations, we identify each performance obligation and evaluate whether the performance obligations are distinct within the context of the contract. Determining whether products and services are considered distinct performance obligations that should be accounted for separately versus together may require significant judgment. Performance obligations that are not distinct at contract inception are combined.

If we identify multiple distinct performance obligations, we evaluate each performance obligation to determine if there is a stand-alone selling price. In instances where stand-alone selling price is not directly observable, such as when we do not sell the product or service separately, we determine the stand-alone selling price using information that may include market conditions and other observable inputs. Judgment is required to determine the stand-alone selling price for each distinct performance obligation.

Our development contracts are primarily fixed-fee contracts. If control of deliverables occurs over time, we recognize revenue on fixed fee contracts on the proportion of total cost expended (under Topic 606, the 'input method') to the total cost expected to complete the contract performance obligation. For contracts that require the input method for revenue recognition, the determination of the total cost expected to complete the performance obligations on fixed fee contracts involves significant judgment. We incorporate revisions to hour and cost estimates when the causal facts become known.

Inventory valuation

Inventory is computed using the first-in, first-out (FIFO) method and is stated at the lower of cost and net realizable value. We make 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.

Share-based compensation

We issue share-based compensation to employees in the form of stock options and restricted stock units (RSUs), and performance stock units (PSUs). We account for the share-based awards by recognizing the fair value of share-based compensation expense on a straight-line basis over the service period of the award, net of estimated forfeitures. The fair value of stock options is estimated on the grant date using the Black-Scholes option pricing model. The fair value of RSUs is determined by the closing price of our common stock on the grant date. The PSUs are valued using a binomial option pricing model using the following inputs: stock price, volatility, and risk-free interest rates. Changes in estimated inputs or using other option valuation methods may result in materially different option values and share-based compensation expense.

Income taxes

Significant judgment is required in evaluating our tax position and in determining our provision for income taxes, our deferred tax assets and liabilities and any valuation allowance recorded against our net deferred tax assets. We record a valuation allowance when necessary to reduce deferred tax assets to the amount expected to be realized. Based on our history of losses since inception, the available objective evidence creates sufficient uncertainty regarding the realizability of the deferred tax assets. Our actual tax exposure may differ from our estimates and any such differences may impact income our tax expense in the period in which such determination is made.

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, 2018 COMPARED TO YEAR ENDED DECEMBER 31, 2017.

Product revenue

| | 2018 | % of total revenue | 2017 | % of total revenue | \$ change | % change |
|-----------------------|------|--------------------------|----------|--------------------------|------------|----------|
| <i>(In thousands)</i> | | | | | | |
| Product revenue | \$ - | - | \$ 2,300 | 23.9 | \$ (2,300) | (100.0) |

Product revenue is revenue from sales of our products which are LBS engines, MEMS and ASICs. Revenue is recognized when the product is shipped to the customer because control passes to the customer at the point of shipment. Our product sales generally include acceptance provisions, however, because we generally can objectively determine that we have met agreed-upon customer specifications prior to shipment, control of the item passes at the time of shipment.

We did not recognize any product revenue during the year ended December 31, 2018. Product revenue backlog at December 31, 2018 and 2017 was zero and \$4.3 million, respectively. The change in backlog from September 30, 2018 to December 31, 2018 was due to the uncertainty of fulfilling the remainder of our March 2017 order from Ragentek. We are pursuing our legal rights to enforce the contract.

License and royalty revenue

| | 2018 | % of total revenue | 2017 | % of total revenue | \$ change | % change |
|-----------------------------|-----------|--------------------------|--------|--------------------------|-----------|----------|
| <i>(In thousands)</i> | | | | | | |
| License and royalty revenue | \$ 10,011 | 56.9 | \$ 350 | 3.6 | \$ 9,661 | 2,760.3 |

License and royalty revenue is revenue under license agreements to our PicoP® scanning technology. We recognize revenue on upfront license fees at a point in time if the nature of the license granted is a right-to-use license, representing functional intellectual property with significant standalone functionality. If the nature of the license granted is a right-to-access license, representing symbolic intellectual property, which excludes significant standalone functionality, we recognize revenue over the period of time we have ongoing obligations under the agreement. We will recognize revenue from sales-based royalties on the basis of the quarterly reports provided by our customer as to the number of royalty-bearing products sold or otherwise distributed. In the event that reports are not received, we will estimate the number of royalty-bearing products sold by our customers.

In May 2018, we signed a five-year license agreement with a customer granting them exclusive license to our LBS technology for display-only applications. The license represents functional intellectual property which derives a substantial portion of its utility from its significant standalone functionality. The intellectual property is not expected to substantially change during the license period, nor are we contractually or practically required to use updated intellectual property during the license life. During the year ended December 31, 2018 we completed the performance obligations required by the contract. As a result, we recognized \$10.0 million in license revenue during the year ended December 31, 2018.

During the year ended December 31, 2018 we recognized \$11,000 from ongoing per unit royalties. During the year ended December 31, 2017 we recognized \$350,000 from ongoing per unit royalties.

Contract revenue

| | 2018 | % of total revenue | 2017 | % of total revenue | \$ change | % change |
|-----------------------|----------|--------------------|----------|--------------------|-----------|----------|
| <i>(In thousands)</i> | | | | | | |
| Contract revenue | \$ 7,596 | 43.1 | \$ 6,984 | 72.5 | \$ 612 | 8.8 |

Contract revenue includes revenue from performance on development contracts and the sale of prototype units and evaluation kits based on our PicoP® scanning engine. Our contract revenue in a particular period is dependent upon when we enter into a contract, the value of the contracts we have entered into, and the availability of technical resources to perform work on the contracts. We recognize contract revenue either at a point in time, or over time, depending upon the characteristics of the individual contract. If control of the deliverable(s) occur over time, the revenue is recognized in proportion to the transfer of control. If control passes to the customer only upon completion and transfer of the asset, revenue is recognized at the completion of the contract. In contracts that include significant customer acceptance provisions, we recognize revenue only upon acceptance of the deliverable(s).

We identify each performance obligation in our development contracts at contract inception. The contracts generally include product development and customization specified by the customer. In contracts with multiple performance obligations, we identify each performance obligation and evaluate whether the performance obligations are distinct within the context of the contract. Performance obligations that are not distinct at contract inception are combined.

Our development contracts are primarily fixed-fee contracts. If control of deliverables occurs over time, we recognize revenue on fixed fee contracts on the proportion of total cost expended (under Topic 606, the "input method") to the total cost expected to complete the contract performance obligation. For contracts that require the input method for revenue recognition, the determination of the total cost expected to complete the performance obligations on fixed fee contracts involves significant judgment. We incorporate revisions to hour and cost estimates when the causal facts become known.

In April 2017, we signed a contract with a major technology company to develop an LBS display system. Under the terms of this agreement, we may receive \$14.6 million in fees for development contingent on completion of milestones. As of December 31, 2018, we have received \$10.7 million in fees for development work. We are recognizing revenue on the \$14.6 million in development fees over time utilizing the input method of total costs

expended to total cost expected to complete the performance obligation. The original contract was for \$14.0 million in fees for development, but the customer added \$632,000 in additional work to total \$14.6 million. As of December 31, 2018, we have recognized \$12.1 million of contract revenue from development fees on this agreement.

The increase in contract revenue during the year ended December 31, 2018 compared to the same period in 2017 was attributed to increased contract activity. Our contract backlog, including orders for prototype units and evaluation kits, at December 31, 2018 and 2017 was approximately \$2.5 million and \$9.3 million, respectively. The April 2017 development contract represents \$2.5 million of the contract backlog and is scheduled for completion during the second quarter of 2019.

Cost of product revenue

| | 2018 | % of product revenue | 2017 | % of product revenue | \$ change | % change |
|-------------------------|----------|----------------------------|----------|----------------------------|-----------|----------|
| <i>(In thousands)</i> | | | | | | |
| Cost of product revenue | \$ 5,468 | n/a | \$ 4,359 | 189.5 | \$ 1,109 | 25.4 |

Cost of product revenue includes the direct and allocated indirect costs of products sold to customers. Direct costs include labor, materials, reserves for estimated warranty expenses, and other costs incurred directly, or charged to us by our contract manufacturers, in the manufacture of these products. Indirect costs include labor, manufacturing overhead, and other costs associated with operating our manufacturing capabilities and capacity. Manufacturing overhead includes the costs of procuring, inspecting and storing material, facility and other costs, and is allocated to cost of product revenue based on the proportion of indirect labor which supported production activities.

Cost of product revenue can fluctuate significantly from period to period, depending on the product mix and volume, the level of manufacturing overhead expense and the volume of direct material purchased. Cost of product revenue was higher during the year ended December 31, 2018 due to write downs of inventory totaling \$4.4 million in 2018 compared to \$1.0 million in 2017. This was offset by lower material costs due to zero product shipments compared to the prior year.

During the year ended December 31, 2018, we did not expense manufacturing overhead associated with production capacity in excess of production requirements. During the year ended December 31, 2017, we expensed \$538,000 of manufacturing overhead associated with production capacity in excess of production requirements.

Cost of contract revenue

| | 2018 | % of contract revenue | 2017 | % of contract revenue | \$ change | % change |
|--------------------------|----------|-----------------------------|----------|-----------------------------|-----------|----------|
| <i>(In thousands)</i> | | | | | | |
| Cost of contract revenue | \$ 5,170 | 68.1 | \$ 5,503 | 78.8 | \$ (333) | (6.1) |

Cost of contract revenue includes both the direct and allocated indirect costs of performing on contracts and producing prototype units and evaluation kits. 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 decrease in the cost of contract revenue during the year ended December 31, 2018 compared to the same period in 2017 was attributed to fewer active contracts.

Research and development expense

| | 2018 | 2017 | \$ change | % change |
|----------------------------------|-----------|-----------|-----------|----------|
| <i>(In thousands)</i> | | | | |
| Research and development expense | \$ 24,666 | \$ 15,096 | \$ 9,570 | 63.4 |

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. We assign 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 our customers. We believe that a substantial level of continuing research and development expense will be required to further develop our scanning technology.

The increase in research and development expense during the year ended December 31, 2018, compared to 2017, was attributable to higher costs related to subcontractors and increased headcount and personnel-related compensation and benefits expenses related to our LBS engine development.

Sales, marketing, general and administrative expense

| <i>(In thousands)</i> | 2018 | 2017 | \$ change | % change |
|--|----------|-----------|-----------|----------|
| Sales, marketing, general and administrative expense | \$ 9,523 | \$ 10,156 | \$ (633) | (6.2) |

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 the year ended December 31, 2018 compared to the same period in 2017 was attributed to the reversal of reserves in connection with the settlement of certain claims of approximately \$563,000 and decreased travel and recruiting expenses that were offset partially by increased purchased services.

Income taxes

No provision for income taxes has been recorded because we have experienced net losses from inception through December 31, 2018. At December 31, 2018, we had net operating loss carryforwards of approximately \$398.1 million for federal income tax reporting purposes. In addition, we have research and development tax credits of \$8.6 million. During 2018, \$7.1 million federal net operating losses expired unused. A majority of the net operating loss carryforwards and research and development credits available to offset future taxable income, if any, will expire in varying amounts from 2019 to 2038, if not previously used.

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 carryforwards.

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, 2018 or at December 31, 2017.

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, product sales, and licensing activities. At December 31, 2018, we had \$13.8 million in cash and cash equivalents.

Based on our current operating plan that includes expected proceeds from a development contract signed in April 2017 with a major technology company, we anticipate that we have sufficient cash and cash equivalents to fund our operations through June 2019. Our receipt of proceeds under our April 2017 development contract is subject to our completion of certain milestones, and we can provide no assurance that such milestones will be completed. We will require additional capital to fund our operating plan past that time. We plan to obtain additional capital through the issuance of equity or debt securities, product sales and/or licensing activities. There can be no assurance that additional capital will be available to us or, if available, will be available on terms acceptable to us or on a timely basis. If adequate capital resources are not available on a timely basis, we intend to consider limiting our operations substantially. This limitation of operations could include reducing investments in our production capacities, research and development projects, staff, operating costs, and capital expenditures.

These factors raise substantial doubt regarding our ability to continue as a going concern. Our consolidated financial statements have been prepared assuming we will continue as a going concern and do not include any adjustments that might be necessary should we be unable to continue as a going concern.

Operating activities

Cash used in operating activities totaled \$22.6 million during 2018, compared to \$15.5 million in 2017. Cash used in operating activities resulted primarily from cash used to fund our net loss, after adjusting for non-cash charges such as share-based compensation, depreciation and amortization charges and changes in operating assets and liabilities. The change in cash flows from operating activities in 2018 was primarily attributable to increased operating expenses versus the prior year.

Investing activities

Cash used in investing activities totaled \$1.1 million in 2018, compared to \$3.0 million in 2017. Purchases of property and equipment totaled \$1.1 million in 2018, compared to \$3.1 million in 2017. We received no proceeds from the sale of property and equipment during 2018, compared to sales proceeds of \$59,000 in 2017.

Financing activities

Cash provided by financing activities totaled \$20.5 million in 2018, compared to \$20.3 million in 2017. Principal payments under capital leases and long-term debt was \$12,000 in 2018 and zero in 2017.

The following is a list of our financing activities during 2018 and 2017.

- In December 2018, we raised \$4.2 million before issuance costs of approximately \$524,000 through an underwritten public offering of 7.0 million shares of our common stock.
- In June 2018, we raised \$18.0 million before issuance costs of approximately \$1.4 million through an underwritten public offering of 14.4 million shares of our common stock.
- In August 2017, we raised \$11.5 million before issuance costs of approximately \$1.1 million through an underwritten public offering of 5.5 million shares of our common stock.
- In August 2017, we raised \$3.2 million before issuance costs of approximately \$26,000 through a private placement of 1.5 million shares of our common stock.
- During the second quarter of 2017, we received \$906,000 from the exercise of warrants to purchase 460,000 shares of common stock, which warrants were issued in connection with earlier financing transactions.
- During the second quarter of 2017, we received gross proceeds of \$3.7 million before issuance costs of approximately \$125,000 from the sale of 1.7 million shares of our common stock under an ATM agreement that was terminated in June 2017 at our election without penalty.
- During the second quarter of 2017, we received proceeds of \$2.2 million from the sale of 1.2 million shares of our common stock as part of a common stock purchase agreement entered into in September 2016 that was terminated in August 2017 at our election without penalty.

Our capital requirements will depend on many factors, including, but not limited to, the rate at which OEMs and ODMs introduce products incorporating our PicoP® scanning technology and the market acceptance and competitive position of such products. Our ability to raise capital will depend on numerous factors, including the following:

- Market acceptance of products incorporating our PicoP® scanning 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.

If we are successful in establishing OEM or ODM 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 capital requirements to remain high as we expand our activities and operations with the

objective of commercializing our PicoP® scanning technology.

Contractual obligations

The following table lists our contractual obligations as of December 31, 2018 (in thousands):

| | Payments Due By Period | | | | | Total |
|---|------------------------|-----------|-----------|-----------|------|-------|
| | 1 year | 1-3 years | 3-5 years | > 5 years | | |
| Open purchase obligations * | \$ 5,836 | \$ 174 | \$ 174 | \$ - | \$ - | 6,184 |
| Minimum payments under capital leases | 21 | 33 | - | - | - | 54 |
| Minimum payments under operating leases | 654 | 1,332 | 871 | - | - | 2,857 |
| Minimum payments under long-term liabilities | 35 | 18 | - | - | - | 53 |
| Minimum payments under research, royalty and licensing agreements | 12 | 24 | 24 | 12 | † | 72 |
| | \$ 6,558 | \$ 1,581 | \$ 1,069 | \$ 12 | \$ - | 9,220 |

*

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

†License and royalty obligations continue through the lives of the underlying patents, which is currently through at least 2024.

Recent 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, 2018, all of our 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, 2018, our cash and cash equivalents are comprised of short-term highly rated money market savings accounts. The values of cash and cash equivalents as of December 31, 2018, are as follows (in thousands):

| | Amount | Percent |
|---------------------------|-----------|---------|
| Cash and cash equivalents | \$ 13,766 | 100% |
| Less than one year | - | - |
| | \$ 13,766 | 100% |

Foreign Exchange Rate Risk

Our major contract and collaborative research and development agreements, product sales, and licensing activity 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 entered into purchase orders and supply agreements in foreign currencies in the past 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

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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| <u>Consolidated Statements of Operations for the years ended December 31, 2018 and 2017</u> | 26 |
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Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of
MicroVision, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of MicroVision, Inc. (the "Company") as of December 31, 2018 and 2017, the related consolidated statements of operations, shareholders' equity, and cash flows for the years then ended, and the related notes and schedule (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2018 and 2017, 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.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the Company's internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 5, 2019, expressed an unqualified opinion on the Company's internal control over financial reporting.

Going Concern Uncertainty

The accompanying consolidated financial statements have been prepared assuming that 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 an accumulated deficit 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.

Change in Accounting Principle

As discussed in Note 3 to the consolidated financial statements, the Company changed its method of accounting for revenue from contracts with customers.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. 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, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Moss Adams LLP

Seattle, Washington

March 5, 2019

We have served as the Company's auditor since 2012.

MicroVision, Inc.
Consolidated Balance Sheets
(In thousands)

| | December 31, | |
|--|--------------|-------------|
| Assets | 2018 | 2017 |
| Current assets | | |
| Cash and cash equivalents | \$ 13,766 | \$ 16,966 |
| Accounts receivable, net of allowances of \$0 and \$26, respectively | 476 | 15 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 987 | 680 |
| Inventory | 1,109 | 4,541 |
| Other current assets | 1,311 | 1,015 |
| Total current assets | 17,649 | 23,217 |
| Property and equipment, net | 2,993 | 3,251 |
| Restricted cash | 435 | 435 |
| Intangible assets, net | 486 | 602 |
| Other assets | 1,470 | 2,262 |
| Total assets | \$ 23,033 | \$ 29,767 |
| Liabilities and shareholders' equity | | |
| Current liabilities | | |
| Accounts payable | \$ 2,411 | \$ 3,063 |
| Accrued liabilities | 5,602 | 5,864 |
| Billings on uncompleted contracts in excess of related costs | - | 5 |
| Other current liabilities | 10,154 | 10,142 |
| Current portion of capital lease obligations | 21 | - |
| Total current liabilities | 18,188 | 19,074 |
| Capital lease obligations, net of current portion | 33 | - |
| Deferred rent, net of current portion | 695 | 302 |
| Other long-term liabilities | - | 305 |
| Total liabilities | 18,916 | 19,681 |
| Commitments and contingencies (Note 12) | | |
| Shareholders' equity | | |
| Preferred stock, par value \$0.001; 25,000 shares authorized; zero and zero shares issued and outstanding, respectively | - | - |
| Common stock, par value \$0.001; 150,000 shares authorized; 100,105 and 78,597 shares issued and outstanding at December 31, 2018 and 2017, respectively | 100 | 79 |
| Additional paid-in capital | 550,133 | 528,873 |
| Accumulated deficit | (546,116) | (518,866) |
| Total shareholders' equity | 4,117 | 10,086 |
| Total liabilities and shareholders' equity | \$ 23,033 | \$ 29,767 |

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

MicroVision, Inc.
 Consolidated Statements of Operations
 (In thousands, except per share data)

| | Year Ended December 31, | |
|---|-------------------------|-------------|
| | 2018 | 2017 |
| Product revenue | \$ - | \$ 2,300 |
| License and royalty revenue | 10,011 | 350 |
| Contract revenue | 7,596 | 6,984 |
| Total revenue | 17,607 | 9,634 |
| Cost of product revenue | 5,468 | 4,359 |
| Cost of contract revenue | 5,170 | 5,503 |
| Total cost of revenue | 10,638 | 9,862 |
| Gross profit | 6,969 | (228) |
| Research and development expense | 24,666 | 15,096 |
| Sales, marketing, general and administrative expense | 9,523 | 10,156 |
| Total operating expenses | 34,189 | 25,252 |
| Loss from operations | (27,220) | (25,480) |
| Other expense, net | (30) | (6) |
| Net loss | \$ (27,250) | \$ (25,486) |
| Net loss per share - basic and diluted | \$ (0.31) | \$ (0.35) |
| Weighted-average shares outstanding - basic and diluted | 86,983 | 72,786 |

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

MicroVision, Inc.
 Consolidated Statements of Shareholders' Equity
 (In thousands)

| | Common Stock | | Additional paid-in capital | Accumulated deficit | Total shareholders' equity |
|-------------------------------------|--------------|-----------|----------------------------------|------------------------|----------------------------------|
| | Shares | Par value | | | |
| Balance at December 31, 2016 | 68,093 | \$ 68 | \$ 507,249 | \$ (493,380) | \$ 13,937 |
| Share-based compensation expense | 92 | - | 1,288 | - | 1,288 |
| Exercise of warrants and options | 506 | - | 991 | - | 991 |
| Sales of common stock | 9,906 | 11 | 19,345 | - | 19,356 |
| Net loss | - | - | - | (25,486) | (25,486) |
| Balance at December 31, 2017 | 78,597 | 79 | 528,873 | (518,866) | 10,086 |
| Share-based compensation expense | 108 | - | 1,061 | - | 1,061 |
| Sales of common stock | 21,400 | 21 | 20,199 | - | 20,220 |
| Net loss | - | - | - | (27,250) | (27,250) |
| Balance at December 31, 2018 | 100,105 | \$ 100 | \$ 550,133 | \$ (546,116) | \$ 4,117 |

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

MicroVision, Inc.
Consolidated Statements of Cash Flows
(In thousands)

| | Year Ended December 31, | |
|---|--------------------------------|-------------|
| | 2018 | 2017 |
| Cash flows from operating activities | | |
| Net loss | \$ (27,250) | \$ (25,486) |
| Adjustments to reconcile net loss to net cash used in operations: | | |
| Depreciation | 1,722 | 1,141 |
| Amortization of intangible assets | 116 | 116 |
| Non-cash share-based compensation expense | 1,061 | 1,288 |
| Inventory write-downs | 4,414 | 1,004 |
| Other non-cash adjustments | 203 | (42) |
| Change in: | | |
| Accounts receivable | (461) | 230 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | (307) | (555) |
| Inventory | (982) | (4,312) |
| Other current and non-current assets | 663 | (2,314) |
| Accounts payable | (1,079) | 1,147 |
| Accrued liabilities | (374) | 2,226 |
| Billings on uncompleted contracts in excess of related costs | (5) | (138) |
| Other current liabilities | 12 | 9,964 |
| Other long-term liabilities | (305) | 252 |
| Net cash used in operating activities | (22,572) | (15,479) |
| Cash flows from investing activities | | |
| Proceeds on sale of property and equipment | - | 59 |
| Purchases of property and equipment | (1,118) | (3,100) |
| Net cash used in investing activities | (1,118) | (3,041) |
| Cash flows from financing activities | | |
| Principal payments under capital leases and long-term debt | (12) | - |
| Increase in deferred rent | 139 | - |
| Net proceeds from issuance of common stock and exercise of warrants | 20,363 | 20,347 |
| Net cash provided by financing activities | 20,490 | 20,347 |
| Change in cash, cash equivalents, and restricted cash | (3,200) | 1,827 |
| Cash, cash equivalents, and restricted cash at beginning of period | 17,401 | 15,574 |
| Cash, cash equivalents, and restricted cash at end of period | \$ 14,201 | \$ 17,401 |
| Supplemental schedule of non-cash investing and financing activities | | |
| Property and equipment acquired under capital leases | 66 | - |
| Non-cash additions to property and equipment | \$ 445 | \$ 165 |

The following table provides a reconciliation of the cash, cash equivalents, and restricted cash balances as of December 31, 2018 and December 31, 2017:

| | Year Ended December 31, | |
|--|--------------------------------|-------------|
| | 2018 | 2017 |
| Cash and cash equivalents | \$ 13,766 | \$ 16,966 |
| Restricted cash | 435 | 435 |
| Cash, cash equivalents and restricted cash | \$ 14,201 | \$ 17,401 |

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

MicroVision, Inc.
Notes to Consolidated Financial Statements
For the year ended December 31, 2018

1. THE COMPANY AND LIQUIDITY

MicroVision, Inc. is a pioneer in LBS technology that we market under our brand name PicoP®. We have developed our proprietary PicoP® scanning technology that can be adopted by our customers to create high-resolution miniature projection and three-dimensional sensing and image capture solutions. PicoP® scanning technology is based on our patented expertise in MEMS, laser diodes, opto-mechanics, and electronics and how those elements are packaged into a small form factor, lower power scanning engine that can display, interact and sense, depending on the needs of the application. For display, the engine can project a high-quality image on any surface (pico projection), or a retina (AR). For sensing, we use IR lasers to capture three-dimensional data in the form of a point cloud. Interactivity uses the 3D sensing function and the display function to simultaneously project an image that the user can then interact with as one would a touch screen.

We have incurred significant losses since inception. We have funded our 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, product sales and licensing activities. At December 31, 2018, we had \$13.8 million in cash and cash equivalents.

Based on our current operating plan that includes expected proceeds from a development contract signed in April 2017 with a major technology company, we anticipate that we have sufficient cash and cash equivalents to fund our operations through June 2019. Our receipt of proceeds under our April 2017 development contract is subject to our completion of certain milestones, and we can provide no assurance that such milestones will be completed. We will require additional capital to fund our operating plan past that time. We plan to obtain additional capital through the issuance of equity or debt securities, product sales and/or licensing activities. There can be no assurance that additional capital will be available to us or, if available, will be available on terms acceptable to us or on a timely basis. If adequate capital resources are not available on a timely basis, we intend to consider limiting our operations substantially. This limitation of operations could include reducing investments in our production capacities, research and development projects, staff, operating costs, and capital expenditures.

We are introducing new technology and products 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 commercial success of our laser beam scanning (LBS) engines, the rate at which OEMs and ODMs introduce products incorporating our PicoP® scanning technology and the market acceptance and competitive position of such products. If revenues are less than we anticipate, if we fail to meet milestones for future payments or have to repay amounts already received under our April 2017 development contract, if the mix of revenues and the associated margins vary 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 and systems and equipment manufacturers that may require additional investments by us.

These factors raise substantial doubt regarding our ability to continue as a going concern. Our consolidated financial statements have been prepared assuming we will continue as a going concern and do not include any adjustments that might be necessary should we be unable to continue as a going concern.

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 our estimates. We have identified the following areas where estimates and assumptions have been made in preparing the financial statements: revenue recognition, inventory valuation, valuation of share-based payments, income taxes, depreciable lives assessment and related disclosure of contingent assets and liabilities.

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.

Our financial instruments include cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities. The carrying value of our financial instruments approximates fair value due to their short maturities. Our cash equivalents are comprised of short-term highly rated money market savings accounts.

Intangible assets

Our intangible assets consist exclusively of purchased patents. The patents are amortized using the straight-line method over their estimated period of benefit, ranging from one to seventeen years. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. Recoverability of these assets is measured by comparison of their carrying values to the projected undiscounted net cash flows associated with the related intangible assets or group of assets over their remaining lives. 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 raw materials and finished goods assemblies. Inventory is computed using the first-in, first-out (FIFO) method and is stated at the lower of cost and net realizable value. Management periodically assesses the need to account for obsolescence of inventory and adjusts the carrying value of inventory to its net realizable value when required. Inventory that will not be consumed through the normal course of business during the next twelve months is classified as "other assets" on the balance sheet.

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. As our production needs change, we periodically assess the remaining estimated useful life of our production equipment. If necessary, we adjust the depreciation on our production equipment to reflect the remaining estimated useful life. 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 cash

As of December 31, 2018 and 2017, restricted cash was in money market savings accounts and serve as collateral for \$435,000 in irrevocable letters of credit. The restricted cash balance includes a letter of credit which is outstanding in connection with a lease agreement for our corporate headquarters building in Redmond, Washington. The balance is required over the term of the lease, which expires in March 2023.

Revenue recognition

The following is a description of principal activities from which we generate revenue. Revenues are recognized when control of the promised goods or services are transferred to our customers, in an amount that reflects the consideration that we expect to receive in exchange for those goods or services. We generate all of our revenue from contracts with customers.

We evaluate contracts based on the 5-step model as stated in Topic 606 as follows: (i) identify the contract, (ii) identify the performance obligations, (iii) determine the transaction price, (iv) allocate the transaction price, and (v) recognize revenue when (or as) performance obligations are satisfied.

A contract contains a promise (or promises) to transfer goods or services to a customer. A performance obligation is a promise (or a group of promises) that is distinct, as defined in the revenue standard.

The transaction price is the amount of consideration an entity expects to be entitled to from a customer in exchange for providing the goods or services. A number of factors should be considered to determine the transaction price, including whether there is variable consideration, a significant financing component, noncash consideration, or amounts payable to the customer. The determination of variable consideration will require a significant amount of judgment. In estimating the transaction price we will use either the expected value method or the most likely amount method.

The transaction price is allocated to the separate performance obligations in the contract based on relative standalone selling prices. Determining the relative standalone selling price can be challenging when goods or services are not sold on a standalone basis. The revenue standard sets out several methods that can be used to estimate a standalone selling price when one is not directly observable. Allocating discounts and variable consideration must also be considered. Allocating the transaction price can require significant judgement on our part.

Revenue is recognized when (or as) the customer obtains control of the good or service/performance obligations are satisfied. Topic 606 provides guidance to help determine if a performance obligation is satisfied at a point in time or over time. Where a performance obligation is satisfied over time, the related revenue is also recognized over time.

Product revenue

We sell our products to customers under a contract or by purchase order. We consider the sale of each individual item to be one performance obligation. The transaction price is generally either at stated product price per quantity or at a fixed amount at contract inception. Revenue is recognized under Topic 606 when the product is shipped to the customer because control passes to the customer at the point of shipment. Our product sales generally include acceptance provisions, however, because we generally can objectively determine that we have met agreed-upon customer specifications prior to shipment, control of the item passes at the time of shipment.

License and royalty revenue

We recognize revenue on upfront license fees at a point in time if the nature of the license granted is a right-to-use license, representing functional intellectual property with significant standalone functionality. If the nature of the license granted is a right-to-access license, representing symbolic intellectual property, which excludes significant standalone functionality, we recognize revenue over the period of time we have ongoing obligations under the agreement. We will recognize revenue from sales-based royalties on the basis of the quarterly reports provided by our customer as to the number of royalty-bearing products sold or otherwise distributed. In the event that reports are not received, we will estimate the number of royalty-bearing products sold by our customers.

Contract revenue

Our contract revenue in a particular period is dependent upon when we enter into a contract, the value of the contracts we have entered into, and the availability of technical resources to perform work on the contracts. We recognize contract revenue either at a point in time, or over time, depending upon the characteristics of the individual contract. If control of the deliverable(s) occur over time, the revenue is recognized in proportion to the transfer of control. If control passes to the customer only upon completion and transfer of the asset, revenue is recognized at the completion of the contract. In contracts that include significant customer acceptance provisions, we recognize revenue only upon acceptance of the deliverable(s).

We identify each performance obligation in our development contracts at contract inception. The contracts generally include product development and customization specified by the customer. In contracts with multiple performance

obligations, we identify each performance obligation and evaluate whether the performance obligations are distinct within the context of the contract. Performance obligations that are not distinct at contract inception are combined.

Our development contracts are primarily fixed-fee contracts. If control of deliverables occurs over time, we recognize revenue on fixed fee contracts on the proportion of total cost expended (under Topic 606, the 'input method') to the total cost expected to complete the contract performance obligation. For contracts that require the input method for revenue recognition, the determination of the total cost expected to complete the performance obligations on fixed fee contracts involves significant judgment. We incorporate revisions to hour and cost estimates when the causal facts become known.

Cost of product revenue

Cost of product revenue includes the direct and allocated indirect costs of products sold to customers. Direct costs include labor, materials, reserves for estimated warranty expenses, and other costs incurred directly, or charged to us by our contract manufacturers in the manufacture of these products. Indirect costs include labor, manufacturing overhead, and other costs associated with operating our manufacturing capabilities and capacity. Manufacturing overhead includes the costs of procuring, inspecting and storing material, facility and other costs, and is allocated to cost of product revenue based on the proportion of indirect labor which supported production activities. The cost of product revenue can fluctuate significantly from period to period, depending on the product mix and volume, the level of manufacturing overhead expense and the volume of direct material purchased.

Cost of contract revenue

Cost of contract revenue includes both the direct and allocated indirect costs of performing on contracts and producing prototype units and evaluation kits based on our PicoP® scanning engine. 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.

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 major customers and suppliers

Concentration of credit risk

Financial instruments that potentially subject us to a concentration of credit risk are primarily cash equivalents and accounts receivable. We typically do not require collateral from our customers. As of December 31, 2018, our cash and cash equivalents are comprised of short-term highly rated money market savings accounts.

Concentration of major customers and suppliers

In 2018, one customer accounted for \$10.0 million in revenue, representing 57% of our total revenue and a second customer accounted for \$7.4 million in revenue, representing 42% of our total revenue. In 2017, one customer accounted for \$5.8 million in revenue, representing 60% of our total revenue and a second customer accounted for \$2.3 million in revenue, representing 24% of our total revenue.

A significant concentration of our components and the products we sell are currently manufactured and obtained from single or limited-source suppliers, which are primarily located in foreign countries. The loss of any single or limited-source supplier, the failure of any of these suppliers to perform as expected, or the disruption in the supply chain of components from these suppliers could subject us to risks and uncertainties regarding, but not limited to, increased cost of sales, possible loss of revenues, or significant delays in product deliveries, any of which could adversely affect our financial condition and operating results.

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.

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

| | Year Ended December 31, | |
|--|-------------------------|-------------|
| | 2018 | 2017 |
| Numerator: | | |
| Net loss available for common shareholders | \$ (27,250) | \$ (25,486) |
| Denominator: | | |
| Weighted-average common shares outstanding | 86,983 | 72,786 |
| Net loss per share - basic and diluted | \$ (0.31) | \$ (0.35) |

During each of the years ended December 31, 2018 and 2017, we excluded the following securities from 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 shown below (in thousands):

| | Year Ended December 31, | |
|--|-------------------------|-------|
| | 2018 | 2017 |
| Options outstanding and warrants exercisable | 6,619 | 7,007 |
| Nonvested restricted stock units | 1,149 | 185 |
| | 7,768 | 7,192 |

Research and development

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. We assign 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 our customers. Research and development costs are expensed as incurred. We believe that a substantial level of continuing research and development expense will be required to further develop our technology.

Share-based compensation

We issue share-based compensation to employees in the form of stock options and restricted stock units (RSUs), and performance stock units (PSUs). We account for the share-based awards by recognizing the fair value of share-based compensation expense on a straight-line basis over the service period of the award, net of estimated forfeitures. The fair value of stock options is estimated on the grant date using the Black-Scholes option pricing model. The fair value of RSUs is determined by the closing price of our common stock on the grant date. The PSUs are valued using a binomial option pricing model using the following inputs: stock price, volatility, and risk-free interest rates. Changes in estimated inputs or using other option valuation methods may result in materially different option values and share-based compensation expense.

The following table summarizes the amount of share-based compensation expense by line item on the Statement of Operations (in thousands):

| | Year Ended December 31, | |
|--|-------------------------|----------|
| | 2018 | 2017 |
| Cost of product revenue | \$ - | \$ 39 |
| Research and development expense | 439 | 546 |
| Sales, marketing, general and administrative expense | 622 | 703 |
| | \$ 1,061 | \$ 1,288 |

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.

Recent accounting pronouncements

In June 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2018-07 (ASU 2018-07) Compensation - Stock Compensation (Topic 718), Improvements to Nonemployee Share-Based Payment Accounting. Currently, Topic 718 only includes share-based payments to employees. ASU 2018-07 expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. The new guidance will be effective for fiscal years beginning after December 31, 2018, including interim periods within that fiscal year. We do not expect the adoption of ASU 2018-07 to have a material impact on our financial statements.

In February 2016, the FASB issued Accounting Standards Update 2016-02 (ASU 2016-02), Leases (Topic 842). ASU 2016-02 requires lessees to recognize a right-of-use asset and lease liability in the balance sheet for all leases, including operating leases, with terms of more than twelve months. Recognition, measurement and presentation of expenses and cash flows from a lease by a lessee have not significantly changed from previous guidance. The amendments also require qualitative disclosures along with specific quantitative disclosures. The new guidance will be effective for fiscal years beginning after December 15, 2018, and interim periods within those years, with early adoption permitted. The amendments may be applied on a modified retrospective basis. We have chosen to adopt this guidance on January 1, 2019 using a cumulative-effect adjustment to retained earnings. The most significant impact will be recognition of right-of-use assets and lease liabilities for our office lease. Accounting for our capital leases remains substantially unchanged. Adoption of the standard will result in the recognition of a right-of-use asset of approximately \$1.6 million, a lease liability of approximately \$2.5 million, and a reduction in other short-term and long-term liabilities of \$873,000. Adoption of the standard will not have a material impact on our statement of operations.

3. REVENUE RECOGNITION

In May 2014, the FASB issued Accounting Standards Update 2014-09 (ASU 2014-09), Revenue from Contracts with Customers (Topic 606), an updated standard on revenue recognition. The core principle of the new standard is for companies to recognize revenue to depict the transfer of goods or services to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. The new standard also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively, and improve guidance for multiple-element arrangements. We implemented ASU 2014-09 as of January 1, 2018 using the full retrospective approach, meaning we restated each prior reporting period presented.

We performed a review of our revenue generating contracts with customers subject to ASU 2014-09, and implementation of this standard has the following material impacts on our financial statements:

i. Timing of revenue recognition under the PicoP® scanning technology license agreement we signed with Sony in March 2015. Under previous guidance, we had been recognizing the upfront license fee payment of \$8.0 million on a straight-line basis over a period of eight years. Under the new guidance, the entire \$8.0 million upfront license fee payment was recognized in the first quarter of 2015. The result of this change in timing resulted in a decrease of \$6.1 million in our beginning 2017 accumulated deficit balance and a reduction in our short-term deferred revenue balance of \$999,000 and long-term deferred revenue balance of \$5.1 million. License and royalty revenue for the year ended December 31, 2017 was reduced by approximately \$999,000.

ii. Timing of revenue recognition on product sales. Previously, we recognized revenue after expiration of the contractual acceptance period. Under the new guidance, we recognize revenue when control of the product transfers to the buyer, which may occur before the expiration of the contractual acceptance period. The result of this change was a net decrease in our beginning 2017 accumulated deficit of \$527,000, as well as a shift in revenue and cost recognition to earlier quarters in 2017.

Disaggregation of revenue

The following table provides information about disaggregated revenue by timing of revenue recognition, (in thousands):

| | Year Ended December 31, 2018 | | | |
|--|-------------------------------------|--|-----------------------------|--------------|
| | Product revenue | License and royalty revenue | Contract revenue | Total |
| Timing of revenue recognition: | | | | |
| Products transferred at a point in time | \$ - | \$ 10,011 | \$ 189 | \$ 10,200 |
| Product and services transferred over time | - | - | 7,407 | 7,407 |
| Total | \$ - | \$ 10,011 | \$ 7,596 | \$ 17,607 |

| | Year Ended December 31, 2017 | | | |
|--|-------------------------------------|--|-----------------------------|--------------|
| | Product revenue | License and royalty revenue | Contract revenue | Total |
| Timing of revenue recognition: | | | | |
| Products transferred at a point in time | \$ 2,300 | \$ 350 | \$ 1,616 | \$ 4,266 |
| Product and services transferred over time | - | - | 5,368 | 5,368 |
| Total | \$ 2,300 | \$ 350 | \$ 6,984 | \$ 9,634 |

Contract balances

The following table provides information about receivables, contract assets, and contract liabilities from contracts with customers (in thousands):

| | December 31, 2018 | December 31, 2017 |
|---|------------------------------|------------------------------|
| Accounts receivable, net | \$ 476 | \$ 15 |
| Costs and estimated earnings in excess of billings on uncompleted contracts | 987 | 680 |
| Other current assets | - | 70 |
| Billings on uncompleted contracts in excess of related costs | - | 5 |
| Other current liabilities | 10,000 | 10,000 |

Under Topic 606, our rights to consideration are presented separately depending on whether those rights are conditional or unconditional. We present our unconditional rights to consideration as "accounts receivable" in our Consolidated Balance Sheet.

Contract assets represent rights to consideration that are subject to a condition other than the passage of time, and are comprised primarily of costs and estimated profits in excess of billings on uncompleted contracts and estimated accrued sales-based royalty revenue.

Contract costs in excess of billing are included in the "Costs and estimated earnings in excess of billings on uncompleted contracts" line of our Consolidated Balance Sheet. This does not represent a change in presentation for contract fulfillment costs; however, for sales-based royalty revenue, revenue was previously not recognized until quarterly royalty reporting had been received from our customer. Under Topic 606, in the event that reports are not received, we estimate the number of royalty-bearing products sold by our customers and are included in "Other current assets". Once quarterly royalty reporting has been received, the related contract assets will be transferred to accounts receivable.

Significant changes in the contract assets and the contract liabilities balances during the period are as follows (in thousands, except percentages):

| | December 31, 2018 | December 31, 2017 | \$ Change | % Change |
|-----------------------------------|----------------------|----------------------|-----------|----------|
| Contract assets | \$ 987 | \$ 680 | \$ 307 | 45.1 |
| Contract liabilities | - | (5) | 5 | 100.0 |
| Net contract assets (liabilities) | \$ 987 | \$ 675 | \$ 312 | 46.2 |

During the year ended December 31, 2018, we billed \$7.1 million on our development contracts. Of this amount, \$680,000 was included in contract assets at December 31, 2017. We also recognized revenue of \$7.4 million during the year ended December 31, 2018, resulting in a contract asset of \$987,000.

Contract acquisition costs

Regarding the adoption of Topic 606, we are required to capitalize certain contract acquisition costs consisting primarily of commissions paid when contracts are signed. We currently do not pay any commissions upon the signing of a contract; therefore, no commission cost has been incurred as of December 31, 2018.

Transaction price allocated to the remaining performance obligations

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied or partially unsatisfied at the end of the reporting period. The estimated revenue does not include the \$10.0 million upfront payment received from a major technology company to develop an LBS display system due to uncertainty around the timing of recognition. Additionally, the estimated revenue does not include amounts of variable consideration attributable to royalties or unexercised contract renewals (in thousands):

| | 2019 | 2020 |
|-----------------------------|-------|------|
| Product revenue | \$ - | \$ - |
| License and royalty revenue | - | - |
| Contract revenue | 2,513 | - |

Impacts to Previously Reported Results

In accordance with Topic 606, the disclosure of the impact of adoption to our condensed consolidated statements of operations and balance sheets was as follows (in thousands, except per share data):

| | Year Ended December 31, 2017 | | |
|--|------------------------------|---------------------------------|-------------|
| | As previously reported | New revenue standard adjustment | As restated |
| Product revenue | \$ 2,300 | \$ - | \$ 2,300 |
| License and royalty revenue | 1,568 | (1,218) | 350 |
| Contract revenue | 7,023 | (39) | 6,984 |
| Cost of product revenue | 4,359 | - | 4,359 |
| Cost of contract revenue | 5,517 | (14) | 5,503 |
| Net loss | (24,243) | (1,243) | (25,486) |
| Net loss per share - basic and diluted | (0.33) | (0.02) | (0.35) |

| | December 31, 2017 | | |
|--|------------------------|---------------------------------|-------------|
| | As previously reported | New revenue standard adjustment | As restated |
| Costs and estimated earnings incurred on uncompleted contracts | \$ 680 | \$ - | \$ 680 |
| Other current assets | 945 | 70 | 1,015 |
| Billings on uncompleted contracts | 5 | - | 5 |
| Deferred revenue - current | 999 | (999) | - |
| Deferred revenue - noncurrent | 4,151 | (4,151) | - |
| Shareholders' equity: | | | |
| Accumulated deficit | (524,086) | 5,220 | (518,866) |

Adoption of the standards related to revenue recognition had no impact to cash from or used in operating, investing, or financing activities on our condensed consolidated statements of cash flows.

4. LONG-TERM CONTRACTS

In May 2018, we signed a five-year license agreement with a customer granting them exclusive license to our LBS technology for display-only applications. As part of the agreement, we received a first payment of \$5.0 million in June 2018 and the second payment of \$5.0 million in October 2018. The contract includes requirements that must be met in order to maintain exclusivity. If this customer acquires a customer, we expect orders for component sales. We may also receive payments for non-recurring engineering expenses associated with process and product transfer and qualification milestones. During the year ended December 31, 2018 we completed the performance obligations required by the contract. As a result, we recognized \$10.0 million in license and royalty revenue during the year ended December 31, 2018.

In April 2017, we signed a contract with a major technology company to develop an LBS display system. Under this agreement, we are working to develop a new generation of MEMS, ASICs and related firmware for a high resolution, LBS-based product that the technology company is planning to produce. Under the agreement, we received an upfront payment of \$10.0 million in 2017 and may receive up to \$14.6 million in fees for development work that is expected to span into the second quarter of 2019. Our receipt of the development fees is contingent on completion of milestones in 2017, 2018, and into the second quarter of 2019. As of December 31, 2018, we have received \$10.7 million in fees for development work and recognized \$12.1 million in revenue. Upon successful completion of the development program,

if the major technology company decides to manufacture the product with the MicroVision display components, the \$10.0 million upfront payment would be applied as a discount to future component purchases from us. If the contract is terminated by the technology company for our failure to meet milestones, the \$10.0 million upfront payment is subject to repayment. We are recognizing revenue on the \$14.6 million in development fees over time based on the proportion of total cost expended (under Topic 606, the "input method") to the total cost expected to complete the contract performance obligation. For the year ended December 31, 2018, we have recognized \$7.4 million of contract revenue from development fees on this agreement. We have an amount equal to the \$10.0 million upfront payment classified as an other current liability on the balance sheet.

The following table summarizes the costs incurred on our revenue contracts (in thousands):

| | December 31, | |
|--|--------------|----------|
| | 2018 | 2017 |
| Costs and estimated earnings incurred on uncompleted contracts | \$ 12,087 | \$ 4,680 |
| Billings on uncompleted contracts | (11,100) | (4,005) |
| | \$ 987 | \$ 675 |
| Included in consolidated balance sheets under the following captions: | | |
| Costs and estimated earnings incurred on uncompleted contracts | \$ 987 | \$ 680 |
| Billings on uncompleted contracts in excess of related costs | - | (5) |
| | \$ 987 | \$ 675 |

5. INVENTORY

Inventory consists of the following (in thousands):

| | December 31, | |
|----------------|--------------|----------|
| | 2018 | 2017 |
| Raw materials | \$ 32 | \$ 53 |
| Finished goods | 1,077 | 4,488 |
| | \$ 1,109 | \$ 4,541 |

As of December 31, 2018 and 2017, \$1.4 million and \$2.2 million, respectively, of materials that are not expected to be consumed during the next twelve months are classified as "other assets" on the balance sheet.

We recorded inventory write-downs of \$4.4 million in 2018 and \$1.0 million in 2017.

6. ACCRUED LIABILITIES

Accrued liabilities consists of the following (in thousands):

| | December 31, | |
|------------------------------|--------------|----------|
| | 2018 | 2017 |
| Bonuses | \$ 1,475 | \$ 1,143 |
| Adverse purchase commitments | - | 500 |
| Payroll and payroll taxes | 608 | 631 |
| Compensated absences | 493 | 436 |
| Warranty | 25 | 153 |
| Relocation | 22 | 90 |
| Deferred rent credit | 178 | 37 |
| Separation agreement | 241 | 359 |
| Prepayments from customers | 1,585 | 1,738 |
| Other | 975 | 777 |
| | \$ 5,602 | \$ 5,864 |

7. PROPERTY AND EQUIPMENT

Property and equipment consists of the following (in thousands):

| | December 31, | |
|--|--------------|----------|
| | 2018 | 2017 |
| Production equipment | \$ 7,124 | \$ 6,573 |
| Leasehold improvements | 909 | 601 |
| Computer hardware and software/lab equipment | 6,082 | 5,515 |
| Office furniture and equipment | 1,342 | 1,304 |
| | 15,457 | 13,993 |
| Less: Accumulated depreciation | (12,464) | (10,742) |
| | \$ 2,993 | \$ 3,251 |

Depreciation expense was \$1.7 million in 2018 and \$1.1 million in 2017.

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 \$770,000 and \$713,000 in the year ended December 31, 2018 and \$704,000 and \$704,000 in the year ended December 31, 2017.

8. INTANGIBLE ASSETS

Our intangible assets consist exclusively of technology-based purchased patents. The gross value of our intangible assets was \$1.6 million in each of the years ended December 31, 2018 and 2017. Amortization expense was \$116,000 in 2018 and \$116,000 in 2017. In 2018 and 2017 there were no impairments recorded and none of our patents were abandoned in prosecution. The following table outlines our estimated future amortization expense related to intangible assets held at December 31, 2018 (in thousands):

| Years Ended December 31, | Amount |
|--------------------------|--------|
| 2019 | \$ 115 |
| 2020 | 98 |
| 2021 | 80 |
| 2022 | 71 |
| 2023 | 54 |
| Thereafter | 68 |
| | \$ 486 |

9. COMMON STOCK

In December 2018, we raised \$4.2 million before issuance costs of approximately \$524,000 through an underwritten public offering of 7.0 million shares of our common stock.

In June 2018, we raised \$18.0 million before issuance costs of approximately \$1.4 million through an underwritten public offering of 14.4 million shares of our common stock.

In August 2017, we raised \$11.5 million before issuance costs of approximately \$1.1 million through an underwritten public offering of 5.5 million shares of our common stock.

In August 2017, we raised \$3.2 million before issuance costs of approximately \$26,000 through a private placement of 1.5 million shares of our common stock.

During the second quarter of 2017, we received \$906,000 from the exercise of warrants to purchase 460,000 shares of common stock, which warrants were issued in connection with earlier financing transactions.

During the second quarter of 2017, we received gross proceeds of \$3.7 million before issuance costs of approximately \$125,000 from the sale of 1.7 million shares of our common stock under an ATM agreement that was terminated in June 2017 at our election without penalty.

During the second quarter of 2017, we received proceeds of \$2.2 million from the sale of 1.2 million shares of our common stock as part of a common stock purchase agreement entered into in September 2016 that was terminated in August 2017 at our election without penalty.

10. WARRANTS

During the second quarter of 2017, we received \$906,000 from the exercise of warrants to purchase 460,000 shares of common stock, which warrants were issued in connection with earlier financing transactions.

The outstanding warrants to purchase 2.0 million shares of our common stock that we sold in our March 2014 offering have an exercise price of \$2.47 per share and expire in March 2019.

The following table summarizes activity with respect to our common stock warrants for the periods shown below (in thousands):

| | Warrants to purchase common shares | | Weighted- average exercise price |
|---|---|----|---|
| Outstanding at December 31, 2016 | 3,761 | \$ | 2.23 |
| Granted: | | | |
| Exercise price less than intrinsic value | - | | - |
| Exercise price greater than intrinsic value | - | | - |
| Exercised | (460) | | 1.97 |
| Canceled/expired | (1,328) | | 1.97 |
| Outstanding at December 31, 2017 | 1,973 | | 2.47 |
| Granted: | | | |
| Exercise price less than intrinsic value | - | | - |
| Exercise price greater than intrinsic value | - | | - |
| Exercised | - | | - |
| Canceled/expired | - | | - |
| Outstanding at December 31, 2018 | 1,973 | \$ | 2.47 |
| Exercisable at December 31, 2018 | 1,973 | \$ | 2.47 |

There were no common stock warrants issued in 2018 and 2017.

The following table summarizes information about our common stock warrants outstanding and exercisable at December 31, 2018 (in thousands):

| Exercise price | Warrants outstanding | | | Warrants exercisable | |
|----------------|--|---|---|--|---|
| | Outstanding at December 31, 2018 | Weighted- average remaining contractual term (in years) | Weighted- average exercise price | Exercisable at December 31, 2018 | Weighted- average exercise price |
| \$2.47 | 1,973 | 0.21 | \$ 2.47 | 1,973 | \$ 2.47 |
| | 1,973 | | | 1,973 | |

11. 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.

Description of Incentive Plan

Our 2013 Incentive Plan has 10.8 million shares authorized, of which 3.0 million shares were available for awards as of December 31, 2018.

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, 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:

| Assumptions (weighted-average) | Year Ended December 31, | |
|--|-------------------------|---------|
| | 2018 | 2017 |
| Volatility | 73% | 79% |
| Expected term (in years) | 3.2 | 4.0 |
| Risk-free rate | 2.8% | 1.6% |
| Expected dividends | 0.0% | 0.0% |
| Pre-vest forfeiture rate | 8.5% | 8.5% |
| Grant date fair value of options granted | \$ 0.58 | \$ 1.03 |

Options Activity and Positions

The following table summarizes activity and positions with respect to options for the periods shown below (in thousands):

| Options | Shares | Weighted-average exercise price | Weighted-average remaining contractual term (in years) | Aggregate intrinsic value |
|---|---------|---------------------------------|--|---------------------------|
| Outstanding as of December 31, 2016 | 4,003 | \$ 3.94 | 7.3 | \$ 4 |
| Granted | 1,724 | 1.76 | - | - |
| Exercised | (46) | 1.87 | - | - |
| Forfeited or expired | (647) | 6.09 | - | - |
| Outstanding as of December 31, 2017 | 5,034 | 2.94 | 6.6 | 53 |
| Granted | 1,229 | 1.16 | - | - |
| Exercised | - | - | - | - |
| Forfeited or expired | (1,617) | 3.51 | - | - |
| Outstanding as of December 31, 2018 | 4,646 | \$ 2.27 | 7.0 | \$ - |
| Vested and expected to vest as of December 31, 2018 | 4,364 | \$ 3.04 | 6.8 | \$ - |
| Exercisable as of December 31, 2018 | 2,252 | \$ 2.30 | 5.0 | \$ - |

The intrinsic value of options exercised during the year ended December 31, 2017 was \$40,000. No options were exercised during the year ended December 31, 2018.

The total grant date fair value of options vested during the years ended December 31, 2018 and 2017 was \$958,000 and \$1.0 million, respectively. As of December 31, 2018, our unrecognized share-based compensation was \$1.6 million related to options, which we plan to amortize over the next 2.3 years.

On September 30, 2018, we issued 583,333 performance stock units to our executives. The performance criteria is the achievement of the Company's share price of \$2.50 sustained for 60 of trailing 90 days before the PSUs are earned ("Earned PSUs"). To the extent the PSUs become Earned PSUs they shall be eligible to vest as to one-third (1/3) of the PSUs subject to the Award on the each of the first three (3) anniversaries of June 5, 2018, subject to the executive's continuous employment on the applicable vesting date. If there are outstanding but unearned PSUs as of a vesting date and the PSUs become Earned PSUs prior to the next vesting date the Earned PSUs that would have vested on any earlier vesting date shall become immediately vested and deliverable. The PSUs are valued using a binomial option pricing model using the following inputs: stock price, volatility, and risk-free interest rates. We issued 291,667 RSUs to our executives that vest one-third on each of the first three anniversaries of June 5, 2018. We also issued 180,000 RSUs to members of the board. The members of the board vest ownership in the RSUs on the earlier of the day prior to the date of the Company's annual meeting of shareholders following the date of grant, or one year from the grant date, provided the member of the board continues to serve as a director on the vesting date.

As of December 31, 2018, our unrecognized share-based compensation related to the RSUs was \$607,000, which we plan to amortize over the next 2.1 years. As of December 31, 2018, our unrecognized share-based compensation related to the PSUs was \$16,000, which we plan to amortize over the next 2.4 years.

12. COMMITMENTS AND CONTINGENCIES

Litigation

During 2018, we settled all related claims with Asia Optical relating to its previously filed complaint for arbitration for less than related reserves.

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 our financial position, results of operations or cash flows.

Purchase commitments

At December 31, 2018, we have \$6.2 million in open purchase obligations that represent commitments to purchase inventory, materials, capital equipment, and other goods used in the normal operation of our business.

Lease commitments

We lease our office space and certain equipment under capital and operating leases with initial or remaining terms in excess of one year. Future minimum rental commitments under capital and operating leases for years ending December 31, are as follows (in thousands):

| Years Ended December 31, | Capital leases | Operating leases |
|--|----------------|------------------|
| 2019 | \$ 27 | \$ 654 |
| 2020 | 27 | 656 |
| 2021 | 9 | 676 |
| 2022 | - | 696 |
| 2023 | - | 175 |
| Thereafter | - | - |
| Total minimum lease payments | 63 | \$ 2,857 |
| Less: amount representing interest | (9) | |
| Present value of capital lease obligations | 54 | |
| Less: current portion | (21) | |
| Long-term portion at December 31, 2018 | \$ 33 | |

Net rent expense was \$834,000 in 2018 and \$531,000 in 2017.

13. INCOME TAXES

A provision for income taxes has not been recorded for 2018 and 2017 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, 2018, we have net operating loss carryforwards of approximately \$398.1 million for federal income tax reporting purposes. In addition, we have research and development tax credits of \$8.6 million. During 2018, \$7.1 million federal net operating losses expired unused. A majority of the net operating loss carryforwards and research and development credits available to offset future taxable income, if any, will expire in varying amounts from 2019 to 2038, if not previously used.

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 limitations on our ability to use a portion of our net operating loss carryforwards.

On December 22, 2017, legislation commonly known as the Tax Cuts and Jobs Act, or the Tax Act, was signed in to law. The Tax Act, among other changes, reduces the U.S. federal corporate tax rate from 35% to 21%, requires taxpayers to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings.

We applied the guidance in Staff Accounting Bulletin No. 118 ("SAB 118") when accounting for the enactment date effects of the Tax Act in 2017 and throughout 2018. At December 31, 2017, we completed our accounting for all the enactment date income tax effects of the Tax Act under Accounting Standards Codification 740, *Income Taxes*. At December 31, 2017 and 2018, we did not have any foreign subsidiaries and the international aspects of the Tax Act are not applicable. Our accounting for these items is now complete.

We implemented ASU 2014-09, Revenue from Contracts with Customers (Topic 606), as of January 1, 2018 using the full retrospective approach. The application of the full retrospective approach had no impact to 2018 and prior income tax expense due to a full valuation allowance. The effect of adoption reduced our 2017 deferred tax assets by \$1.1 million, which was offset by a change in valuation allowance.

Deferred tax assets are summarized as follows (in thousands):

| | December 31, | |
|---|--------------|-----------|
| | 2018 | 2017 |
| Deferred tax assets | | |
| Reserves | \$ 1,152 | \$ 1,561 |
| Net operating loss carryforwards | 83,608 | 82,210 |
| R&D credit carryforwards | 8,593 | 7,435 |
| Depreciation/amortization deferred | 15,884 | 13,005 |
| Other | 6,076 | 5,944 |
| Net deferred taxes before valuation allowance | 115,313 | 110,155 |
| Less: Valuation allowance | (115,313) | (110,155) |
| Deferred tax assets | \$ - | \$ - |

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 an income tax benefit.

We did not have any unrecognized tax benefits at December 31, 2018 or 2017.

We recognize interest accrued and penalties related to unrecognized tax benefits in tax expense. During the years ended December 31, 2018 and 2017 we did not recognize any interest or penalties.

We file income tax returns in the U.S. federal jurisdiction and various states. Due to our operating loss and credit carryforwards, the U.S. federal statute of limitations remains open for 1998 and onward.

14. 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 are made at the discretion of our Board of Directors. During the years ended December 31, 2018 and 2017 we contributed \$376,000 and \$278,000 to the plan, respectively.

15. QUARTERLY FINANCIAL INFORMATION (Unaudited)

The following table summarizes our unaudited quarterly financial information for the periods shown below (in thousands, except per share data):

| | Fiscal Year 2018 | | | |
|---------------------------------------|------------------|---------------|----------|-----------|
| | December 31, | September 30, | June 30, | March 31, |
| Revenue | \$ 1,833 | \$ 11,572 | \$ 2,014 | \$ 2,188 |
| Gross profit | (2,606) | 8,927 | 333 | 315 |
| Net income (loss) | (11,948) | 289 | (8,459) | (7,132) |
| Net loss per share, basic and diluted | (0.13) | - | (0.10) | (0.09) |

| | Fiscal Year 2017 | | | |
|---------------------------------------|------------------|---------------|----------|-----------|
| | December 31, | September 30, | June 30, | March 31, |
| Revenue | \$ 2,302 | \$ 5,425 | \$ 1,339 | \$ 568 |
| Gross profit | (248) | (278) | 346 | (48) |
| Net income (loss) | (8,119) | (5,762) | (5,656) | (5,949) |
| Net loss per share, basic and diluted | (0.10) | (0.08) | (0.08) | (0.09) |

16. SUBSEQUENT EVENTS

In January 2019, we sold 2.0 million shares of our common stock at a price of \$0.60 per share to Shehnee Lawrence-Farhi in a registered direct offering for gross proceeds of \$1.2 million.

In March 2019, we filed a Notice of Arbitration in Hong Kong against Ragentek alleging breach of contract. The relief sought is \$4.0 million dollars plus interest and arbitration costs. At this time we cannot predict the likelihood of a favorable outcome.

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

There have been no changes in or disagreements with accountants on accounting or financial disclosure matters during our fiscal years ended December 31, 2018 and 2017.

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)) under the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), prior to the filing of this Form 10-K. Based upon that evaluation, our CEO and CFO concluded that, as of December 31, 2018, 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). Our management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on its evaluation under the framework in *Internal Control - Integrated Framework (2013)*, our management concluded that our internal control over financial reporting was effective as of December 31, 2018.

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

The effectiveness of our internal control over financial reporting as of December 31, 2018 has been audited by Moss Adams LLP, an independent registered public accounting firm, as stated in its report, which is included herein.

(d) *Changes in Internal Control Over Financial Reporting.* There was no change in our internal control over financial reporting during the quarter ended December 31, 2018 which has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Report of Independent Registered Public Accounting Firm

To the Shareholders and the Board of Directors of
MicroVision, Inc.

Opinion on Internal Control over Financial Reporting

We have audited MicroVision, Inc.'s (the "Company") internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB"), the consolidated balance sheets of MicroVision, Inc. as of December 31, 2018 and 2017, the related consolidated statements of operations, shareholders' equity, and cash flows for the years then ended, and the related notes and schedule (collectively referred to as the "consolidated financial statements") and our report dated March 5, 2019, expressed an unqualified opinion on those consolidated financial statements and included explanatory paragraphs relating to going concern uncertainty and change in accounting principle.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control Over Financial Reporting included in Item 9A. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

/s/ Moss Adams LLP

Seattle, Washington
March 5, 2019

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 10 of Form 10-K and not provided in Item 4A will be included under the caption "Discussion of Proposals Recommended by the Board" in our 2019 Proxy Statement and is incorporated herein by reference. Our 2019 Proxy Statement will be filed with the SEC prior to our 2019 Annual Meeting of Shareholders.

ITEM 11. EXECUTIVE COMPENSATION

The information required by this Item 11 of Form 10-K will be included under the captions "Executive Compensation," "Compensation Committee Interlocks and Insider Participation," and "Director Compensation for 2018" in our 2019 Proxy Statement and are incorporated herein by reference.

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

Information as of December 31, 2018, regarding equity compensation plans approved and not approved by shareholders is summarized in the following table (in thousands, except per share data):

| 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 | 4,646 | \$ 2.27 | 2,991 |
| Equity compensation plans not approved by shareholders | - | - | - |
| Total | 4,646 | | 2,991 |

The other information required by this Item 12 of Form 10-K will be included under the caption "Information about MicroVision Common Stock Ownership" in our 2019 Proxy Statement and is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

The information required by this Item 13 of Form 10-K will be included under the captions "Certain Relationships and Related Transactions" and "Board Meetings and Committees" in our 2019 Proxy Statement and are incorporated herein by reference.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The information required by this Item 14 of Form 10-K will be included under the caption "Independent Registered Public Accounting Firm" in our 2019 Proxy Statement and is incorporated herein by reference.

PART IV.

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(A) Documents filed as part of this Annual Report on Form 10-K:

1. Consolidated Financial Statements

- Report of Independent Registered Public Accounting Firm
- Consolidated Balance Sheets as of December 31, 2018 and 2017
- Consolidated Statements of Operations for the years ended December 31, 2018 and 2017
- Consolidated Statements of Shareholders' Equity for the years ended December 31, 2018 and 2017
- Consolidated Statements of Cash Flows for the years ended December 31, 2018 and 2017
- Notes to Consolidated Financial Statements

2. Financial Statement Schedules

Schedule II

MicroVision, Inc.
Valuation and Qualifying Accounts and Reserves Schedule

(In thousands)

| Year Ended December 31, | Balance at beginning of fiscal period | Charges to costs and expenses | Additions Charges to other accounts | Deductions | Balance at end of fiscal period |
|-------------------------|---|-------------------------------------|--|------------|---------------------------------------|
| 2017 | | | | | |
| Tax valuation allowance | \$ 166,844 | \$ (55,608) | \$ - | \$ - | \$ 111,236 |
| 2018 | | | | | |
| Tax valuation allowance | \$ 111,236 | \$ 4,077 | \$ - | \$ - | \$ 115,313 |

All other schedules are omitted because they are not applicable, or because the information required is included in the consolidated financial statements and notes thereto.

3. Exhibits

The following exhibits are referenced or included in this Annual Report on Form 10-K.

| Exhibit Number | Description |
|----------------|--|
| 3.1 | <u>Amended and Restated Certificate of Incorporation of MicroVision, Inc., as amended.</u> ⁽²⁾ |
| 3.2 | <u>Certificate of Amendment to the Amended and Restated Certificate of Incorporation of MicroVision, Inc.</u> ⁽⁴⁾ |
| 3.3 | <u>Certificate of Amendment to the Amended and Restated Certificate of Incorporation of MicroVision, Inc. dated June 7, 2018.</u> ⁽⁷⁾ |
| 3.4 | <u>Bylaws of MicroVision, Inc.</u> ⁽⁵⁾ |
| 4.1 | <u>Form of Specimen Stock Certificate for Common Stock.</u> ⁽¹⁾ |
| 4.2 | <u>Form of Warrant dated March 18, 2014 issued under the Securities Purchase Agreement dated as of March 13, 2014 by and between MicroVision, Inc. and the investors named therein.</u> ⁽⁶⁾ |
| 10.1 | <u>2013 MicroVision, Inc. Incentive Plan, as amended.</u> ^{(7)*} |
| 10.2 | <u>Third Amendment to Lease Agreement between BRE WA Office Owner, LLC and MicroVision, Inc., dated July 25, 2017.</u> ⁽⁸⁾ |
| 10.3 | <u>Change of Control Severance Plan.</u> ^{(3)*} |
| 10.4 | <u>Employment Agreement between MicroVision, Inc. and Perry Mulligan dated November 21, 2017.</u> ^{(8)*} |
| 23.1 | <u>Consent of Independent Registered Public Accounting Firm - Moss Adams LLP.</u> |
| 31.1 | <u>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.</u> |
| 31.2 | <u>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.</u> |
| 32.1 | <u>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.</u> |
| 32.2 | <u>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.</u> |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document |

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

- (1) Incorporated by reference to the Company's Post-Effective Amendment to Form S-3 Registration Statement, Registration No. 333-102244.
- (2) Incorporated by reference to the Company's Form 10-Q for the quarterly period ended September 30, 2009.
- (3) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2011.
- (4) Incorporated by reference to the Company's Current Report on Form 8-K filed on February 17, 2012.
- (5) Incorporated by reference to the Company's Current Report on Form 8-K filed on November 27, 2013.
- (6) Incorporated by reference to the Company's Current Report on Form 8-K filed on March 13, 2014.
- (7) Incorporated by reference to the Company's Amendment No. 2 to Form S-1 Registration Statement, Registration No. 333-222857.
- (8) Incorporated by reference to the Company's Form 10-K for the year ended December 31, 2017.

* Management contracts and compensatory plans and arrangements required to be filed as exhibits pursuant to Item 15(b) of this Annual Report on Form 10-K.

ITEM 16. FORM 10-K SUMMARY

None.

SIGNATURES

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

MICROVISION, INC.

Date: March 5, 2019

By /s/ Perry M. Mulligan

Perry M. Mulligan
Chief Executive Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the following capacities on March 5, 2019.

Signature

Title

/s/ Perry M. Mulligan

Perry M. Mulligan

Chief Executive Officer and Director
(Principal Executive Officer)

/s/ Stephen P. Holt

Stephen P. Holt

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

/s/ Simon Biddiscombe

Simon Biddiscombe

Director

/s/ Robert P. Carlile

Robert P. Carlile

Director

/s/ Yalon Farhi

Yalon Farhi

Director

/s/ Slade Gorton

Slade Gorton

Director

/s/ Bernee D.L. Strom

Bernee D.L. Strom

Director

/s/ Brian V. Turner

Brian V. Turner

Director

/s/ Thomas M. Walker

Thomas M. Walker

Director